ECONOMIC POLICY CO-ORDINATION AND POLICY REGIMES IN THE EUROPEAN UNION

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Abstract. *In this article, it is argued that coordination of economic policies in the European Union has not led to a weakening of the role of the nation states in shaping their own economic policies. Rather, what can be witnessed is the prevalence of national policy goals through the discretionary implementation of the common rules at the expense of the simpler approach of minimal harmonisation. To support this argument, the author looks at the process of policy coordination in three major areas of the EU: Single Market, Economic and Monetary Union and Social Policies.*

Introduction

In the European Union policy co-ordination amongst member states takes different forms, with varying participants, legal bases and degrees of coercion of public and private actors. However, one recurrent feature is that the goals and the balance of interests of the member states and other actors are embedded in the institutions and procedural rules that govern decision-making and the implementation of Community law. The peculiar balance of laws, implementing rules, sanctions and jurisdictional remedies defines the policy regime in the different areas.

Policy co-ordination is a broad expression. It has often been used to mean member states undertaking the same (discretionary) action – e.g. an expansionary fiscal policy – at the same time. However, it is not very likely that this kind of co-ordination will occur in the Union (although there have been examples) since decision-making is slow and powers are dispersed among independent authorities (the member states and their diverse institutions). Rather, co-ordination of policies will normally involve:

(i) Shared goals, that is agreement on the common direction and end-result;

(ii) Community rules and procedures to force/encourage progress towards those goals in a medium-term perspective;

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(iii) Different institutions and policy approaches for the implementation of common decisions in the member states.

In this context, the co-ordination of policies may entail a gradation of constraints on member states, from weak requirements of compatibility – not working at cross-purpose – to stronger conditions of consistency of policies and policy tools, up to the imposition, or prohibition, of certain actions (European Commission 2001c).

Moreover, rules and procedures created for one purpose are subject to erosion and reinterpretation, and evolve in response to the interests of the different actors and their bargaining power, sometimes with radical deviations from the original intentions. Consequently, within each policy regime it is necessary to consider the tensions emerging between the actors and the ensuing modifications of goals and procedural rules.

This paper discusses three regimes for the co-ordination of economic policies in the EC Treaty – "pillar one" of the European Union – namely the Single Market, macro-economic policy co-ordination, and the Open Coordination Method increasingly applied to a broad range of social policies to foster their "convergence". For each regime, the paper highlights the relationship between policy goals and institutional design, and the evolutionary forces at work. An overall assessment of their interaction in shaping "pillar one" economic policies concludes the paper.

1. Integration in the internal market

The Single Market is the paramount example of "negative" integration – following Jan Tinbergen's well-known definition – that is, integration achieved by removing obstacles to the operation of market forces and "creating an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured" (Article 14 of the EC Treaty).

The institutional design is relatively straightforward. The "motor" is the principle of mutual recognition of national laws and regulations, first established by the Court of Justice with its famous "Cassis de Dijon" decision in 1979. Mutual recognition may be denied, on a non-discriminatory basis, for legitimate reasons of public interest when it can be shown that the national rules of another member state do not afford "equivalent protection".

In such case, the Community can intervene and issue a directive establishing a common platform of protection – through "minimal harmonisation" – to eliminate the restriction and undesirably low national standards. Accordingly, "new approach" directives only determine the "essential requirements" of protection and not the technical details of implementation; once the essential requirements are met, mutual recognition cannot be refused and becomes an "absolute" principle.

Competition policy completes the system by preventing anti-competitive practices in the

enlarged European market and restraining member states' ability to support "national champions" with state aid.

Two aspects of this system are worth stressing; in a way they are the two sides of the same coin. On one side, the system requires the Community to intervene only when there is a threat to the principle of free circulation but otherwise lets different national rules coexist. It is thus a flexible system that – unlike other parts of the Treaty – contains intrinsic safeguards of subsidiarity.

On the other side, as a result of the principles of "direct effect" and "supremacy" of Community law, established by the Court of Justice in the early 1960s,[1] and the Commission's "own" powers to prosecute infringements of Community law,[2] the binding force of negative integration on member states is quite strong. Mutual recognition implies that national rules for the protection of safety, health, consumers, savers and the environment, will compete with each other; with the result, it has been claimed, that fear of driving away the mobile factors of production may lead to a regulatory "race to the bottom".

