

THE LEGAL FOUNDATIONS OF THE ECONOMIC SYSTEM DURING A PERIOD OF TRANSITION FROM A PLANNED TO A MARKET ECONOMY

Report of the European Commission for Democracy through Law, drawn up on the basis of a study by Professor Michel HERBIET, Professor of Law at the University of Liège

Any attempt to analyse the legal foundations of the economic system during a period of transition from a planned to a market economy poses a particular challenge, given the fundamental nature of the questions raised and the frequent complexity and uncertainty of the answers.

The problem is relatively straightforward: faced with the transition from a planned economy, characterised by the collective ownership of the means of production and centralised state planning, to a market economy - a process calling for major reforms which must involve the establishment of a new body of laws designed to facilitate the smooth running of the economy - governments have asked a number of questions:

- what are the fundamental legal principles on which market economies are based?
- should the rules be set out within the rigid framework of the constitution? or
- is it not better to leave the matter to legislation or regulations?

I.

Without dwelling too much on the two notions of a planned and a market economy, some attempt to identify the key elements of the legal framework of a market economy appears essential.

* The first is the recognition and protection of different forms of property.

This area encompasses the legal issues relating to the breaking up of monopolies, the privatisation of public enterprises and assets and the restitution of property.

Private ownership of the means of production must become the main form of ownership, but others can exist alongside.

* The second element is the formal recognition of freedom of economic activity, involving freedom to engage in business and to exercise the occupation of one's choice, freedom of establishment and to set up in business, freedom of enterprise and freedom of labour.

* The third element relates to contractual relationships, involving a recognition of freedom of contract and the role of contracts as the cornerstone of the economic system.

* Fourthly, there is principle of principle of free competition, based on economic freedom and the equality principle, which relates to competition between different individuals and between individuals and the state. While the principle does not prohibit public authorities from engaging in economic activities, they may not do so under conditions which would exempt them from normal legal requirements.

* A further element is freedom of association, which includes not only the freedom to establish associations or companies but also the freedom to belong to or withdraw from them, to operate and develop them and to dissolve them. This freedom includes the freedom to form and join trade unions.

* Other, more economic, aspects of such a system include:

- the establishment of an effective price mechanism;
- control of the monetary mechanisms, involving the establishment of a restrictive and stable monetary policy and the creation of an independent central bank;
- removing restrictions on foreign trade, with the introduction of a realistic exchange rate;
- the development of an effective tax system and the abolition of generalised state subsidies, all accompanied by a strict budgetary policy;
- provision for proper accounting systems for firms;
- regulations governing marketable securities and financial markets.

All these elements are intended to safeguard the long-term future of the market economy but they must also influence its inherent workings to take account of a series of general objectives of a higher order, which are social as well as economic in nature.

Thus, the market economy must be social, in the sense that it operates for the benefit of society as well as individuals. In this way it allows the taking into account of the interests of all parts of society, in particular employers and employees.

This means that the state must remedy certain deficiencies, through the provision of a social welfare framework and by regulating economic activity or creating public enterprises to fill the gaps where the market economy is not performing properly.

Together, these elements constitute a necessary condition for a market economy. Not a sufficient condition, however; private economic agents still have to exploit the opportunities now available to them.

The Commission is also extremely aware of the special circumstances of the countries in economic transition. Most of the basic elements of a market economy have already been enshrined in their legislation; nevertheless, reforms have to be implemented gradually and the market economy is still only operating imperfectly. It would probably be unrealistic, if not impossible, therefore, to expect these countries to incorporate all the legal provisions in force in the west at one go; the transition must be completed gradually and smoothly.

Having identified the basic principles of the market economy and taking into account the reservations just made, the next step is to consider the role of the constitution in this field.

II.

The role of constitutions in the economic field

Do constitutions, with their rigid frameworks, offer the most appropriate legal basis for the establishment and functioning of market economies? To what

extent is it preferable to leave this task to legislation and government regulations?

- The specific role of the constitution ...

Constitutions are essentially the expression of the political community's fundamental legal values. They provide a basis for, and at the same time a constraint on government activities. Constitutions are generally confined to a statement of basic principles, with the detailed application of these principles being left to legislation.

- ... in the economic sphere

Constitutions necessarily form the basis of states' legal and economic systems. They must safeguard the stability and predictability of free markets.

Their most important function is to provide a clear framework, founded on the rule of law, but they should set out only the most essential rules.

