Introduction

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This book provides the reader with an economic analysis of the most important elements of EU law and the mechanisms of decisions within the EU. All the authors are well-known scholars of this discipline and have written their chapters especially for this volume. The authors presented a first draft of their chapters at a manuscript conference in Hamburg and improved their drafts on the basis of invited and prepared comments and the general discussion.

The process of European integration is, on the one hand, a “truly unique endeavor. Nowhere else in the world has a group of countries come to be so integrated by peaceful means” (Baldwin and Wyplosz 2004, XXI). On the other hand, the actual architecture of the European Union has evolved as a compromise between conflicting philosophies of integration. First of all, there has been a conflict between intergovernmentalists, who look at European integration as an increased coordination and cooperation between sovereign governments, and federalists, who imagine the United States of Europe as a true political federation, characterized by powerful supranational institutions. However, there is another, much more important, conflict in the views on European integration: “the dirigiste economic management style of France and the free market, laissez faire style of the United Kingdom” (Alesina and Giavazzi 2006, 125).

The history of European integration after World War II comprises a multitude of facets and can be described in a nutshell as follows (Eichengreen 2007; Nello 2009, Chapters 1 and 2). Originally, European integration was triggered by the political motivation to avoid war between European countries in the future. After the failure of the European Defence Community and the European Political Community in 1954 the founding members decided to relaunch European integration on an *economic* basis. Having started already in 1952 with the European Coal and Steel Community (ECSC) as a community of six Member States (Belgium, France, Italy, Luxembourg, the Netherlands and West Germany), aimed at coordinating and controlling some economic activities in the coal and steel sector (at the time the key industry for both the military sector and the economy as a whole), the community extended its scope in 1958 in the Treaties of Rome – the Treaty establishing the European Economic Community (EEC Treaty), which was the most important one for the daily life of the European citizens, and the Treaty establishing the European Atomic Energy Community (EAEC Treaty) – by making all economic activities subject to integration. Several revisions and consolidations of the Treaties affected the allocation of competences between the community level and the Member States as well as the rules of the collective decision making processes at the community level. In 1967 the Merger Treaty fused the institutions of the three Communities.

After long controversial discussions the former EFTA countries Denmark, Ireland and the UK joined the Community in 1973. The European Parliament decided in 1975 by a resolution to replace the term “European Economic Community” by “European

Community.” After the end of dictatorship, Greece (1981), Spain and Portugal (both in 1986) became Member States.

The Single European Act from 1986 enacted the first major revisions of the Treaty in order to complete the internal market by the end of 1992. The Treaty of Maastricht (1993) formally confirmed the term “European Community” and included *inter alia* a time schedule for establishing a monetary union and a legal framework for the organization and operation of a European Central Bank. It added to the “supranational pillar,” consisting of the three Communities, two “intergovernmental pillars” (“Common Foreign and Security Policy” and “Justice and Home Affairs”), and established the “European Union” as a kind of common roof for the three pillars.

After the fall of the iron curtain, the formerly neutral countries Austria, Finland and Sweden decided to join the Union in 1995. Five years later, as a consequence of the German reunification, the territory of Eastern Germany was integrated into Germany and the European Union. Already in 1993, the heads of Member States’ governments had met in Copenhagen and invited the Central and Eastern European countries to join the Union, provided they meet the so-called Copenhagen Criteria, consisting of some political criteria (democracy and rule of law), economic criteria (a functioning and competitive market economy) and the ability to take on the *acquis communautaire*, i.e. the body of EU legislation, jurisdiction, practices, principles and objectives binding for the Member States.

Since the then existing institutions were designed to enable and support collective decision making in a small community, consisting of six members, the expectation of enlarging the European Union by a large number of Central and Eastern European countries triggered several attempts to adapt the architecture of the institutions to a much larger and more heterogeneous Union. The Treaty of Amsterdam (1999) introduced some minor changes, shifted some issues such as visa, asylum and immigration policies from the third (intergovernmental) pillar to the first (supranational) pillar and renamed the former as “Police and Justice Co-operation on Criminal Matters.” These measures aimed at the development of the European Union as an “Area of Freedom, Security and Justice.” However, already at the moment they signed the Treaty of Amsterdam it was clear to all Member States that the objective, to prepare the EU for Eastern enlargement, had not been achieved. The Treaty of Nice, which followed in 2003, was also not very successful in this respect. The next attempt of further integration, the Constitutional Treaty drafted by a Constitutional Convention, was rejected in 2005 by a French and a Dutch referendum.

