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The European Agenda: Issues of Globalization, Equity and Legitimacy

LOUKAS TSOUKALIS

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Tsoukalis: *The European Agenda: Issues of Globalization Equity and Legitimacy*

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The European Agenda: Issues of Globalization, Equity and Legitimacy

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Introduction

The European Union (EU) approaches the end of the century with a heavily loaded agenda; and a very important one indeed. In the course of less than two years, important new policy decisions are scheduled to be taken, while long-standing commitments will have to undergo the difficult test of endurance in European societies and international markets. What happens during this short period is likely to influence in a big way the shape of the European construction for several years to come. Turning points is a much abused term in political parlance; yet it could be employed with much justification in the present conjuncture.

The EU is faced with yet another variation of the now familiar combination (challenge is, arguably, a more appropriate term to use) of widening and deepening; and the stakes are higher than ever before. Twelve active applications for membership have been waiting at the Council's table. They have come from countries with significantly lower levels of economic development than those already in and with political systems which can only draw on a relatively short (and, in some cases, highly inadequate) experience of parliamentary democracy. The further enlargement of the EU to the east and the south is about the redrawing of the economic and political map of Europe; and it is also a form of collective underwriting of economic prosperity as well peace and security on the European continent.

The further deepening of European integration as an end in itself, but also as a means of preventing the dilution of common policies and the weakening of institutions through the accession of new members (an old concern of those already in), is no less important. It is centred on economic and monetary union (EMU) scheduled to start on 1 January 1999. But it is also about the strengthening of the European political system, and institutional reform in its narrower definition. Neither has had much luck at the latest intergovernmental conference (IGC) which has delivered very little of substance in this area. Institutional reform and political union have therefore been postponed once again, although they have surely not been abandoned for ever. Deepening is also about the reform of internal policies, and most notably the common agricultural policy (CAP) as well as structural policies, which together account for more than 80 per cent of the EU budget.

In July 1997, the Commission submitted to the Council an important document in which it tries to set the main parameters for the development of the

Union in the years to come. The so-called *Agenda 2000* (European Commission, 1997*a*) sketches with a broad brush the shape of a radically reformed CAP; it highlights the main elements of structural policies in an enlarged EU; and it outlines the new financial framework extending to the year 2006. Last but not least, it proposes a strategy for enlargement, naming the countries which may start first what promise to be long and arduous negotiations leading to accession, while also proposing ways and means of dealing with those countries which may have to spend an even longer time in the waiting room. It is an ambitious document which seems to contain at least some of the main elements of a package deal aimed at reconciling widening with deepening. It is also a document which clearly tries to take into account the interests of different parties as well as the existing balance of power. Since then, things have moved fast. In March 1998, the Commission came up with more detailed proposals on the CAP, structural policies and the budget, while the accession process was formally launched with eleven candidate countries. This, however, needs to be distinguished from the actual accession negotiations which begin with only six countries on the basis of the Commission's proposals.

EMU and institutional reform, although essential elements of the overall package linking widening with deepening, are not part of *Agenda 2000*. As far as EMU is concerned, the course of action regarding the transition to the final phase and the eventual replacement of national currencies by the euro had already been clearly set out. In May 1998, the Council selects the countries to become founding members of EMU; it decides on the bilateral conversion rates between their currencies; and it also appoints the members of the executive board of the European Central Bank (ECB). As for institutional reform, the Commission acknowledged the fact that the new Treaty of Amsterdam, which still needs to be ratified, falls far short of what will be required for an enlarged Union. It added that the reform of the composition and functioning of institutions should precede further enlargement. In other words, a new IGC will be needed, according to the Commission, before enlargement takes place.

I propose to discuss below some of the broader issues linked to the Union's main agenda. They will be grouped under three headings, namely globalization, equity and legitimacy. They are all highly political issues usually camouflaged in official documents under a technocratic cloak. The emergence of a stronger and larger EU very much depends on how these issues are tackled. They are, of course, highly political issues, despite the fact that the specific parts are mostly of an economic nature. This should be hardly surprising. Who says that high politics can be divorced from economics in our societies?