Constitutions have a critical role, but it must remain a modest one since they are not appropriate vehicles for the detailed regulation of the principles governing market economies. They lack the flexibility which the regulation of market conditions requires.

Extreme prudence is therefore called for in laying down the constitutional framework for economic activity. Constitutions must not be used to establish detailed rules and regulations; this is better left to ordinary legislation.

III.

What basic principles should be incorporated into constitutions?

Constitutions should confine themselves to the basic foundations of the new economic system

However, two types of fundamental right need to be distinguished:

- traditional rights and freedoms, that is essentially negative freedoms which impose on the state a duty to refrain from action;
- fundamental economic and social rights, also referred to as positive freedoms in that they require the community to act in a very specific fashion.

Without dwelling on this distinction and at the risk of simplification, it can nevertheless be said that traditional rights and freedoms (which include economic freedom) require governments to refrain from imposing restrictions on them. On the other hand, they do not grant citizens any entitlement to benefits or advantages from the authorities.

Economic and social rights are different in nature; they are relative and contingent and are often much more clearly policy oriented. They require the state to take positive action and give citizens a right to call on the authorities to act. They are intended to achieve a transition from de jure or formal to de facto or real equality.

These rights are based on the notion of solidarity, according to which the community has a certain number of responsibilities vis-à-vis the individual. Citizens, as well as governments, therefore have a duty to co-operate to achieve social and economic progress.

However, the demands placed on governments must be reasonable; governments cannot do everything at the same time or immediately. They have to exercise choice and set priorities. Economic and social rights have to be introduced gradually as public resources permit and they imply a wide power of discretion on the part of the authorities.

It is therefore difficult to treat the two types of rights and freedoms in an identical fashion.

Which traditional economic rights and freedoms should be included in a constitution? The main ones include:

- the right to property, while making it clear that its use must be subject to the interests of society, leaving open the possibility of expropriation;
- freedom of trade and industry, which involves free enterprise, free competition and freedom of movement of workers, goods, capital and services;
- freedom of contract, which involves the right to enter or not to enter into contracts, to choose the other contracting party or parties and to freely determine the content of the agreement;
- freedom of association, including the creation of distinct legal entities; this right cannot be subject to any preventive measures and includes the right to unite to protect and improve working and economic conditions;
- the principle of equality before the law and non-discrimination, though this is a legal and not an economic right; it includes fiscal equality, that is the absence of special tax privileges.

However, constitutions must confine themselves to proclaiming these traditional freedoms and leave it to legislation to clarify, and if necessary restrict, their application.

Any such restrictions must be specific and limited, and must be justified by the general interest or the need to maintain public order. They must be provided for - directly or indirectly - in legislation and should never call into question the very existence of these fundamental rights. They must be necessary, effective and commensurate with the requirements and the gravity of the situation, and should not amount to an excessive erosion of the freedom concerned (the principle of proportionality).

Another issue is whether to incorporate as such in a constitution the principle of state intervention in the economy. It seems that the decision may be influenced by a country's particular institutional arrangements. Thus, in countries with a federal structure, the division of powers between the federal authorities and their counterparts in the states or their equivalent may require a clear constitutional statement of where the power to intervene in economic matters lies. The Swiss example was cited, though the same does not apply in Belgium.

The Commission is fairly reluctant to accept that the principle of state intervention in the economy should be explicitly referred to in the constitution. Even where the state, or the public authorities in general, are expected to play a significant role in the economy, there is little to be gained from any specific reference to such intervention, other than as an exception to the principle of economic freedom, justified by the general interest. The latter would more or less dispose of any risk that this freedom might be drastically curtailed. On the other hand, economic freedom could be seriously threatened if the concept of state intervention - a highly flexible notion whose content is inevitably related to the party or group in power and the economic and social theories in vogue at any particular time - is given constitutional status.

The fluctuating nature of state intervention does not make it very compatible with highly stable constitutional provisions to protect fundamental rights and freedoms.

If it is enshrined in the constitution, state economic intervention may become ossified, thus reducing its effectiveness. Yet one of the first requirements of such a process is that it should be capable of rapid adaptation to a changing economic climate.

Which economic and social rights should be incorporated in constitutions?

It should first be pointed out that such rights are rarely included in the body of a constitution, but rather in a preamble, and that there is no relationship between the fact that they have constitutional status and the recognition they receive. Indeed, experience shows that there is no real correlation between the inclusion of these rights in a constitution and the level of protection or benefits actually provided.