Scharpf (1999), for example, has argued that the balance between the goals of an integrated market and a cohesive society has been skewed unduly in favour of the former by this "constitutionalisation" of integration and competition rules. He refers, in particular, to member states' inability to use macro-policies to fight unemployment, to tax mobile factors of production for re-distributive purposes, and to grant monopoly power to public utilities for reasons of general interest.

In reality, the first and second of these restrictions are more a consequence of globalisation and capital mobility than a specific effect of Community policies, and the third may be overrated, as will be discussed. Scharpf himself is ready to acknowledge that a regulatory "race to the bottom" has not occurred in critical policy areas such as the environment.

But the indictment is more serious: it is that Community policies of market integration (with majority voting) have caused a permanent loss of control by member states over the fundamental direction of their economic policies.

It seems to me that this contention is contradicted by actual developments in important policy areas. I will provide examples from financial services and public utility services, and discuss some recent changes in decision-making in the Single Market.

[1] Case C-26/62, Van Gend Loos v. NDL Administratie der Belastingen, **ECR** 1963 p. 1, and Case C-6/64, Flaminio Costa v. Enel, **ECR** 1964 p. 585.
[2] Articles 211 and 226, and the specific powers for the implementation of competition policy under Title VI of the EC Treaty.

Financial services

Basically, the free circulation of services in the Single Market rests on the same principles as apply to goods. Freedom to provide services is listed, along with the other Single Market freedoms, among the fundamental objectives of the Community. Financial services fall within the general category of services (Articles 49-55 on the freedom to provide services and Articles 43-48 on the freedom of establishment). However, in 1981 the Court of Justice ruled that these provisions were not "directly applicable" and had to be implemented by directives (Story and Walters 1997). The member states were thus able to retain control of the content of Community legislation.

In principle, mutual recognition (of national licences) and "minimal" harmonisation (of prudential rules) are fully applicable to financial services (O'Keeffe and Carey 2002). A (non-discriminatory) restriction on the provision of services may be justified by a legitimate ("general good") interest of a non-economic nature, as in "Cassis de Dijon", where "that interest is not safeguarded by the rules to which the provider of the service is subject in the member state of its establishment",[3] and the restrictions are necessary and proportionate for the purpose.[4]

In practice, however, mutual recognition in financial services has not worked and the market for financial services has remained segmented along national lines; so much so that the European Council in Cardiff (1998) deemed it necessary to launch a new Financial Services Action Plan (FSAP) and adopt special decision-making procedures for its implementation (cf. the Report by the Committee of Wise Men 2001). The main reason is that countries with higher standards of investor protection and business conduct wanted to prevent their erosion by the free supply of services by providers from other member states. "Single passport" rules for providers of financial services have thus had to coexist with host-country business conduct and investor protection rules which have hampered integration and effective competition.

The prevalence of host-country rules was implicitly recognised by Article 11 of the Investment Services Directive (93/22/EC), which enumerates objectives of minimal protection that do not preclude member states from enacting more stringent rules (Tison 2002). While these may not lead to unjustified restrictions on the free movement of services or financial firms, in practice large differences in national rules have been deemed compatible with the Treaty even when serving similar purposes.

Accordingly, this is an area where member states have not relinquished control and national preferences have delayed and muted integration. Quite clearly, progress has been dictated by the needs of the financial industry much more than the Treaty rules on integration (Story and Walter 1997). Rules and procedures have accommodated national preferences rather than bending them.

[3] Case C-279/80, Criminal proceedings against Webb, **ECR** 1981 p. 3305 §9.
[4] Case C-55/94, Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, **ECR** 1995 p. I-04165.

Public services and the application of Article 86

Public services constitute a sensitive aspect of public policy. Since the late-1980s the Commission has gradually tried to apply competition rules to this area, which is dominated by large state-owned companies. At the outset the Commission was careful not to propose a general liberalisation programme and proceeded instead on a pragmatic step-by-step basis.

The rationale for the liberalisation and privatisation of public utilities was self-evident. In most instances public ownership of utilities had resulted in expensive and low-quality services, slow innovation and large financial deficits; the interests of politicians, managers and employees had prevailed over those of consumers. Experience in the UK indicated that the liberalisation of telecommunications and gas had brought substantial benefits. From a European perspective the fragmentation of utilities markets came to be seen as a major obstacle to innovation and growth. Meanwhile, technology had started to erode the "natural monopoly" justification for public ownership, especially in telecommunications.

