

# Overcoming Economic Nationalism: The “Invisible Hand” Solution of the European Union

By Gerhard Wegner\*

## Abstract

After the First World War, a previously well-functioning economic order collapsed in Europe and the Western countries. Economic nationalism of the interwar period also changed the international economic order dramatically and became one issue of the Colloque Walter Lippmann. After the “half- and three quarters Western democracies” (Tooze 2015) of the period prior to World War I had turned into full democracies, they proved incapable of restoring the liberal pre-war economic order domestically and in international trade. Bilateral and multilateral trade negotiations failed, giving rise to a new debate on the prerequisites of an international economic order. I argue that decades later the European Union found a solution to that issue. Of key importance was the gradual constitutionalization of the European Treaties. I show that the trade liberalization prepared by the courts resembles a concept suggested by Jan Tumlir but defies application to non-EU countries. By transforming fundamental economic freedoms laid down in the European Treaties into subjective rights through jurisprudence of the European Court of Justice, the process of trade liberalization occurred in a non-politicized mode. The incompleteness and tardiness of creating a Common Market was the inevitable price for this success story. A withdrawal from this constitutionalization of basic economic freedoms, as proposed recently, for example, cannot be recommended. Their arguments are being examined. The reduction of the European Treaties would lead to a re-politicization of trade policy bearing unforeseeable consequences for free competition.

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## 1. Introduction

The collapse of the international economic order turned out to be a severe problem for democracies after the First World War. The participants of the Colloque Walter Lippmann (CWL) addressed this issue under the heading of “economic nationalism”

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\* Chair of Institutional Economics and Political Economy, University of Erfurt, Nordhäuser Str. 63, 99089 Erfurt, Germany. The author can be reached at [gerhard.wegner@uni-erfurt.de](mailto:gerhard.wegner@uni-erfurt.de).

without, however, presenting a comprehensive analysis (Reinhoudt and Audier 2018, 129–147). By contrast, Wilhelm Röpke (1942), as a proven expert of international trade in the interwar period, dealt extensively with the problem of a defective international economic order. In retrospect, his assessment of the international economic order before the Great War order turned out to be positive, even though protectionist tendencies had already arisen. Although the German economy participated in these tendencies, it nevertheless became increasingly integrated into the world economy. During their emigration, Austrian economists such as Hayek (2007) or Mises (2014) presented the picture of a highly interventionist and protectionist German pre-war economic policy. However, this portrayal is misleading as it blends the National Socialist war economy of the time with the economic order in Germany before the Great War. In contrast to Habsburg-Austria, German (namely Prussian) economic policy remained committed to a liberal economic conception during the 19<sup>th</sup> century until WWI (Hentschel 1978); this even earned Prussian trade policy the verdict of Smithian dogmatism from historians of the Bielefeld School (Wehler 2008, 293).

The First World War brought about a real shock for free trade. Despite various efforts, it was not possible to re-establish the relatively stable and workable order of (moderate) free trade. At the CWL the participants attributed this failure in their judgment wholly to nationalism. However, as the pre-war order was hardly characterized by less nationalism, it is apparently not a sufficient explanation for the new interventionism. Certainly, the contaminated international relations between the winners and the defeated nations stood in the way of the establishment of a viable international economic order. But even between powers that remained neutral during WWI, trade relations did not resume to pre-war levels after the cessation of conflict. The foundation of newly founded nation states in Central and Eastern Europe aggravated the impact of protectionism even further. The new political map artificially severed former trade relations between economic areas, bringing the further development of the regional division of labor to a halt.

Against this historical background, economic theory began to reflect on the requirements of an international economic order. While previous discussions concentrated on the justification of the advantages of free trade over protectionism, this new debate focused on the political and institutional requirements for a workable international economic order. The relevance of this question has become urgent today in view of new unpredictable interventions into international trade instigated by the American government, which had formerly taken a leadership role in removing customs barriers. We have learned that trade between otherwise allied nations is more vulnerable than the GATT and WTO trade rounds of recent decades suggest. The stability of the international economic order has once again become an issue today.