Globalization and the European Model

Globalization has become one of those buzz words of our times. Politicians and journalists, economists and sociologists, they all talk about globalization, although they seem to draw different theoretical or policy conclusions. When used to draw attention to the considerable acceleration of the process of economic internationalization during the recent period, or to the benefits to be derived from a more efficient allocation of resources and stronger competition, coupled with the constraints imposed on government action, there is arguably little to disagree with. When, however, references are made to the 'global' economy as something that already exists, which is also irreversible and economically superior and/or 'modern' (thus implying that markets are always good and governments bad), then globalization becomes ideologically loaded, although consistent with prevalent economic orthodoxy. More than that perhaps, globalization often serves as a convenient myth or even a scapegoat (Hirst and Thompson, 1996:6).

The external trade of EU-15 in goods (excluding trade between the members of the Union), expressed as a percentage of GDP, is now virtually the same as it used to be about 35 years ago, namely around 10 per cent. This figure is very similar to the one for the United States. Thus, the two biggest trading blocs in the world are still relatively closed economies, as anybody might have expected, when in sober mood, given their size. True, member countries of the Union have become much more open, but this is almost entirely due to the increase in intra-EU trade which now accounts for almost 70 per cent of the total trade of an average EU member. The high degree of EU's self-sufficiency in trade terms is expected to increase further as a result of enlargement.

Statistics on merchandise trade are, of course, not the only indicator of economic interdependence. In recent years, trade in services has been growing faster than trade in goods, although still accounting for approximately one-fifth of total world trade. Foreign direct investment (FDI) flows have also been growing faster than world trade, thus leading to a significant restructuring of world production, especially in services and high technology products (Greenaway, 1993; European Commission, 1997*b*). This has been in turn linked to the widespread and rapid diffusion of new technologies accompanied by major institutional innovations. Restructuring at the global level also needs to be considered in conjunction with the establishment of wide networks and cooperation agreements among firms, covering the whole range from research and development to marketing and distribution. The rapid growth of trade in intermediate products and intra-company trade is also consistent with the trend towards an increasing internationalization of production.

A similar, although much more pronounced, trend can be observed with respect to financial markets. And this is directly linked to the revolution in communications and the rapid liberalization of capital movements. Capital, and even more so financial capital, is, of course, much more mobile than either goods or labour. Drucker (1997:162) talks about 'virtual money [that] has total mobility because it serves no economic function... And because it serves no economic function and finances nothing, this money also does not follow economic logic or rationality. It is volatile and easily panicked by a rumor or unexpected event'. Many economists would take objection to the alleged lack of economic function of what Drucker calls virtual money, although hardly anybody could disagree with the reference to volatility and the implied 'herd instinct' of financial markets.

In terms of foreign exchange and to a lesser extent bonds, we can perhaps already talk about 'global' markets; not yet about stocks, although the links between national markets are becoming much stronger with time, as witnessed, for example, during the recent financial crisis in East Asian markets and the repercussions felt in the stock exchanges of Western industrialized countries; and even less so about retail finance where international integration takes place at a more modest pace and mainly through the increasing interconnection of what are still national markets. In this respect, global networks are a more common phenomenon than global actors.

The large ongoing restructuring of both the manufacturing sector and financial services in Europe, manifested largely through the wave of mergers and acquisitions (many of them cross-border), has been in turn linked to liberalization and/or deregulation. Undoubtedly part of an international phenomenon, it has not, however, been unaffected by political decisions taken at the national and European level. In several policy areas, specific European policy answers have been formulated in response to international developments. This applies as much to the new 'regimes' on banking and financial services, as it does to technical standards and regulations, not to mention competition policy (Tsoukalis, 1997; Pelkmans, 1997).

The concern expressed about globalization by those who have not been fully converted to the new economic orthodoxy (*la pensée unique*, as referred to by French unbelievers; see also Fitoussi, 1995) concentrates usually on the effects of globalization on the state, also raising wider issues of governance (which is not confined to state institutions), and the distribution of benefits and losses among different groups of society. The two kinds of effects are closely linked together.

During the so-called Golden Age for European economies (Crafts and Toniolo, 1996), which lasted until the early 1970s, regional integration was based on a symbiosis between external liberalization and the strengthening of the economic role of the state on the domestic level (see also Milward, 1992). This was summarized in the phrase 'Keynes at home and Smith abroad'. An important consequence of this symbiotic relationship was that integration was essentially limited to trade in goods. It started to break down in the years of stagflation when industrial activism and other forms of national economic protectionism opened large holes to the European edifice. Later, the internal market programme ushered the EC/EU into a new phase which is mainly about the mixed economy.