The Treaty provisions concerning Single Market policies for public utilities are contained in Article 86 of the EC Treaty. Paragraph one provides that member states may not adopt measures contrary to the Treaty, notably as regards non-discrimination and competition rules. Paragraph two balances the previous provision by requiring that the application of the Treaty in this area "not obstruct the performance, in law or fact, of the particular tasks assigned" to public utilities. Paragraph three entrusts the Commission with the task of overseeing the application of these principles and gives it the power – "where necessary" – to address appropriate directives or decisions to member states.

This last provision is the most contentious since it gives the Commission "own" powers to issue directives without Council and Parliament approval. However, while upholding the use of these powers against member states on various occasions, the Court of Justice has ruled that their scope is defined by the norms that the Commission is trying to enforce. In other words, directives issued under Article 86 cannot not be used to introduce new general obligations on member states.

For its part, the Commission has clarified that Article 86 only applies to services of economic interest and companies that are engaged in commercial or industrial activity, and has declared that it will respect the following principles:

(i) Neutrality with regard to the (public or private) ownership regime (under Article 295 of the Treaty);

(ii) Freedom for member states to define public service and public service obligations; and,

(iii) Proportionality of measures restricting competition and internal market freedoms, in the sense that they may not exceed what is necessary for effective fulfilment of the mission entrusted

to the public utility company (European Commission 2001a).

Thus, the goal of market opening finds a limit in public service obligations. Member states may maintain privileges and exclusive rights for public utilities or special funding arrangements to ensure that these obligations are met. Restrictive measures must respect principles of transparency, necessity and proportionality, but they are by no means excluded.

Moreover, in a public speech in October 1996, the then competition commissioner, Karel van Miert, explained that "whenever the Commission has to adopt measures on the basis of Article 86, it always takes care to carry out extensive consultations with the European Parliament, the Council, the Member States and the parties concerned to reach the broadest possible consensus".

Early experience with the application of competition policy in this area did produce controversy and friction with some member states. Their concerns found their way into the Treaty on the occasion of the revision in Amsterdam. The new Article 16 (formerly 7d) of the EC Treaty provides that "the Community and the Member States ... shall take care that such services operate on the basis of principles and conditions which enable them to fulfil their missions".

The application of these principles is reflected in the uneven pace of liberalisation, most advanced in telecommunications and air transport, less advanced in postal services, railways, and gas, where it is feared that the market would not ensure adequate services throughout the country, and the technology and infrastructure lend themselves less readily to a multiplicity of providers. Decisions to proceed or delay are taken at the highest level by the European Council, as recently shown again in the case of energy market liberalisation.

Changing decision-making procedures

The Single Market legislative programme was by and large completed by 1993 and soon after started to make its impact felt. Under its rules, the Community has acquired extensive powers of scrutiny and oversight of national legislation. Council Directive 98/34/EC (previously 83/189/ECC) requires all technical measures liable to affect the free circulation of goods and services to be notified to the Commission; in 1996 the Court of Justice ruled that measures that had not been notified would be null and void.[5]

The Commission is charged with ascertaining whether technical measures are compatible with the free movement obligations; it may issue a "reasoned opinion" demanding appropriate changes and, if the member state concerned refuses to comply, it may take the case before the Court of Justice. It may also ask the member state

[5] Case C-194/94, CIA-Security International, **ECR** 1996 p. I-2211.

to suspend adoption of the national measure (standstill).

On the other hand, as mentioned earlier, member states may adopt restrictive measures to the extent that they can show that there is a "sufficient" public interest. Safeguard measures are explicitly allowed under Articles 30, 46 and 95 of the EC Treaty, on various grounds of "imperative need", and may also be provided for by individual liberalisation directives.

The post-1992 balance between the Community goal of liberalisation and member states' ability to protect public health and safety was questioned following the "mad cow" food scare in 1997. Member states complained that Commission powers interfered unduly with national prerogatives. The result was that Article 95 – the principal legal basis of Single Market legislation – was amended to correct the balance of powers in favour of member states.

Accordingly, Paragraph four now provides that member states may maintain national measures – on grounds of major need referred to in Article 30, or relating to the protection of the environment or the working environment – even after the adoption of harmonised legislation; and Paragraph five allows member states to introduce new measures in a harmonised area based on new scientific evidence or specific problems that have emerged after the adoption of harmonised legislation. After a national measure has been notified, the Commission has six months (twelve in exceptional cases) to decide whether it is compatible with the Treaty – a very tight time constraint in view of the complex procedures. In the absence of a decision, the measure is deemed to be approved. If a restrictive national measure is found to be legitimate, the Commission must immediately propose new legislation.