Jan Tumlir (1983) discovered a pioneering solution a few decades ago. The core of his proposed solution was the anchoring of a liberal economic order in the courts instead of making it responsive to the political winds of trade diplomacy. It is imperative to highlight that the European Union comes close to Jan Tumlir's idea at first

glance and has actually, at least inside Europe, realized a solution to the problem of an international economic order, which had preoccupied the discussion participants at the CWL. However, unlike Tumlir's conception, the European Union achieved this solution not by political design but unintendedly in an "invisible hand process" in which courts were the key promoters. Of crucial importance has been the gradual constitutionalization of the European Treaties by the case law of the European Court of Justice (ECJ). However, it is precisely this creeping process, which for a long time went unnoticed by the public, that makes the European solution inapplicable to world trade in general, something which Jan Tumlir, the chief philosopher of the GATT, has overlooked. As a result, the European Common Market characterized by the removal of trade barriers emerged in a depoliticized fashion. After the outcome and the underlying mechanism that guarantees its irreversibility has been fully understood, the European quasi-constitution has been called into question again. Among other things, the claimed support for neoliberal economic policy without democratic legitimation is the stumbling block. I attempt to show that these fears, as expressed by the political scientist Susanne Schmidt (2019) and the renowned constitutional judge Dieter Grimm (2016), are unfounded. On the contrary, their recommendations of a re-politicization of trade policy in the European Union would likely lead to serious trade restrictions in Europe. A relapse into protectionism would appear on the horizon as a new threat, especially at a time of deep crisis such as the one the Union has just experienced.

In the next section, I describe the characteristics of the interwar international economic order as opposed to its predecessor before WWI, thereby referring to Hayek's proposal for a creating a supranational federal state, which he viewed as a viable option to overcome economic nationalism. Then, in section III, I outline Jan Tumlir's proposal for a constitutionalization of the economic order, which is safeguarded by courts rather than governments. Finally, I discuss how this process (unintendedly) removed non-tariff trade barriers in Europe and analyze Grimm's and Schmidt's reservations against the "overconstitutionalization" of the EU Treaty.

## **2. Economic Nationalism and the Collapse of the International Economic Order in the Interwar Period**

It was not until the interwar period that economists like Röpke became aware that the pre-war period had witnessed a workable international economic order for decades. A network of international trade relations, most of which included the principle of most-favored-nation treatment, created an order of moderate free trade. The Cobden-Chevalier treaty between Britain and France in 1860 inspired Prussia to follow, while the South-German states hardly had any other choice than joining the Prussian free-trade policy with France. As a result of the most-favored nation treat-

ment which became standard in many European trade agreements, discrimination against individual nations was curbed and a regime of lower tariffs spread across the European continent. Even when the trade agreements were always only limited in time, the interests of a renewal were usually strong enough. The gold standard brought additional stability to the international economic order, since, in the event of imbalances in the foreign exchange balance, the burden of adjustment was on the domestic price level; a nominal devaluation of the currency was ruled out as a policy instrument, so that the fear of a ruinous devaluation race was absent (Röpke 1942).

The shrinkage of the agricultural sector as a result of the plentiful supply of cheap agricultural goods to the world market confronted most economies with major challenges. This long-term structural change as a result of industrialization favored protectionism, which, however, remained essentially limited to the agricultural sector. Especially in France, the United States and Germany, small and medium-sized farmers formed an important constituency that demanded protectionism. Economic policy gave way to this demand to some extent. However, more intense protectionism was contained because economic policy had to weigh agricultural interests against the interests of the urban bourgeois and proletarian classes, whose interest in growing prosperity was at odds with agricultural interests (see also Wegner 2016). For this reason, economic policy, especially in Imperial Germany, shifted constantly between these two interest groups and had to find compromises. The policies of Chancellor Bismarck and his successor Caprivi represented the opposite poles of this search for compromise.