However, even without major institutional reforms, ten new Member States joined the EU in 2004 (Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia), and two more followed in 2007 (Bulgaria and Romania). Four years later, after controversial discussions within and between the Member States, the Lisbon Treaty entered into force, which consists of the Treaty on European Union (TEU), the Treaty on the Functioning of the European Union (TFEU) and the Charter of Fundamental Rights of the European Union. Some institutional reforms aim at facilitating collective decision making at the EU level, the “pillar structure” has been abolished and the European Union replaces the European Community as a legal personality. Today (2011), the EU consists of 27 Member States with a population of about 500 million people and produces a GDP of more than 12

trillion euros, which implies that the EU is the largest integrated economic area in the world.

From a law and economics point of view, at least three stories of European integration have to be told. The first one is the single market story. This story is about the development of European integration from fragmented national markets to a single (internal) European market, based on the four fundamental freedoms: the free movement of goods, services, persons and capital. The first step towards achieving this objective was the establishment of a customs union, i.e. a free trade area plus common external tariffs, which was completed already in July 1968. Only in 1985, however, when Jacques Delors became president of the European Commission, were many remaining non-tariff barriers identified and a legislative program was enacted in order to complete the internal market by the end of 1992. Further steps to open national markets already had been triggered in 1979 by the famous *Cassis de Dijon* judgment of the European Court of Justice, which stated that in general all goods lawfully manufactured and marketed in one Member State should also be accepted in the other Member States. This means that the prohibition of discrimination on grounds of nationality has been extended to the prohibition of (even non-discriminatory) barriers to trade. Instead of forcing the Member States to apply the same standards to domestic and foreign products, each Member State had to mutually recognize the product standards applied in other Member States. Only if some “mandatory requirement in the general interest” of the importing country would be violated, this country would not necessarily infringe EU law by refusing the import of the goods concerned. Later on, the tendency to extend the prohibition of discrimination to the prohibition of barriers to free movement and to apply the principle of mutual recognition has been extended, more or less, to the other fundamental freedoms as well. Consequently, the price of opening national markets has been accompanied by some loss of national sovereignty. From this “market-oriented” point of view, the power of the supranational EU authorities has been used to open the fragmented national markets by keeping protectionism of the Member States down.

The second story is about centralization of policy instruments in Brussels to the detriment of Member States’ sovereignty. Basically, national sovereignty may be undermined by two forces: by market forces (mutual recognition, see first story) or by the supranational authorities in Brussels. According to the principle of conferral, a supranational authority “can act only within the limits of the competences conferred upon it by the Treaties” (Article 5(2) TEU). On the one hand, more competences have been conferred on the supranational authorities in the course of time by the revisions of the Treaties. On the other hand, there has been a tendency towards “competence creep” to the benefit of the EU, due to the fact that there are some open provisions concerning the allocation of competences between the EU and its Member States. The principle of subsidiarity, designed to slow down this centralization process in areas with shared competences, has not been completely successful so far. According to the theory of fiscal federalism (Oates 1972, 1999), centralization of competences can only be justified if there are economies of scale and regional spill-overs and if the preferences of the decentralized regional units (the Member States) are not too heterogeneous. When applying this idea to the actual allocation of competences between the EU and Member States it turns out that in some areas, such as agricultural policy and parts of environmental policy, we face too much centralization, whereas in other areas, such as defence policy and international relations,

the role of the Member States is still too strong. We should add that the controversial discussions on how to allocate competences between supranational institutions and Member States refer not only to public law issues, such as quality, safety and environmental standards but also to the question of how rules of private law should come into being (Faure and van der Walt 2010; Wagner 2009). The range of opinions reaches from “no need for harmonizing private law” to the request by the European Parliament to create a unified European civil code. However, when talking about the allocation of competences, one should not forget about the implications for political decision making and the related information and incentive problems. This brings us to the third story.