Thus, member states' powers to maintain national measures and to take protective action for reasons of public policy have been enhanced, and the Commission's powers to oppose them have been curbed. The Council has shown that it is fully capable of changing the Commission's powers when these are found to interfere excessively with national prerogatives.

Two other developments in recent legislation are worth discussing for their effects on the content and quality of Union legislation and the balance of power within the "institutional triangle" of Union institutions.

The first development is the adoption – by the European Council in Göteborg in June 2001 and the European Parliament in February 2002 – of the new "Lamfalussy" procedures for decision-making in the field of financial services.

These procedures have been designed to speed up implementation of the FSAP; however, a side effect has been an increase in the scope of primary legislation and the relative weight of national governments, the Ecofin and the Commission in shaping financial market rules. The reason is simple: the responsibility for primary legislation (Level 1 legislation) has been assigned to the Ecofin Council (with co-decision

with Parliament), assisted by a new Council Committee – the European Securities Regulatory Committee (ESRC) made up of member state officials. The task of enacting implementing regulations (Level 2 legislation) has been assigned to the Commission assisted by the Securities Committee under standard "Comitology" procedures. Financial market regulators – such as the British FSA, the Italian Consob and the French COB – are consulted and may give their views on legislation and implementing rules; however their formal task has been narrowed to ensuring the consistency of implementing measures at national level (Level 3). The Commission has also acquired strong powers of enforcement of common rules.

As may be seen, the first two legislative proposals under discussion with the "Lamfalussy" procedures – the Directives on market abuse (COM(2001) 281 of 30 May 2001) and on the single prospectus for security issues (COM(2001) 280 of 30 May 2001) – are characterised by very detailed and complex harmonising prescriptions in areas normally left to secondary legislation in national regulation. It appears that member states officials and the Commission are exploiting their new place in the legislative process to regain ground at the expense of national agencies; as is usually the case, hard bargaining leads to complex legislation that will be more difficult to implement.

2. The co-ordination of macro-economic policies in the European Union

Under Title VII (Articles 98-124) of the EC Treaty, the framework for the co-ordination of macro-economic policies rests on three pillars:

(i) A single monetary policy geared mainly to maintaining price stability and entrusted to an independent central bank (the ECB), which may support the general economic policy of the Community when this does not endanger the primary target of price stability;[6]

(ii) Decentralised fiscal policies, which, however, have to respect the twin constraints of the Excessive Deficit Procedure (Article 104 of the EC Treaty, forbidding deficits in excess of 3 percent of GDP) and the Stability and Growth Pact (SGP, aimed at achieving a balanced budgetary position in the medium term);[7]

(iii) A procedure for mutual surveillance of

[6] The Community does not have an explicit exchange rate policy. Article 111 of the Treaty leaves open the possibility for the Council, "acting unanimously", to conclude agreements on an exchange rate system (Paragraph One) and, lacking such an agreement, to formulate by qualified majority general orientations for exchange rate policy" in relation to third currencies. Any such action must be "consistent with the objective of price stability" and may be taken only in "exceptional circumstances" such as an "evident misalignment" of the euro exchange rate (Council Resolution on the Co-ordination of Economic Policies in Phase Three of EMU and Articles 109 [now 111] and 109B [now 111§2] of the EC Treaty).

[7] The SGP consists of a European Council Resolution (97/C 236/01) adopted in Amsterdam on 17 June 1997, two Council Regulations – both of 7 July 1997 – n. 1466 on strengthened surveillance and co-ordination of economic policies, and n. 1467 on the clarification of excessive deficit procedures, and a Code of conduct on the content and presentation of stability and convergence programmes, adopted by the Ecofin Council in 1998 and revised in July 2001 (cf. European Commission 2002a).

economic policies – which member states "shall regard as a matter of common concern" – entrusted to the Ecofin Council and implemented by the latter by agreeing and jointly monitoring the Broad Economic Policy Guidelines (BEPG).

The first two pillars do not entail coordination to achieve a specific aggregate fiscal policy stance, although the Council has the power to act in special circumstances.[8] The policy mix is the indirect result of the independent actions of the ECB and the national governments. Thus, here the policy approach displays features of "negative integration" and subsidiarity, as in the Single Market.