After the First World War, international trade was subject to severe disruptions (Röpke 1942; Schröder 2011).<sup>1</sup> The defeated Germany was exposed to serious discrimination of its trade policy at least until 1925; it had to grant the most-favored-nation treatment to other nations, but was itself discriminated against in trade. This discrimination proved to be a major obstacle to economic recovery due to its high reparations burden, as reparations were payable in foreign exchange which necessitated a trade balance surplus of the German economy. Severe protectionism made the achievement of this trade balance surplus impossible. Great Britain and France, on the other hand, were not willing to accept free trade with Germany, all the more since they had the illusion of not being dependent on trade with other European powers; rather, they were apparently content to have their own colonial empire as a substitute for more integrated trade relations. Despite international conferences at which a revival of free trade was sought, including the World Economic Conference in Geneva in 1927, it was ultimately more attractive for political actors to solve their domestic economic problems through protectionism.

In the further course of the interwar period, Germany succeeded in overcoming discrimination in trade policy and initially concluded trade agreements with Eastern European countries on the basis of most-favored-nation treatment (see Schröder 2011

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<sup>1</sup> For an overview, see Kindleberger 1989.

for a concise study). Finally, French policy had to abandon its policy of economic isolation of Germany, partly because of Germany's greater economic importance on the continent. At the end of the 1920s, even the United States offered such a trade agreement, which was a political breakthrough for German politics at first glance. Unfortunately, since the United States turned to protectionism, the most favored nation clause failed to provide free trade a boost. In the end, the international economic order was fundamentally damaged.

Against this historical background, economic theory turned for the first time to the analysis of the institutional requirements of an international economic order. This was a novelty in the history of economic theory, since the advantage of free trade over protectionism was no longer discussed but implicitly assumed. Rather, the focus was on the question of how an international trade order could be protected from arbitrary interference from national politics. Thus, the question of the interdependence of the economic and political orders shifted to the center of interest. While free trade remained the normative reference, liberal economists started to understand that a free trade regime required a corresponding political order. Public policy demanded constitutional constraints in order to protect trade policy from arbitrary interferences that characterized the interwar period. Röpke (1945), in particular, saw the lack of predictability in trade policy as the real problem for the international economic order. Democracy fails to provide a solution here, since political competition is conducive to short-term political solutions at the expense of an economic order that has many features of a transnational public good. Protectionist policy makers who are lenient towards interest groups will have a competitive edge over liberal politicians who aim for an order which enhances long-term growth – but in so doing cannot avoid imposing adjustment costs on interest groups. For this reason, Röpke also held reservations about international trade diplomacy (*ibid.*). Politicians would use the stage of international diplomacy to favor groups to which they had made promises in their domestic election campaigns.

The interwar period witnessed an intriguing debate among liberal economists who had developed various proposals for an international economic order, most of which were inherently tentative or utopian. In a widely acclaimed book, Slobodian (2018) describes this discussion in great detail, presenting the liberal proposals as a global liberal conspiracy against democracy. Unfortunately, he clouds this very profound historical portrayal with an insufficiently complex understanding of the real challenge. Slobodian's implicit defense of economic nationalism as democratic sovereignty ignores the free-rider problem of an international economic order. The collapse of the international order constituted a real problem that challenged Western democracies. Their claim to sovereignty in foreign trade issues ultimately proved to be self-dam-

aging as it undermined their own growth potential. This is precisely what the liberal debate focused on.<sup>2</sup>

Generally, the liberal proposals were tentative and preliminary. It turned out that even economists lacked a full understanding of the well-functioning international economic order before the Great War. Thus, Lionel Robbins criticized economists for advocating the rule of law exclusively as a condition for *domestic* capitalism. In his view, they failed to extend the role of institutions to the international level. “Where relations between different states were concerned, there indeed its attitude has become that of philosophical anarchism” (Robbins cited in Tumlir 1983, 73). Even this verdict falls short of a proper understanding of the pre-war order since an international order emerging from treaties is misleadingly termed “anarchic.” Robbins proposed a solution that was in line with liberal “anti-anarchism” to introduce an authority with coercive rights at the international level (Slobodian 2018, 99–102).