The internal market programme has produced some transfer of powers from the nation-state to European institutions, although usually different in kind: the emphasis is now on regulation and not on direct intervention (Majone, 1996; Tsoukalis and Rhodes, 1997). A two-tier regulatory structure has been created in several policy areas, with a sometimes ambiguous division of powers between European and national authorities. Yet, there is little doubt that the internal market has produced an even more substantial transfer of power from the state to the market. This has been much reinforced by international developments, while being consistent with the prevailing economic ideology. The weakening of state power has been perhaps as much by design as by default. The shift in the balance between the state and the market can be at least partly attributed to the weakness of the European political system; when the will is there to go beyond negative integration, common instruments prove difficult to handle and legitimacy is usually lacking.

Some observers talk about the 'restructuring' of the Western European state (Cassese and Wright, 1996). Yet, in terms of its traditional economic functions, namely the allocation, redistribution and stabilization functions, it is arguably more accurate (and less agnostic) to talk about the weakening of the state. In this respect, European integration and international developments seem to work in parallel. The strengthening of market forces at the expense of state power has generally been welcomed in the name of economic efficiency. Considerations about equity and stability have been gradually pushed in the background, although perhaps not for good.

There are important issues which could eventually lead to some reordering of priorities. Increasing income inequalities and the crisis of welfare systems in the industrialized world are one such example. The instability of financial markets are another, coupled with a worrying trend towards the privatization of profits and the socialization of risks (and losses) in this sector, as witnessed once again with the official (and IMF) response to the recent financial crisis in Asia. The crisis has also raised fears of systemic instability and it has produced calls for closer regulation of international financial capital; and some have come from rather unexpected sources such as Mr Soros (*Financial Times*, 31 December 1997/1 January 1998).

The symbiosis between external liberalization and different versions of the European mixed economy and the welfare state, already mentioned above, had lasted for many years. It had been a major characteristic, indeed a precondition, of the long economic boom of the postwar period. In more recent years, further liberalization, directly linked to the internal market programme and international developments, has been accompanied by a very substantial increase in unemployment which seems to be the counterpart to the large increase in income inequalities experienced in the United States, and also the UK which has followed the American example in terms of labour market deregulation (for recent trends in the dispersion of earnings, see European Commission, 1997*b*; Atkinson, 1996; OECD, 1995).

The link with liberalization/globalization has been the subject of a vigorous debate in academic circles and elsewhere. Some writers have attributed much of the increase in unemployment in the EU (and falling relative wages of unskilled workers in the USA) to the rapid growth of imports of manufactured goods from developing countries (Wood, 1994). Others argue that technological change has played the dominant role in modifying labour markets (Cooper, 1994), while still others link, at least in part, the growth of unemployment in Europe to restrictive macroeconomic policies coupled with the so-called hysteresis in labour markets (CEPR, 1995; Blanchard and Summers, 1986). Most have perhaps underestimated the effects of free trade and capital mobility on the relative power of governments, owners of capital and labour (close to it comes the argument developed by Rodrik, 1997). Power has always been an awkward concept for economists to handle.

Regional economic integration, and the process of internationalization more generally, coupled with technological change, puts a premium on skills and on the flexibility and mobility of factors of production. Thus, capital tends to gain more than labour, and professionals more than unskilled workers. In the words of Caporaso (1996:44), 'the regionalization of the European economy, guided by the EU, is not a politically innocent process'. As Europe (and the process of integration) becomes more and more identified with economic liberalization, those who perceive themselves as losers from this process tend to rally behind nationalist flags. Some evidence of this can be found in voting patterns and opinion polls of recent years, with the French referendum on the Maastricht treaty being one of the clearest examples. On the other hand, Euro-sentiments seem to be closely related to the economic climate. There is, for instance, a close correlation between annual rates of economic growth in the EU and popular support for European unification (Tsoukalis, 1997). Love for Europe, even in modest quantities, seems to go first through the pocket of European citizens.

Those who find it difficult to adjust to rapid technological change and economic liberalization continue to turn to national institutions, because they simply have nowhere else to turn (Judt, 1997). Thus, the 'nation-state' becomes some kind of a 'Jesus rail' for the losers. Mortimer has a very vivid description: 'In the bewildering new world the nation-state is no longer the engine of modernisation. Instead, it has become the "Jesus rail" - the handle that a white-knuckled passenger clings onto shouting "Jesus", as the car he is travelling in hurtles round a blind corner' (*Financial Times*, 6 April 1994).