The rationale of the SGP mainly lies in the possibility that EMU may loosen the financial constraint on deficit spending due to member states' ability to borrow on a broader capital market and at cheaper rates that no longer incorporate a risk premium for exchange rate depreciations.

The status of the BEPG is less clear. According to Article 99 of the EC Treaty, "the Council shall, acting by a qualified majority on a recommendation from the Commission, formulate a draft for the broad guidelines of the economic policies of the Member States and of the Community, and shall report its findings to the European Council" (Paragraph One). In turn, the European Council shall "adopt a recommendation setting out these broad guidelines" (Paragraph Two). The Ecofin Council monitors the consistency of economic policies with these guidelines (Paragraph three) and, when it finds that they are not consistent or "risk jeopardising the proper functioning of economic and monetary union", may issue a recommendation to the member state concerned (Paragraph 4). The Commission is empowered to obtain all the necessary information from the member states, and has the initiative in proposing the draft guidelines and preparing periodic assessments of performance. Council decisions in this area, including recommendations, are not legally binding, although they do carry considerable weight.

In the three years since the inception of EMU, the present approach has worked satisfactorily. The ECB has acted cautiously but on the whole effectively in the face of incipient inflation in 2000 and the economic slowdown in 2001, and its record of independence has been good (Alesina et al.). Public debts and budget deficits have been coming down, as a ratio to GDP, and automatic budget stabilisers provided desirable support for economic activity in 2001 (some 0.5 per cent of GDP, according to Commission estimates). The overall policy-mix is regarded as having been broadly appropriate, though not as aggressively counter-cyclical as in the United States (European Commission 2002a, ECB 2002).

And yet, some of the member states and the Commission would like a radical change. In a widely publicised pamphlet, Jacquet and

[8] For example, in October 1999 the Ecofin Council approved a directive to let member states temporarily lower (for three years) the VAT rate on certain labour intensive services, if they so wished, in order to cushion the cyclical impact of a sharp downturn of activity in Asia (cf. Directive 1999/85/EC of 22 October 1999).

Pisany-Ferry (2001) have advocated strengthened macro-policy co-ordination that would encompass joint determination of the fiscal stance and the policy mix, as well as "positive ECB reaction to structural reforms that boost output".

They argue that co-ordination to prevent destabilising behaviour by some actors (regime-preserving co-ordination) does not necessarily ensure policy-optimising co-ordination, that is "the best possible distribution of fiscal policy decisions", notably in view of the increased interdependence brought about by EMU and the Single Market programme. In their view, policy co-ordination at the euro-zone level would provide support for national reform policies and "relieve the ECB from the excessive burden of being viewed as the sole policy actor within the area", thus reinforcing, rather than weakening, its independence.

This argument for "positive" coordination mainly relies on the existence of fiscal policy spillover across countries, due to the (positive) interest rate effects of expansionary demand policies and other inflation and productivity effects of the public sector budget. However, empirical evidence of such spill over effects is scanty (Gros and Hobza 2001, Wyplosz 2002). In addition, the desirability of discretionary anti-cyclical fiscal policy finds little theoretical and empirical support (Taylor 2000, Balassone and Franco 2001).

A different case for co-ordinating public spending policies has been made by Melitz (2000), who has argued that – while the effects of automatic stabilisers are on the whole rather weak[9] – public spending in the Union suffers from a systemic tendency to increase more rapidly than taxation because of aging and other structural reasons, and that opportunistic governments will exploit periods of rapid economic growth to relax spending constraints. Korkman (2001) agrees that "there is nothing in the SGP ... to prevent member states from undertaking pro-cyclical expenditure increases and tax reductions during periods of strong growth".

In reality, a majority of member states already have some sort of medium-term framework for keeping public expenditure and the overall deficit in check, including internal stability pacts to keep local government spending in check (Fischer 2001). Furthermore, empirical evidence indicates strong disciplinary effects of the public debt on the size of the deficit (Melitz 2000 and Wyplosz 2002), and no evidence of asymmetrical behaviour of the deficit in downswings and upswings (Wyplosz 2002). Buti and Sapir (2001) find that EMU has passed the early credibility test since "pre-emptive co-ordination aimed at reducing policy-induced shocks and enhancing adaptability to shocks has worked fairly well".