Hayek (1976) held reservations about this idea and developed the conception of a federal supra-national state. Such a state would also possess sovereignty, but its power would be limited by the federal order. Hayek’s underlying idea was that a (European) supra-national state had to unite so many group interests that it could no longer favor individual groups without discriminating against others. In a federal state, in contrast to a nation state, any effects from discrimination would be “internalized” and therefore provoke political resistance. Free trade could thus prove to be the lowest common denominator of an economic policy in the supranational state that could gain majoritarian support. In (small) nation states, on the other hand, it is much easier to privilege groups, which is why protectionism would find support by political competition. Therefore, the economic sovereignty of the nation state should be transferred to a federal supra-national state in order to anchor free trade.

However, these reflections turned out to be thought experiments and only had a certain chance of realization for the remaining colonial empires. Apart from this, the interwar period remained a time of high protectionism. Political integration to overcome trade barriers was a utopia. Agreements under international law to dismantle trade barriers failed due to a lack of support from the electorate or the rapidly increasing number of autocrats. It should be stressed, however, that even democracies did not favor open trade policy, although it cannot be ruled out that democracies would have understood its advantages in the longer term.

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<sup>2</sup> Slobodian’s account repeatedly gives the impression that the liberals, as paid henchmen of capital (to allude to Marx’s preface on *Capital*), sought to damage Western society. For a fair criticism of Slobodian, see Kolev (2020).

### 3. Tumlir's Reflections on a Viable International Economic Order

The period after WWII has seen the establishment of an international economic order for the Western economies. The Bretton Woods system and the foundation of the IMF inaugurated a monetary order. The GATT paved the way for constraints on untrammelled protectionism, even though it was a long avenue until customs barriers were significantly reduced in various tariff negotiations. The foundation of the European Economic Community paved the way for the abolishment of tariffs. "Customs duties on imports and exports and charges having equivalent effect" were banned by the European Economic Community (Art. 30 of the Treaty of Functioning of the European Union, TFEU in the following). The abolishment of tariffs did not occur until 1968, but already in the early beginning of the European Economic Community the long-term goal of a common market created an institutional environment which encouraged enterprises to take a transnational orientation. Shock-like protectionism was no longer to be feared. In contrast to the interwar period, (West-) Germany developed into an export nation. However, the experience from the interwar period continued to shape liberal verdicts on economic integration. Liberal economists in Germany, such as Röpke or the minister of economic affairs, Ludwig Erhard, had strong reservations about the founding of the EEC. Since they feared that the European Economic Area would be sealed off by the Customs Union, they interpreted its foundation as a precursor of the re-emergence of, this time regional, protectionism. This reservation was certainly not unfounded; French economic policy in particular repeatedly stressed the idea of a "fortress Europe." However, economic policy of Germany and the Netherlands, and later also British policy, were oriented far more towards free trade, which is why the liberal reservations turned out to be unfounded in later years. Likewise, the tariff reduction rounds under the GATT, promoted by the American government, dispelled such concerns to considerable extent (McAdam 2020).

However, whenever national economic policy faces an economic crisis expressed in the form of stagnation, unemployment, foreign debt and a fiscal deficit, politicians toy with protectionist ideas and thereby muster some public support. This scenario occurred in the late 1970s and early 1980s, when the United States abandoned the Bretton Woods system of fixed exchange rates, and Western economies witnessed a wave of imports from Japan and emerging economies. The economic rise of new economies made structural change unavoidable in the leading Western economies. But governments refused to accept this reality and tried to overcome the crisis with a mixture of Keynesian economic policy and neo-protectionism. Since tariffs had already been significantly lowered by the GATT rounds, protectionism was subject to much tighter limits than in the interwar period. Instead, the economic nations resorted to non-tariff trade barriers as an effective means of protecting their national economies. Hidden trade restrictions became possible while quantifiable tariff barriers remained low.

Against this historical background, liberal economists resumed their reflections on a workable international economic order. Jan Tumlir (1983) developed his idea of anchoring free trade by taking up the economic discussion from the interwar period. He was aware that spreading economic interventionism in the Western countries, which (as in the case of France) did not shy away from wage and price controls and from foreign exchange controls, is complementary to foreign trade protectionism. The isolation of the national economy from the outside only gives domestic interventionism sufficient scope. But the opposite conclusion also applies: If free trade principles can be constitutionalized, they will also support a liberal economic policy domestically. Free trade would undermine economic policy that attempts to prevent structural change. In the same vein, free trade would signal to companies which productive activities have become unprofitable and encourage them to reallocate their resources. As a result, national prosperity would increase, with the costs of economic adjustment being deducted. These, however, are sunk costs, while subsidies for ailing industries would be recurrent costs.

