The European Union: A Free Order?

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Introduction

To non-European countries anxious to establish their liberal and democratic credentials admission to the European Union looks very tempting. Believers in the free market are entranced by its superficial attractiveness. Western Europe was saved from the ravages of socialism by its apparent commitment to capitalism and the relative peace that the continent has experienced since the end of the Second World War is often attributed to its internationalism. Though they seem to forget that the defeat of communism and the preservation of the integrity of Europe were brought about by America rather than the countries of the continent, which were largely free riders on the military strength of the US. No doubt the progenitors of the original European movement towards unity were inspired by the bitter memories of nationalism and a genuine fear of communism. Again, the fact that through various phases, European countries gradually submitted their legal systems to an international jurisdiction must have encouraged believers in the rule of law to think that Europe's legalism was a welcome relief from that national sovereignty which had so disfigured Europe's history.

It is not so difficult to show, however, that the allure of a free Europe has less substance when it is closely examined.[1] Thus so far from creating a free order in which individual market exchanges determines output and one that allows capitalism to develop under the rule of law and is committed wholeheartedly to free international trade, the development of European cross-national institutions is beginning to show signs of creating a new superstate which exhibits the inclusiveness and illiberality which were such features of the old nation states. As we shall see, its much-heralded commitment to the rule of law is meretricious rather than genuine, for the legal order of the Union is as active in expanding the powers of this new superstate as it is in defending individual liberty. With regard to economics, the system resembles F. A. Hayek's[2] notion of 'ordered competition' rather the 'competitive order', in that the laws under which traders operate

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are designed to bring about a certain kind of highly regulated welfarist 'end state' rather than to facilitate exchange and to protect liberty. To prove this case I shall have to enquire into the meaning of a federal order, account for liberty under law and explain the logic of competition both in the economic and in the jurisdictional senses. I shall be helped in this enquiry by some reference to the American federal system. It will be shown that all federal systems, despite their sometimes elaborate constitutional arrangements, show a tendency to centralisation if the feature of *jurisdictional competition* is not preserved.

From its original foundations the European Union was not an unpromising institutional arrangement for a free order. The European Economic Community, which was established by the Treaty of Rome in 1957, had developed out of the European Steel and Coal Community and was basically a free trade area. Although it has had from the beginning a Council of Ministers (the legislative body), a Commission (a kind of super-civil service), a parliament (which had few powers) and a judicial system these and did not intervene excessively, if it all, with the internal affairs of member states. Although progress was slow towards establishing a truly free European market, member states maintained many economically-inefficient restrictions on the free movement of goods, services, capital and people, it was possible to envisage the development of a free market through both economic and jurisdictional competition. But historically, while there has been some progress towards the creation of a European free market, there has also been a systematic, and apparently unstoppable, march towards European political integration and the centralisation of law-making power over many areas of economic and social life.[3] The significant event this seemingly inexorable process was the transformation of the EEC into the European Community, important in this was was the Single European Act of 1987 (that is not a parliamentary statute but an agreement approved unanimously by all member states) and the change into the European Union after the Treaty of Maastricht in 1992 (though it was not ratified by some member states till 1993). During this time the membership of the European institutions has expanded from the original six to fifteen (Britain joined in 1973). The most significant long-term development has been its change from a collection of independent states, each with an autonomous legal system, into an integrated political unity subject to *common* laws in certain areas (rather as the American states switched from the Articles of Confederation to the federal Constitution in 1789). Euro-enthusiasts want to take this process a stage further so that all Europeans are eventually subject to the same tax and welfare laws, have a comon foreign policy and have acquired European citizenship. This will result in the member states of the European Union having less autonomy than do the American states.

Before I discuss the details of the transformation it is necessary to understand what is meant by certain key terms from a classical liberal perspective. The consistent classical liberalism doe not restrict competition merely to the market in goods and services. He sees liberty as being more efficaciously protected if there is competition between political units; that the harmful effects of the drive for political power will be ameliorated if people have choice of the rules by which they are to live. Indeed, classical liberals have always doubted the efficacy of 'cardboard protections', i.e. constitutional rules, against the potential tyranny of monopoly government. The history of federal arrangements in the twentieth century is hardly promising for those who believe in limited government under the rule of law. Americans themselves have witnessed the gradual accretion of power to the federal element - to the Congress and the Presidency and away from the component states in their

political system.[4] Complicit in all this has been the Supreme Court, the very institution which was originally entrusted with the responsibility of preserving the Constitution. Now, the competitive element, which was originally the defining feature of American constitutionalism, has been all but eliminated. It was, of course, Roosevelt and his New Deal which did the most damage to the Constitution so that since 1937 (when the Court abandoned its protection of economic liberties) Americans have had common standards in economic regulation, civil liberties (including controversial issues such as abortion) and welfare (nationalised pensions were introduced in 1935). The right of exit can have little value if the state to which you flee has the same laws as all the others.