The main criticism, however, is one of excessive rigidity of the SGP rule, especially in view of the protracted slowdown of economic activity in the European Union since 2001 that is

[9] The same result is obtained by Wyplosz (2002).

pushing a number of member states against the 3 percent deficit ceiling. It is argued that the Union is confronted with an exogenous shock and that the SGP rule is unduly constraining countries' ability to take growth-enhancing measures. Accordingly, it is proposed that growth-enhancing investment should be excluded from the deficit ceiling (the so-called golden rule of public finance). The problem is that the notion of public investment is ill defined and exposed to manipulation by "opportunistic" politicians (Balassone and Franco 2001). Furthermore, the golden rule may open the way to the excessive growth in government debt that the SGP was meant to avoid.

In order to meet this objection, Pisany-Ferry (2002) has proposed that a "debt sustainability pact" be substituted to the current deficit-based SGP as a "sound finance" criterion; but the definition of the debt would have to include all government liabilities, including unfunded pension liabilities and any other off-balance sheet items. The proposal makes good economic sense, since it would allow greater flexibility to accommodate growth-enhancing investment and over time favour high return public investments. However, given that most Union member states have large pension liabilities, in practice the increase in budgetary flexibility would be limited.

While a compelling analytical and empirical case for change has not been made, the Ecofin Council and the Commission are pressing for strengthened co-ordination through the BEPG. In February 2001 the Ecofin Council addressed a recommendation to the Irish government, under Article 99§4 of the EC Treaty. The Irish budget was criticised for being pro-cyclical and "inconsistent with the BEPG adopted by the Council in 2000", in spite of a sound government budget and the stellar performance of the Irish economy over the previous decade. Soon afterwards, in March, the Ecofin Council and the Commission sent a Report to the European Council in Stockholm on "The contribution of public finances to employment and growth". The report posits additional requirements for sound public finances, namely:

(i) The need to avoid pro-cyclical fiscal policies, notably by imposing strict expenditure controls;

(ii) Criteria for sustainable tax cuts in the medium term, including "an appropriate balance and sequencing ... between running down public debt, cutting taxes, and financing public investment in key areas"; and

(iii) A strategy for tackling the economic and budgetary consequences of an aging population, including pension reform.

The European Commission's Communication (2001b) provides an ambitious blueprint for overhauling the content and procedures of policy co-ordination within the Ecofin Council. Many of the suggestions in that document have been retained in the Commission's proposals to the European Convention convened to prepare the institutional reforms of the Union (Commission 2002b).

The Commission wants to develop "activity indicators to provide a synthetic view of the euro

area" and, on that basis, "as an exact an evaluation as possible of the stance of the policy mix", prepared twice a year. It also intends to elaborate, in consultation with the ECB, detailed rules on the appropriate policy response to changing economic conditions – including rules for the general conduct of policy, policy responses to particular shocks, and the instruments necessary for the implementation of these responses. And it would propose fully specified common policies for the Union and the euro-area.

Strengthened co-ordination on all macro and structural matters would require appropriate institutional and procedural changes. The Commission proposes the following: the euro-zone Council should be given formal decision-making powers; the Commission should be given "own" powers in the drafting and implementation of the BEPG, including the possibility of issuing warnings addressed directly to member states that the Council could only reject by a unanimous vote; there would be regular formal meetings between the presidents of the ECB, the Euro-zone Economic Council and the Commission so as "to strengthen the European view of the assessment of national policies";[10] and, finally, national policy-making processes would be strictly co-ordinated with decision-making at Union level.

The position of the Ecofin Council on these proposals is not yet known. However, they are surely determined to have the last word on the substance of policy decisions. This was apparent in their decision in February 2002 to reject a Commission proposal to address an early warning to Germany and Portugal with regard to their failure to comply with the budgetary objectives in their stability programmes.[11] In June 2002, in Seville, the European Council decided to relax somewhat the SGP obligations by requiring member states to aim at a budgetary position "close-to-balance" over the medium term, rather than "balanced", and by deferring (by one year) the deadline for achieving that goal by the countries that were out of line.

These procedural changes would undoubtedly strengthen Community institutions and their capacity to intrude into national policies enormously. Whether in practice this would be feasible and effective is an open question. However, some of the changes seem to be already taking place without any serious discussion of their desirability or much evidence of the need for them.

[10] The possibility of a formal participation of the president of the ECB in the meetings of the Eurogroup has been envisaged in the Nice Treaty revisions. As has been noted, while an exchange of views may always be useful, there is a risk that institutional meetings of this type provide an officially sanctioned forum for fiscal authorities to put undue pressure on the ECB (Alesina et al. 2001).