Tumlir was frustrated by trade diplomacy and even more critical about a supra-national authority. He viewed both representations as a vehicle for interest groups rather than an approach for lowering trade barriers. He also did not see a solution in a federal supra-national state, the kind of which Hayek pondered. In this view, the federal supra-national state is also dependent on interest groups and would only duplicate the interventionism of the nation state. This objection does not take into account Hayek's arguments in favor of a federal supra-national state. But Tumlir's argument is certainly correct to the extent that the federal state must take account of these vested, well-organized interest groups. Aside from this, it can be assumed that the trade interests of nations of unequal economic and political weight will not be pursued equally.

Tumlir's basic idea is to "de-politicize" the international economic order by strengthening the role of national courts, which can be called upon by economic actors. He notes: "Broadly speaking, the closer adjustment of international and national economic order can only be brought about by securing a firmer grounding in national law for the economic-political engagements governments undertake internationally" (*ibid.*, 80). Put differently, nation states remain the subjects of an international economic order, but the enforcement of trade agreements becomes a matter for the courts. This would at least provide a solution for Western democracies, which at the end of the 1970s had expanded their interventionism to the detriment of free trade. But Western democracies have independent courts that can act independently of political pressure or lobbying by interest groups, rendering the idea of anchoring free trade in national courts attractive.

Tumlir makes reference to the European Economic Community which has generated such a solution. However, he has overlooked that this European solution did not result from political design but emerged from a long-lasting process and gradual constitutionalization of the European Treaty behind the backs of politicians, interest



groups and even legal scholars. This “invisible hand process” can hardly be mimicked on the international level. As an intended solution, it would have been hard to imagine this outcome even in the European Union, as recent proposals for a revision of the European Treaty evince.

#### **4. The Constitutionalization of the Common Market in the EU**

The constitutionalization of the Common Market was the result of a drawn-out process in the European Union in which the ECJ played a significant role. Two decisions were fundamental in this respect. In 1963, the ECJ decided that community law was directly applicable in the member states. This allowed market participants to appeal to their national courts if they felt that their economic freedoms under the Treaty of Rome had been violated. The national courts then had to refer the case to the ECJ, which interpreted community law. This application of community law could take place without the involvement of national governments and therefore occurred in a non-politicized mode. A year later, the ECJ clarified the question of how to deal with a conflict between national law and community law. It decided that national law still exists but is “not applicable.” Effectively, European law takes precedence over community law (Grimm 2016, 12–13). This limitation of national sovereignty was no part of the Treaty of Rome and would not have been readily accepted. In practice, however, the member states complied with it, even though national constitutional courts clarified the limits of the primacy of European over national law in later years.

In effect, the European Treaties were gradually transformed into a constitution – a process that had long escaped notice by the public and even by legal scholars. The cases treated by the courts were simply too unimportant in their direct economic impact, which is a fundamental difference to international trade agreements. Therefore, the public largely ignored the transformation. However, the long-term effect was nevertheless powerful. As a result, the member states became deprived of an important component of economic sovereignty, although they remained “masters of the treaties,” and the transfer of competence principally remained limited to objectives laid down in the European Treaties (principle of limited empowerment).

However, the ECJ did not simply apply the treaties, but widened the meaning of articles referring to economic freedoms (free movement of goods and services, free movement of capital, free movement of workers and freedom of establishment). The judgement in the “Cassis-de-Dijon” case was of key importance in this respect: here the ECJ transformed the prohibition of discrimination on grounds of nationality laid down in Article 30 TEC into a prohibition of restrictions. Customs barriers and quantitative restrictions on imports had already been prohibited previously. However, before the “Cassis-de-Dijon” decision, the member states could make domestic regulations mandatory for imports from other European member states (country of

destination principle). As an implication, exporters had to comply with the regulations of each member state to which they planned to export their goods. Although the ECJ did not see an explicit “quantitative restriction” on imports resulting from domestic regulations, it ruled this as a “measure having equivalent effect.” Therefore, the domestic regulation was considered to be incompatible with Article 30 TEC, which gave way to a new type of regulatory order in the European Community. Now it was sufficient for exporters to comply with the regulation of their own country (country of origin principle) while ignoring the regulations of their (European) export market.