Europe and Federalism

It took America roughly 170 years to lose her federal system but Europe is moving at a much faster pace. It is not just the politicians who have been instigators in the movement towards centralism, the European Court of Justice has been as effective in reducing member states' powers under the guise of implementing the 'European idea'. It began with the ENEL v. Costa case (1962) in which the Court struck down an Italian statute and declared that in the case of a jurisdictional conflict European law should be superior to a member state's law. There was nothing in the Treaty of Rome that validated this decision, it was simply the assertion of judicial power. There is, in fact, no necessity for the superiority of European law and, in a loose arrangement of states which already have established legal traditions, it was bound to become a precedent for further harmonisation. Indeed, the European enthusiasts envisage a code law system for the whole of the continent which ultimately has a political purpose – the unification of Europe. In English common law, judges reason in a non-political way in a case by case manner. In this system precedent is of overwhelming importance. In European law judges, in disputed cases, refer back to the preambles to Treaties and the loose wording of these statements, most of which embody some vague commitment to European unity, can always be used to validate any particular act of centralisation.

It is with bitter irony that classical liberals have noticed that one of the most important political acts of centralisation, the Single European Act (1987) has a perfectly respectable intellectual pedigree in public choice theory. Prior to 1987, decisions in the Council of Ministers, the formal legislative body of the Union, were subject to the unanimity rule (the 'Luxembourg compromise', which had been established through the efforts of the French President, Charles de Gaulle). This allowed sole dissidents to a proposed regulation to 'hold out' indefinitely and prevent the development of a free, competitive European market. Some member states retained controls on capital movements and restrictions on the movement of labour between countries. Italy persisted with exchange controls right up to the introduction of the European common currency (the Euro) in 1999. Of course, the Virginia school of political economy had long recognised the hold out problem and recommended the use of something like a two thirds voting rule for the production of public goods. In a similar manner, the Single European Act introduced qualified majority voting to counter this obstructionism, although the veto remains in some areas, notably taxation.

The original purpose of the Single European Act was perfectly consistent with the tenets of free market economics. It was to remove impediments to the unrestricted movement of goods, services, capital and people (the 'Four Freedoms' which the authors of the Treaty of Rome were so rightly anxious to protect). But in fact it has proved to be a secret anti-market weapon, for the legislators, supported by the Court, have used it to establish common standards, in terms of economic regulation and social

conditions, so that the competitive advantage which the poorer countries may have is eliminated. It is easy to understand why France and Germany should wish to impose their very strict industrial rules and high non-wage labour costs on the rest of Europe. The poorer countries are rewarded for their compliance by financial grants from the Union itself, which further binds countries into a centralised system. The Court is only too eager to go along with the ambitions of the Eurocentralists. Britain tried to resist the Working Time Directive (which limits the hours per week any European can work) by using its veto, but the Court naturally accepted the argument of the Council of Ministers and the Commission that the Directive was a Health and Safety measure, which is subject only to qualified majority voting.

Although the Court has been quite effective in striking down laws of the member states that are anti-competitive they have never ruled against a significant centralising Regulation or Directive from the Council of Ministers. Europe has long had a Social Charter, a common set of anti-competitive welfare standards, from which Britain secured an opt-out (reversed by the Blair government) in the Treaty of Maastricht negotiations. It is certain that it will be imposed on future members of the Union. To reinforce the centralising tendency the Union has developed the 'constitutional' concept of *Acquis communitaire*, or Community heritage). This means that any regulations, directives or policy initiatives become locked into the system and cannot be repealed in the way that legislation can in conventional parliamentary regimes; all new countries that join are bound to accept everything that has gone before them.. Only a new treaty, which is subject to unanimity, can change them and treaties regularly extend the centralising processes. And, of course, the presence of the veto here can have devastating effect in preventing pro-market changes. As a matter of fact, the German constitutional court tried to stop the centralisation when it considered the constitutional validity of the Maastrict Treaty. While it approved the Treaty, the court argued that Europe was a confederation of autonomous legal systems and that German law and rights were superior to Europe's. But the abandonment of the Deutschmark was upheld a little later (1998) without a murmur.