[11] The Commission inserted a statement in the official minutes of the meeting declaring that Germany's and Portugal's policy commitments "respond to the substance of the concern of the Commission Recommendation for an early warning", and reaffirming the essential role of the early warning procedure in the SGP. But the damage was done.

3. Positive integration and the "open coordination" method

Historically in the European Community every step in the integration process has been accompanied by measures of "positive integration" designed to facilitate adjustment and maintain economic and social cohesion while strengthening market forces and competition. These polices were mainly of a re-distributive nature[12] and designed to gain acceptance of the "core" integration goals of the Community, but over time they have proved ineffective, expensive, and a source of major distortions in the economy. Moreover, the policy consensus in the Union has increasingly stressed flexibility, investment in human capital and incentive-compatible social policies rather than protection.

With the Amsterdam revision, a new tool of policy coordination has found formal recognition in the Employment Title of the EC Treaty (Articles 125-30), following early experiments in labour market policy co-ordination within the Labour Ministers Council (the "Luxembourg" co-ordination process). Other "processes" were added in the subsequent years by the European Council, with co-ordination extending to structural reform policies (the "Cardiff " process), macro-policies (the "Cologne" process), and a comprehensive programme for innovation and human capital (the "e-Europe" programme adopted in Lisbon). The new approach was baptised the "open co-ordination method" (OCM) by the European Council in Lisbon.

At the outset, explicit recognition of employment as a positive goal of policy, notably with the introduction of quantitative targets, was meant to operate as a counter-weight to the Maastricht criteria for sound financial policies. However, along the way it has evolved into a "soft" co-ordination tool for the implementation of the new strategy to adapt the Union's social model to the requirements of a more flexible and dynamic economy (cf. European Council 2000).

The institutional balance of responsibilities for economic policies has also been modified following the decision – also taken in Lisbon – to devote, each semester, a special meeting of the European Council to economic and social questions. While previously the responsibility for setting goals and reviewing progress on the various fronts basically belonged to the Ecofin Council, with the BEPG,[13] it has now been taken over by the heads of state and government in the European Council. They have also instructed the Ecofin Council to take account of the opinions of the different Council formations in formulating the BEPG. This explicit role of the European Council goes beyond the tasks of arbiter and

[12] The Common Agricultural Policy and the Structural and Cohesion Funds are the paramount examples; but the complete list is much longer and comprises such things as research and industrial policy, the trans-European networks, consumer protection, the environment, assistance in institution building (as in the present enlargement exercise), and more.

[13] Cf. European Council Resolution on Economic Policy Co-ordination in Phase Three of EMU of 13 December 1977. The legal basis of the BEPG is provided by Article 99 of the EC Treaty.

strategic motor of the Union; it involves genuine decision-making on economic and social policies and monitoring their application (Commission 2001c, De La Porte 2002).

The ingredients of the OCM were spelled out in Lisbon by the European Council and include:

(i) Fixing common guidelines for national policies in various policy areas – e.g. employment policies, education and training for employability, flexible labour markets, aging and sustainable pension systems, social exclusion – with dates for their implementation;

(ii) Developing indicators (benchmarks) of national performance as a means for comparing best practice;

(iii) Asking countries to adopt national action plans to implement the common guidelines

(iv) Undertaking joint monitoring and review of results, thus bringing peer pressure to bear in order to sustain progress.

Two features worth stressing concern the role of the Commission and subsidiarity. While these coordination exercises involve areas of policy that are not within the competence of the Union, almost inevitably the Commission has taken on an important role in proposing policy guidelines, developing indicators and providing comparative analysis of results. Thus, the Commission is emerging as a main player in shaping overall economic policy in the Union alongside the European Council and outside the normal Community framework.

For their part, member states retain considerable freedom to adapt policy guidelines to national contexts and decide their preferred approach to implementing them. On the other hand, while not legally bound by the Treaty, de facto, member states face new constraints on decision-making since they are obliged to debate and decide their national plans in time for the meetings of the European Council. This also means that they all carry out the exercise at the same time. Furthermore, their performance, relative to the other member states, is regularly exposed and compared in public reports prepared by the Commission, thereby putting pressure on governments to match best performance.

The European Council has also stressed the importance of involving a broad range of stakeholders in consultations at all policy stages, from the formulation of guidelines to their implementation and review. Thus, national Parliaments, social partners and other national players are increasingly involved in the discussions on European policies. Their legitimacy and acceptance are likely to benefit from these features of decentralisation and involvement.