The case law of the ECJ corresponds to the procedure outlined by Jan Tumlir: Market participants that consider their economic freedom restricted by other members state appeal to a national court, which subsequently refers the case to the ECJ for a verdict. No government is involved. The particular issue of French liqueur imports to Germany was economically unimportant, but set a very far-reaching precedent as the decision applied to all commercial goods. Depending on the willingness to take trade restrictions to court, the European market transformed itself from a free trade regime into a Common Market. Accordingly, the regulatory principle changed from the country of destination principle to the country of origin principle. What mattered was the long-term effect of the court’s decision. The barriers to trade were not removed overnight, but “washed out” in a long-term process. Only reluctantly did the public become aware of this process since it occurred in a de-politicized fashion, and the far-reaching implications of some decisions transpired only gradually, often resulting from cumulative effects of former decisions.

Economists later discovered that the ECJ, with its “Cassis-de-Dijon” jurisprudence, had paved the way for an integration strategy that Jan Tinbergen had previously described as “negative integration” (Streit and Kiwit 1999). Tinbergen’s analysis was rather sketchy, but its perception by political scientists and lawyers proved to be momentous because it was not without misunderstandings (Tinbergen 1965). Scharpf explains the distinction as follows:

*Negative integration* refers to the removal of tariffs, quantitative restrictions, and other barriers to trade or obstacles to free and undistorted competition. *Positive integration*, by contrast, refers to the reconstruction of the larger economic unit (1999, 45).

Positive integration means transferring the institutional framework from the member states to the European Union, i. e. “harmonizing” the legal rules for market action. This option was still open to the European Union, but proved to be unfeasible because of the enormous difficulty of replacing the legal systems of the member states that have evolved over time. Hence, negative integration is still the most convenient form of creating a common market, efforts of establishing European rules in many realms notwithstanding.

Recently, however, the distinguished constitutional theorist and former judge at the Federal Constitutional Court of Germany, Dieter Grimm (2016), has taken a critical view of negative integration. Grimm arrives at his verdict because he interprets negative integration as the ultimate removal of any regulation:

The European Court of Justice has not only prevented national protectionism, as the treaties expressly required of the member states, but has also extensively interpreted the prohibitions of protection as bans on regulation. Since then, the member states are no longer in a position to maintain their own protection standards, for example for consumer protection, occupational health and safety, health protection, etc., irrespective of whether protectionist goals are pursued with national law (*ibid.*, 37–38).<sup>3</sup>

This interpretation is surprising because the ECJ has by no means denied the member states their regulatory competence. They only lack the right to apply them to importers from other member states. Domestic producers are still subject to state regulation. This results in unequal treatment and raises the question of whether member states can maintain a high standard of regulation if it is in accord with the preference of their electorate. For Grimm, Scharpf or Schmidt, there seems to be no doubt that national economic policy will lack the capability to regulate the market in the long term due to the principle of negative integration. That is why they judge the constitutionalization of the European Treaties with respect to market freedoms as an aberration. Accordingly, the economic freedoms laid down in the treaties should be deprived of their quality of subjective rights. As a consequence, trade diplomacy between the member states should determine the extent of economic integration.

Empirical evidence issues caution vis-à-vis fears of insufficient consumer protection: Regulatory standards in consumer protection or environmental protection were never as high as today. This applies both to European regulations and those of the member states. Such empirical observation finds support by a critical reflection of the “race-to-the-bottom” hypothesis which critics of negative integration put forward in this respect. Theoretically, the possibility exists that a particular EU member state could gain a competitive advantage by undercutting the regulatory standards of other member states and thereby lowering the production costs of its own exporting industry. For example, a lower standard of occupational health or safety could create new export opportunities in the European Union. Consequently, the argument goes, other member states would respond by lowering their regulatory standards as well which sets the “race-to-the-bottom” in motion. Critics of negative integration apparently conceptualize European member states as “GDP-maximizers,” which can take regulations as a variable with no regard of the well-being of their own citizens.