The third story is about democracy in a multi-level system. Apart from the question at which level the collective decision making should be done it has to be decided how to organize the representation of the Member States at the EU level. The actual solution reached by the EU is a compromise between two conflicting principles: “One man one vote,” which would give the smallest countries a weight close to zero, or “one country one vote,” which would be less appealing for the bigger countries. The main institutions at the Community level have been the European Commission, the Council of Ministers, the European Council, the European Parliament, and the European Court of Justice. In the course of the last 50 years there has been a tendency to give the supranational component in collective decision making at the EU level a larger weight, by reducing unanimity voting to the benefit of qualified majority voting and by increasing the importance of the directly elected European Parliament with respect to the Council of Ministers. Today, regular law-making at the EU level requires an initiative by the European Commission and majority votes by both the Council of Ministers and the European Parliament (co-decision procedure).

When putting the three stories together, we face the phenomenon which has been recently described by Rodrik (2011) as the “globalization paradox.” According to this paradox, which holds not only for the globalized world as a whole but also for regionally integrated parts of the world, such as the European Union, it is not possible to achieve at the same time complete economic integration (a single market), national sovereignty and political democracy. With sovereign nation states and complete economic integration, characterized by the free movement of goods, services, persons and capital, the national parliaments and governments are not free any more to follow their policies based on political majorities within the countries, but have to make their policies dependent on the markets. The price is a loss of political democracy. With economic integration and centralization of the policies at the federal level political democracy may be re-established. However, the price is a loss of national sovereignty, to the benefit of the supranational authorities. If one wants to keep national sovereignty and political democracy as well, one has to accept some loss of economic integration, i.e. some fragmentation of the markets due to obstacles to the free movement of goods, services, persons and capital.

European Union law crucially affects the everyday life of the people living in the 27 Member States, and also of those parties outside the European Union who engage in transactions with EU citizens. As Pelkmans (2001, 36) put it: “The EEC is a regulatory machinery, not a spending tree.” On the one hand, the EU budget is comparatively small: whereas the EU budget amounts to around 1 percent of the European Union’s GDP, the corresponding share in the Member States varies between one-third and more than 50 percent. On the other hand, the European Union produces every year thousands of

legislative acts that address every facet of people's life. The following legislative instruments are available (Article 288 TFEU). A *Regulation* is directly binding in all Member States. A *Directive* has to be transposed into national law before entering into force. It leaves discretion to Member States with regard to some of its content and with regard to its systematic place in the body of the national law. It can for instance be transformed as a separate law or imputed into an existing law such as the civil code. A *Decision* is only binding on those to whom it is addressed. Moreover, there are two types of "soft law" with no binding force: *Recommendations* and *Opinions*. Whereas the number of binding legislative acts (regulations, directives and decisions) issued in the period 1971–75 amounts to about 2,600, the number increased in the period 1996–2000 to around 11,400 – a 500 percent increase (Alesina and Giavazzi 2006, 121–3). According to recent data by EUR-Lex the corresponding number of legislative acts issued in the period 2006–10 amounts to more than 12,400.

The European Court of Justice (ECJ) specified in a series of landmark decisions in the 1960s and 1970s the legal relationship between the Community and the Member States. In 1963 the ECJ ruled that provisions of the Treaty could have *direct effect*; i.e. provisions of binding EC law which are clear, precise and unconditional enough to be considered justiciable can be revoked and relied on by individuals before national courts (*Van Gend & Loos*, case 26/62). In *Costa v ENEL* (case 6/64) the ECJ established the *supremacy* of EC law with respect to the national law of the Member States: "The transfer, by Member States, from their national orders in favour of the Community order of the rights and obligations arising from the Treaty, carries with it a clear limitation of their sovereign right upon which a subsequent unilateral law, incompatible with the aims of the Community, cannot prevail." Moreover, in 1984 the ECJ required national courts to interpret domestic law, as far as possible, *in the light of and in conformity with Community law* (*Colson and Kamann v Land Nordrhein-Westfalen*, case 14/83). Finally, the ECJ established in a series of decisions, starting with *Francovich* in 1991 (case 6 & 9/90), the principle of *state liability* for breach of Community law.