It should not be concluded from this that their inclusion in a constitution is valueless, but it is necessary to proceed with caution.

The Commission is of the opinion that only a few economic and social rights should be referred to in a constitution, and then not in too much detail or in the same form as traditional rights and freedoms. One good example to follow may be that of the German Basic Law, which lays down that the German Federal Republic is a "social state", without going into further detail about what this concept entails.

Only really fundamental economic and social rights should be included. The result otherwise is likely to be a reduction in parliaments' room for manoeuvre and an undue increase in the power of the courts. Moreover, the experience of countries which have attempted to list such rights in detail is that they do not lend themselves to clear legal definition.

It is also preferable to include only those rights for which there is already an appropriate legal framework, so that giving them constitutional status represents a form of consecration.

The next step is to identify the principles and the methods to be adopted.

What is required is an affirmation of the principle that economic and social rights as a whole are recognised, and possibly a statement of how the principle applies to individual rights, but only in the form of minimum standards or a negative wording of the type "no-one shall be deprived except ...".

The hard core of these economic and social rights would include the rights to work, health, social security, a secure existence, suitable accommodation, a favourable environment and leisure.

It would then be left to legislation to determine the nature, content and form of these rights, provide for their protection and regulate their exercise, as well as to adapt them to changes in society.

It should also be stressed that the principle of equality and non-discrimination - identified earlier as one of the constitutionally protected traditional rights and freedoms - probably is the best safeguard of social values. The judicious application of this principle can be markedly more effective than the enumeration of a long list of economic and social rights.

IV

The role of legislation in the economic field

Legislation plays a fundamental but finite role, since it translates the basic principles laid down in the constitution into detailed form.

Regulations restricting economic rights and freedoms must have a statutory basis - either in broad-ranging legislation, particularly in the areas of security, health and public order, or in specific or individual statutes dealing with particular fields or economic activities - and must not pose a threat to the very existence of these rights and freedoms.

There are two main legislative approaches to the regulation of fundamental rights: direct intervention, with the state taking on the role of entrepreneur, industrialist, trader or financier, and/or the use of state authority to regulate an activity or behaviour, with the authorities acting not as a substitute for private initiative but as an external influence on the conditions of production, distribution or consumption.

The second option - indirect, unilateral intervention based on the imposition of constraints - involves two main approaches:

- the repressive approach, in which economic activities are allowed to develop and the authorities only intervene to curb excesses (examples include regulations governing product content, pricing or information on quantities). This approach entails only limited restrictions to fundamental rights and freedoms;
- the preventive approach, in which the exercise of an economic activity is subject to registration or a license, or may even be prohibited; here, the aim is to exercise prior control with a view to preventing rather than curing problems.

Two main legislative approaches are used:

- legislation proper, which only needs to be supplemented by purely implementing regulations which can be adopted by the different hierarchical levels of the competent authorities;
- enabling legislation (framework acts and acts conferring special powers), which grant the executive powers for which the constitution does not make express provision:
 - framework laws lay down the policy guidelines and principles which are to be followed but leave it to the executive to draw up the detailed regulations;
 - laws conferring special powers may be seen as the actual delegation to the executive, for a set period and within a strictly determined area of responsibility, of the legislature's power to amend or repeal existing legislation.

This procedure makes it possible to implement reforms very rapidly, but at the risk that democracy will lose its identity.

V.

The role of regulations in the economic field

Regulations play an important part in this area because the rapidity and flexibility with which the regulating authority - at whatever level - can act reflects

the needs of the economic sector.

However, the executive's scope for action is often limited. With certain exceptions, it does not possess independent regulatory powers, its area of competence being subject to the requirement of a statutory basis. It is the legislature which generally determines the scope, content and objectives of the regulatory powers granted to the executive.

While this power is sometimes confined to the application, pure and simple, of existing legislation, in cases of special powers being conferred or of framework legislation it extends beyond mere execution, with the administration enjoying considerable room for manoeuvre and generally a choice of methods to be used.

The increasing trend towards enabling legislation in the economic sphere, which is a consequence of the need for flexible rules and a rapid response, does pose a certain threat to the survival of the principle of legality. There is a risk of an unwarranted extension of discretionary executive power, when the objectives of the legislation are not stated sufficiently clearly or when the range of means available to the administration precludes detailed judicial supervision.

The tendency for regulatory authority to be devolved fairly far down the hierarchy of norms is justified by the need to respond more appropriately and more flexibly to economic reality.