This stylized argument sheds light on the critical presupposition which Scharpf, Grimm and Schmidt apply: the neglect of democracy. Only autocratic regimes such as China or Russia could act as GDP-maximizers and ignore the regulatory preferences of its citizens. In democracy, by contrast, negative integration links economic and political competition (Streit and Kiwit 1999). Lowering regulatory standards in occupational health and safety or local environmental goods could indeed reduce production costs, but voters would bear the costs of such strategy. If they disapprove of lower regulatory standards, they are able to vote politicians out of office. This argument applies to any regulations which affect domestic consumers as well as con-

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<sup>3</sup> Schmidt concurs with Grimm’s argument; see Schmidt (2018; 2019).

sumers outside the jurisdiction.<sup>4</sup> Gaining a competitive commercial edge while neglecting domestic consumers will be difficult to achieve in a democracy. Political rivals of incumbent politicians could challenge such a strategy of lowering regulatory standards.

Authoritarian countries where citizens are not able to articulate their preferences for regulation constitute a different case. A strategy of gaining a competitive edge by lowering regulatory standards policy may be taken into consideration, but in this case policy failure rather than market failure would be the real cause. If, however, the electorate in a democracy accepts deregulation because it prioritizes economic benefits, such deregulation would not qualify as market failure. Voters simply weigh the costs against the benefits of regulation and make a choice.

A free-riding policy to the detriment of other member states becomes rational in principal if the costs of deregulation, for example in the form of lower environmental standards, can be shifted to other jurisdictions. Climate policy is a case in point. However, this issue is less relevant for the EU, which holds regulatory competences in environmental politics. In addition, particularly in the realm of transnational environmental goals such as the protection of climate, member states exhibit the willingness to take on a “pioneering role,” which seems to diminish the prevalence of a “race-to-the-bottom.”

As a result of his concerning the “over-constitutionalization” of the European Treaties, Grimm suggests that the Treaty be revised and be brought in line with usual constitutions; at the same time, the competence of the ECJ would shrink. He views economic freedoms and competition policy which have constitutional rank as a particular problem (Grimm 2016, 163; see also Schmidt 2019). While liberal economists such as Robbins, Hayek or Röpke would have embraced the constitutionalization of economic freedoms, critics seek to re-politicize the Common Market. Obviously, the Common Market as it has emerged would not survive such reform.

On the whole, the process of constitutionalization of the Treaties must be viewed ambivalently. The ECJ gained control of European integration which deprived the member states of political control. As a result, the EU has transformed itself into an administrative and judicial body, which helps to explain the growing skepticism towards the EU. Whereas the ECJ has interpreted the European Treaties in the sense of an “ever closer Union,” it also has pursued its own integration agenda while ignoring the will of parliaments. That way the European Union has acquired *ultra vires* competences, which extend the competences laid down in the treaties. Now democratic legitimation suffers because member states can be subject to European policies which could be contrary to the will of voters.

A comprehensive analysis of the ECJ’s decisions would stress that a liberal agenda was by no means pursued. Instead, some decisions suggest the goal of a unitary fiscal

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<sup>4</sup> For a more detailed analysis, see Wegner (2004).

state without fiscal competition. A case in point is the (now modified) ECJ ruling that member states must open their universities to students from other member states.<sup>5</sup> According to the ECJ, it would be discriminatory to raise tuition fees only for foreign students. Even small EU countries, which may be fiscally overburdened as a result, must open their universities to all EU students. In many other cases, too, the ECJ obliged member states to make their public goods available for general use, even if domestic taxpayers alone contribute to its financing. This creates a fiscal free-rider problem which the ECJ refuses to take account of in its decision-making. Such decisions support the conjecture that the ECJ sympathizes with the agenda of a single European fiscal state.

These judgments evince that the Common Market and the abolition of market barriers did not result from a liberal agenda but emerged unintentionally. As compared to trade barriers in the interwar period – but also to current trade barriers elsewhere – the EU accomplished a great deal. Exposing trade barriers that result from regulations to political discretion would risk what has been achieved to date, but this is precisely what critics are calling for presently. There are good reasons to separate decisions on trade restrictions from decisions of the majority in parliament.