In all areas of Community (European Union) law, the ECJ has extensively relied on one specific procedure, the so-called *preliminary ruling procedure* (Article 267 TFEU), to develop the substantive law. Since the national courts of the Member States have to ensure that EU law is properly applied in each state there is a risk that the interpretation of EU law might differ between the Member States. The preliminary ruling procedure has been introduced to prevent such a divergence. If a national court is in doubt about the interpretation or validity of some EU law, it may – and sometimes must – interrupt the proceeding and ask the Court of Justice for advice. This advice is called a preliminary ruling and has become, since the middle of the 1990s, the most important way to trigger rulings by the Court of Justice, more important than all *direct actions*, such as, in particular, actions by the Commission against Member States that have failed to fulfill their obligations under European Union law and actions by individuals or organizations to challenge the validity of EU legislation that affects them.

This research handbook analyzes important parts of European Union law from an economic point of view. The focus is on how the development of European Union Law copes with the tension between market integration, national sovereignty and political democracy.

The first part of the book deals with “constitutional issues.” There has been an ongoing controversial discussion for many years on “democratic deficits,” “lack of transparency” and “over-centralization” and “over-bureaucratization” of political decision making in Brussels. It is discussed, for example, whether the European Union strengthens the positions of national governments vis-à-vis national parliaments, whether the European Commission dominates the European Parliament, or whether the European Court of Justice has gained importance to the detriment of the European legislator and to the detriment of the Member States as the “masters of the treaty.” Stefan Voigt compares the constitutional framework of the European Union with nation state constitutions. George Tsebelis analyzes some crucial features of decision making at the European Union level. Manfred Holler also copes with collective decision making in a multi-level system, but with the focus on the allocation of responsibility. Hans-Bernd Schäfer asks the question whether Member States’ liability for the infringement of EU law can deter national legislators from violating European law. Finally, Emanuela Carbonara, Barbara Luppi and Francesco Parisi assess the principle of subsidiarity from an economic point of view.

The second part of the book is related to a central policy issue of many years, the establishment of a single (internal) market, which is closely related to the four fundamental freedoms. Whereas Jacques Pelkmans elaborates on the important principle of mutual recognition with respect to goods and services, Herbert Brücker and Thomas Eger discuss the development of the free movement of persons in the last 50 years and its economic implications. Also important for the establishment of an integrated market are corporation law and corporate governance, which are discussed in Part 3 by Patrick Leyens. It is still far from clear whether it is required, helpful, needless or detrimental to harmonize private law in Europe. This issue is discussed in Part 4 by Michael Faure (tort law) and Fernando Gomez (contract law). In Part 5, Fabrizio Cafaggi and Antonio Nicita address the highly controversial question whether a specific legislation in favor of consumers should supplement the standard remedies in contract law, property law, tort law and antitrust law, and – if the answer is yes – whether the European Union or the Member States should be responsible for consumer protection.

An important question refers to law enforcement in a multi-level governance system, such as the European Union. The two contributions in Part 6 deal with this problem. Nuno Garoupa takes a skeptical view on the harmonization of the enforcement of European Union law. Roberto Pardolesi discusses the recent initiative by the European Commission to strengthen the importance of private enforcement of European antitrust law.

At latest after the Eastern enlargements of 2004 and 2007 the question arose how to cope with an increasing club of heterogeneous countries with different economic structures, different quality of institutions and different cultures and languages (Part 7). Hans-Jürgen Wagener discusses the economic and political implications of the recent and possible future enlargements. Jan Fidrmuc addresses the specific economic problems resulting from the fact that within the European Union today 23 official languages exist.

Finally, the most urgent problems today result from the serious sovereign debt crises in Greece and some other Member States of the Eurozone. In Part 8, Helmut Siekmann provides a detailed analysis of the architecture of the monetary institutions and the monetary policy and their implications for the sovereign debt crisis, with reference to the support mechanisms that have been established or discussed.

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