Thus, while the working methods are decentralised, their goal is increasing "convergence" of economic structures and social institutions. Use of the OCM does not mean that convergence of national policies will be painless. The goal of the Lisbon agenda – to make Europe "the most competitive and dynamic knowledge-

based economy in the world" by 2010 – entails radical market-friendly reforms. Labour market and welfare systems differ widely within the European Union, and the economic case for co-ordination is weak and may be justified for limited goals, such as reducing differences in welfare systems that may distort migration flows or spreading the benefits of policy experimentation (Boeri 2002). Furthermore, policy goals in this area have been mainly shaped with reference to "Nordic" social models; therefore, convergence would entail greater structural changes in "corporatist" systems in the Centre and South of the Union (De la Porte 2002).

The formal equality of obligations and parity of positions in coordination exercises cannot conceal substantial inequalities in the distance that the different member states will need to travel. The effectiveness of the OCM in muting political opposition and legitimating the new ambitions of economic and social "convergence" is still untested.

There is also the question of the consistency of the new coordination framework with the traditional Community legal framework. Scott and Trubeck (2000) note that new forms of governance such as OCM entail "a breakdown of the distinction between rule making and rule application". The success of EU integration has been predicated on direct effect, supremacy and uniform interpretation of Community law, which is the constituent element of its supra-nationalism. There is a risk that the emerging modes of governance will change the perception, and later also the reality, of the institutional balance of powers, with unpredictable effects on the dynamics of integration.

The Commission is aware of the problem and is developing principles to circumscribe application of the OCM. It considers that its use should be limited to cases where harmonising legislation and binding Union intervention would be inappropriate, because the subject matter touches closely on national identity and culture, or national arrangements are so diverse and complex that harmonisation would be "out of all proportion to the objectives". It stresses that resort to the OCM should observe the principle of proportionality, be decided on a case-by-case basis, and not made when there is room for Community intervention under the Treaty (European Commission 2001c).

On the other hand, the Commission does not exclude the possibility of bringing policy areas into the Treaty where the OCM has proved successful and "where the member states are not ready to embrace common legislation … immediately but do have the political will to take very concrete steps towards an identified common objective".

The OCM, thus, may become a precursor of further transfers of tasks to the European Union in very sensitive areas of national sovereignty and, over time, modify the institutional balance and modes of governance in economic policy making – a "grey area" of Union activity where powers and procedures are shaped by political bargaining

within the European Council without any clear definition of legal boundaries.

4. Elements for an overall assessment of policy co-ordination

The approach to economic policy co-ordination embodied the EC Treaty has a fairly simple and logical architecture. Mutual recognition, based on minimal harmonisation of public policy requirements, is to govern integration and the elimination of technical barriers that prevent free circulation among national markets.

The common good of macro-economic and financial stability is entrusted to an independent central bank, with a set of constraints on national budgetary policies designed to limit free riding and opportunistic behaviour by member states. But the latter are to remain free to decide their own policies and choose how much to spend and tax through the budget and how to design their welfare and social safety net.

Recent developments in the balance of powers and decision-making procedures indicate substantial changes to this model, reflecting the reaction by the member states to a feared loss of control over the fundamental direction of their economic policies. The main emerging changes concern the following aspects:

(i) The balance between Community law and national policy goals in the Single Market and economic policy coordination seem to be tilting in favour of the latter; member states display a growing preference for discretionary decisions that override clear and simple co-ordination rules;

(ii) Policy co-ordination at Community level shows increasing ambitions, gradually extending to all aspects of economic and social policies;

(iii) Within Union institutions, decision-making is moving "upwards", from specialised committees to ministerial fora and from ministerial fora to the European Council, with ever-more encompassing goals and procedures.

These trends are not based on the results of an explicit debate over policy design. Indeed, there is little analytical reasoning or empirical evidence in supporting of the changes that are taking place. Rather, the process is the result of political opportunism, administrative interaction (as in Maurer et al. 2000) and ad-hoc Council agenda that fail to appreciate the institutional and policy consequences of individual decisions.

The main risk is that, while creating high expectations amongst the public, this ever-more complex and encompassing policy-approach will reveal ineffective and at the same time blur the responsibilities for policy failures. As a result, Union institutions could be further discredited while national policy makers would find it easier to avoid hard choices and eschew attendant political costs.

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