It does not take much imagination to come up with a protectionist scenario if the prohibition of discrimination in Art. 30 TFEU were interpreted restrictively once again. The dispute over the Services Directive, which aimed at including the country of origin principle to trade in services, demonstrated the likely outcome of the re-politicization of the internal market. Politicians and trade unions mobilized against the directive proposed by the Commission and prevented the implementation of the country of origin principle in the service sector; the latter falls short of the degree of integration, which now exists in the market for goods (Lammers 2010).

In the course of European integration, regulations have gained in importance for the Common Market. In the absence of customs duties and import restrictions in the EU, member states could only resort to regulations in order to protect their markets. During the European fiscal crisis in the years after 2009, the countries particularly affected by the crisis had named the economically more successful member states, above all Germany, as the primary cause of their own crisis. If non-tariff protectionism had been available as an economic policy instrument, politicians would certainly not have hesitated to call for it. In any case, protectionist measures could have been used in negotiations of the European Council to demand concessions in other policy areas.

## 5. Conclusion

To bring our considerations to a conclusion, we must first emphasize the great achievement of the Common Market in Europe. This accomplishment is particularly

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<sup>5</sup> For an overview, see Pechar (2005).

evident in an observation spanning a long-term perspective which includes the interwar period. Considering the debate on the international economic order decades before, one begins to understand the unintended rationality of a process which realized the formerly utopian goal of economic integration.

At the beginning of the European Union, international treaties constituted a transnational economic order. However, it was only the opaque process of constitutionalization that provided the envisaged goal of the Common Market with momentum, since the removal of trade barriers took place in the non-politicized mode of settled case law. In the course of the enlargement rounds of the European Union, a large Common Market was created, comprising over 500 million citizens. Even though the European Monetary Union has meanwhile led to new disturbances in the economic order, at least the danger of an intra-European protectionism – and thus a relapse to the “dark era” of international economic relations – seems to have been averted.

The nature of the invisible-hand-solution which emerged within the EU is distinct from earlier proposals and in particular distinct from Tumlir’s proposal: Not only are economic rights anchored in civil law to be applied by courts; the legal basis to which courts refer itself has, likewise, emerged from courts. Any transfer of this solution to international trade outside the EU would imply political action in the first stage, which would bring back the challenges of trade diplomacy discussed above.

The most serious threat to the Common Market at present comes from regulations passed by the EU itself. Now a coalition of member states can impose tight regulations on a minority of member states (preferably in Eastern Europe) that affect their competitiveness. In this way, the principle of positive integration would prevail over negative integration. One example would be the introduction of a European minimum wage, which German and French politicians have put on the agenda. Since each member state is currently entirely free to introduce a minimum wage in its own country, a European minimum wage can only mean imposing a minimum wage against the will of other parliaments. European legislation would thus, under the pretext of a common social policy, restrict some of the member states in their economic sovereignty. New areas of conflict would result. Above all, one has to worry that prominent European politicians do not understand the workability of negative integration and are striving to undermine the current economic order in Europe with new, ill-considered goals of integration.

It is also obvious, however, that the path of a transnational economic order found in Europe would hardly work for other regions or for the global economic order as a whole. In other words, the role of context – in line with advocates of “contextual economics” – is pivotal here; it is hardly possible to view the emergence of these dynamics in the EU as a blueprint for economic governance in other regions or on a global scale. After all, governments would have to be prepared to give up important elements of their foreign economic sovereignty and transfer them to a supranational institution. This would affect economic powers such as China and the United States in

particular. For the time being, there is no alternative to trade diplomacy, and it would be a welcome development if governments felt committed to international trade agreements.

When the participants of the CWL discussed the problem of economic nationalism in the interwar period, they were far away from a solution. Simply arguing in favor of free trade falls short of the working principle of democracy, as most of the participants of the colloquium understood. The good news from the history of the European Union is that seemingly unconnected legal processes can emerge and “invent” a workable solution beyond both political negotiation and the imagination of economists.

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