There is no formal right of secession for the European member states. If a country is in breach of its European obligations, such as initiating a unilateral withdrawal, the Commission could bring a legal action against it in the Court, the two institutions likely to be most hostile to any derogation from the European ideal. Secession would have to be an extra-legal, political act and although it is unlikely that a 'European army' would suppress it, the costs of political exit would likely be much higher than those in a constitutional regime that permitted it. It is obvious why the European political class has never favoured secession. The only real restraint on the centralising tendency of quasi-federal regimes is the fear of generalised exit by member states.

The Abolition of Competition

Despite its ostensibly pro-market intellectual origins the Single European Act has accelerated the uniformity and anti-competitive nature of the European Union. The ultimate aim of the Commission is to achieve tax harmony, i.e. abolish tax competition. One of the reasons that the Republic of Ireland has achieved extraordinary economic growth in the past decade is its highly generous tax system. It has a rate of corporation tax which approaches zero and has thus attracted significant inward investment. Germany, which has a much more rigorous tax and regulatory regime has suffered massive capital flight. It is linguistically quite misleading to call the Euro fanatics

'federalists', since in a genuine federal regime there is considerable autonomy and legislative and tax independence for the component states or provinces, as was the case in America up until the New Deal. They are the very things that the 'federalists' do not want. At the moment there is no direct taxation power in any of the institutions of the Union (though there is a minimum VAT rule which is binding on member states), it is financed by subventions. But the removal of the veto on tax harmonisation, which has been on the agenda of the Commission for some time, will undoubtedly lead to the formal transfer of tax power away from the states to the Council of Ministers. At present, Britain is struggling to resist a withholding tax on international bond transactions, something that would damage the financial interests in the City of London.

The most important European body is the Commission, which superficially resembles a civil service – the Council of Ministers makes policy and decides legislation while the Commission implements it. But this is an inadequate description produced by observers who are used to parliamentary regimes. It is much more important than a mere bureaucracy for it alone initiates legislation which is passed by the Council, it is responsible for the enforcement of European goals and brings actions in the European Court against recalcitrant member states. The European Parliament is an unimportant body and although it has some esoteric legislative role it is not a legislature in the conventional sense; law is made by the Council of Ministers. However, it can dismiss the *entire* Commission and it did this recently when it turned out that a few of its members were engaging in dishonourable, if not corrupt, practices that even this normally inattentive body could not over-look. In fact, the malpractices were discovered by a professional, accounting official in the Commission whose career suffered as a result of his diligence.

Democracy and the European Union

Eurosceptics often complain about the 'democratic deficit' in the European Union – there are too many unelected bodies in the system - but giving the Parliament effective legislative power would only make matters worse. The real deficit in the European Union is the competitive one; the absence of any real choice by the people for the rules under which live. Democracy, in however sophisticated a form, cannot hold governors to account in an area so large and diverse as the continent of Europe. The familiar problem of rational apathy has a devastating effect in a 'polity' with a population in excess of 300million. Why should the voter care about events, or be rationally informed about public policy, when the effect his vote can have on the outcome of the political process is less than derisory. The problems identified by public choice theory even in small size democracies are obviously insuperable in Europe. For voters to be informed, and even to turn out at elections, they need some incentives.

In the absence of any serious control a polity becomes infested with pressure groups which seek rents from the system. This is why farmers have managed to maintain a grossly inefficient and inequitable system of agricultural subsidies for so long. They have every incentive to lobby politicians intensively, for the beneficial effects of their actions are almost immediate. The long-run advantages of the rule of law, no subsidies and the promotion of an efficient free market are so thinly spread that no one person or group has an interest in promoting them.

James Madison, in defending the federal system of the proposed American Constitution, argued (against the conventional wisdom) in Federalist No. 10 that a democratic and federal system itself would dissipate factions (pressure groups) in a large community. The division of powers and the dual system of government would prevent any one group dominating government.

However, what happened was that as the strength of the centre grew and constitutional restraint weakened the factions formed around the capital and exploited the rest of the country. The US federal budget resembles a set of compromises, bargains and deals between powerful groups each anxious to exploit the 'commons'. Congressmen are (rationally) more concerned to satisfy the demands of their local voters than to promote the public interest.

There is no reason to suppose that a democratised Europe would be very different: human nature is pretty much the same throughout the world.. Factions would form at the parliamentary level if that became the major legislative body. Even without significant powers the European Parliament is already a rent-seekers paradise and if it had real legislative authority it would undoubtedly quickly become a venue for interest group representatives to reallocate the wealth of the community to politically significant sections. It would be impossible for rationally ignorant voters to control this process.

A Competitive Europe?

The solution to the problems of Europe is not more democracy but more competition - at the political level as well as that of the level of conventional markets. The veto should be restored to most actions of government and if member states persist in preserving anti-market privileges for purely selfish and nationalistic reasons they must be allowed to do so–and suffer the economic consequences of this foolish action. The growth of free trade and the efficiencies brought about by globalisation and the international division of labour will soon discipline a country that pursues economically infeasible policies. In a world of mobile money it is not in the self-interest of governments to inflate the currency. Similarly, they will have little incentive to over-regulate in a regime of quicksilver capital, flexible workforces and rapid technological change. And these conditions make it harder for governments to tax and regulate. And this is why the European Union wants to reduce jurisdictional competition. The more the member states are allowed to offer their own rules and taxes the greater will be the prospect of reducing these two main impediments to economic progress. In a fully competitive legal world member states will be compelled to offer lower taxes, lighter regulation and less burdensome state welfare arrangements because if they do not then some other country will and the successful one is likely to attract more capital and labour. In their desire to discredit the less intrusive, less socialistic political regimes the Euroenthusiasts call jurisdictional competition 'social dumping'. They claim that by offering favourable tax rates, lower welfare standards and less stringent environmental rules certain states are ignoring, or reducing, the social wellbeing of modern, progressive societies. Those orders that offer lower standards are more interested in profit than in advancing 'civilisation'. But this is not so. People's tastes for clean air and an aesthetically pleasing countryside are largely functions of their income; as countries get richer they value their environment more highly. But this is no reason for imposing impossibly high *uniform* standards across the whole of Europe. There is even less reason why the taxes and generous welfare provisions of the advanced European states should be imposed on countries which simply cannot afford them.

British Eurosceptics are far too nationalistic. They seem to think that the Union is a sinister organisation designed by France and Germany to advance their interests and to end British traditions such as the common law and the sovereignty of Parliament. But this is not so (and if it were, it is not necessarily bad from a classical liberal perspective, after all it was the unrestrained power of Westminster that allowed Britain to become virtually

socialised after 1945). The problem with the European Union is not that it diminishes national autonomy but that it replaces it with a new form of centralised, all-pervasive political authority – the European super-state. And the reason why the political class in Europe favour this is not because they are French, German or Italian nationalists but because they are European rent-seekers. They are as much a threat to freedom in their own countries as they are to the British liberal tradition. This new form of bureaucratic, regulatory socialism cannot be restrained by constitutional documents embodying lists of rights. We know what courts do with these – they expand them and they reflect the craving for uniformity displayed by the formal political authorities.

Just as monopolies in the economic market can only be restrained by competition the same thing is required in the political world if freedom and prosperity are to be preserved (or restored). Although constitutional documents have a revered history in classical liberal thought their usefulness may be questioned. The American Constitution protects liberty only in the those areas loved by left wing intellectuals – free speech, liberty, the secular state and sexuality. Not since 1937 has the Supreme Court upheld economic liberty against state regulation . The European Union does not even have a formal constitution, it has only the Treaties, which are a gift for interventionists. It is true that if nation states are to co-operate for the benefits of freedom and economic prosperity there must be some international rules; but there is always the danger that even minimalist rules might be used as engines of centralism. If nations could agree on simple rules that guarantee the free movement of goods, services and people and eschew grandiose schemes for a 'more perfect union, or forcommon welfare and environmental standards, they could leave international competition to produce the economic and legal order most consistent with people's choices: not those revealed by crude voting mechanisms but by the daily and continuing plebiscite of the free market. People would naturally gravitate to freedom-enhancing political and legal regimes. The simpler the international rules the less is the need for judicial intervention.

ENDNOTES

1. See R. Vaubel, *The Centralisation of Western Europe*, London, Institute of Economic Affairs, 1995.

2. F. A. Hayek, 'The Meaning of Competition', in *Individualism and Economic Order*, London, Routledge and Kegan :Paul, 1949, pp. 92-106.

3. N. P. Barry, 'There's No Philadelphia in Europe', *The Freeman*, February, 1999, pp. 14-17.

4. T. Dye *American Federalism*, Lexington, D. C. Heath, 1990.