However, this 'Jesus rail' is no longer as effective as it used to be for the protection of panicking passengers. The rapid growth of unemployment constitutes a major political, economic and social problem in itself. Coupled with demographic trends and the accumulation of public debts, it has also put unbearable pressure on European welfare states. Inflexible labour markets and too high (only indirect?) labour costs are generally blamed for high unemployment. Heavy regulation of these markets is perceived to work against the interests of a growing number of 'outsiders', mainly women, the young and the unskilled. These 'outsiders' are forced to live of welfare as they are priced out of the labour market, because of minimum wages and high indirect costs of labour, and also because of restrictive rules on hiring and firing.

There is a growing consensus among economists on the diagnosis and the therapy proposed, the main disagreement now being whether deregulation should go all the way or whether it could take place on a piecemeal basis. And this is likely to be gradually reflected in concrete policy measures. Under the pressure of high unemployment and the increasingly unaffordable cost of welfare payments, European countries are expected to move, some more quickly than others, in the direction of deregulated labour markets, thus following the

American and British examples; and EMU will most probably act as a new and powerful driving force in this respect.

Deregulated labour markets, coupled with technological developments and free trade, will mean, however, greater income inequalities. This may finally become accepted by European societies as part of the package which also includes liberalization and globalization. Such a possibility cannot, of course, be excluded, even though it would have wider political and social implications. Assuming that deregulation of labour markets is indeed an one-way street, the alternative would be that European governments decide to tackle the problems resulting from deregulation without interfering directly with the operation of the labour market. Education and training would certainly help the unemployed to adjust to rapidly changing demand conditions; but they are not a panacea. Dealing with inequalities, as the (inevitable?) product of free markets, would require a major reform of tax and welfare policies, including the elimination of tax disincentives for work and a greater concentration of welfare policies on those really in need. The welfare state would therefore have to be targetted more on poverty and social exclusion, instead of operating largely as a form of subsidy for the middle classes through the provision of universal services (Goodin and Le Grand, 1987).

This policy shift would, however, have wider distributional consequences which would not all too easily be accepted by the large number of those who would end up losing from it. 'Insiders' are much more numerous than 'outsiders', and they also have a more powerful political voice; hence the strong resistance to change. Thus, a policy shift, such as the one described above, would in turn depend on the creation of new political coalitions. The dividing line between traditional left and right has become increasingly blurred (Giddens, 1994). The political forces which call themselves centre-left in some countries, and most notably the New Labour in the UK, seem to be moving, even though hesitantly, in this direction.

It goes without saying that the deregulation of labour markets, coupled with major reforms of tax and welfare policies, will represent a significant change in what is generally called the European social model. The European Commission repeatedly refers to the need to preserve this model, while at the same time calling for structural reforms in European labour markets as a means of safeguarding international competitiveness and tackling unemployment. According to the former President of the Commission, Mr Delors, the European construction, as also the European model of society, rests on three pillars, namely competition, cooperation, and solidarity (Delors, 1994:232).

This may indeed be so. However, defending and/or adjusting this European model to a rapidly changing economic environment is still very much in the hands of national governments. In terms of social policies and the regulation of labour markets, subsidiarity remains the name of the game, European social charters or no charters. The European labour market is highly fragmented, largely because of linguistic and cultural barriers which cannot be easily legislated away. Such barriers are, of course, not high enough to stop people driven by political fear and economic despair, which is true of many migrants coming from third countries. It is not, however, true of intra-EU labour mobility which is still very low.

European social legislation, although not insignificant, has been mostly about the setting of minimum common standards. The Amsterdam treaty has added a new chapter on employment, soon followed by a special summit on employment held in November 1997. They may create expectations which the Union will have difficulties in fulfilling; although this would simply follow the tradition of high rhetoric and little action set by the EU in the social field (Tsoukalis, 1997). In terms of employment policies, EU institutions can provide a framework for discussion; they can also act as a catalyst and legitimizer of policy measures taken at the national level (Koutsiaras, forthcoming). These are not unimportant functions, but it is really as far as common institutions can go. Coordination of national employment policies, on the basis of multi-annual employment programmes submitted by national governments, and multilateral surveillance cannot go further as long as they are not backed by hard constraints; and how could they? It will be like the (lack of) coordination of national budgetary policies before the adoption of the convergence criteria and EMU. But this is arguably not a bad thing, given the wide diversity of economic conditions, including productivity rates, rules and institutions, which still characterizes national labour markets in Europe.

Subsidiarity for social and employment policies, yes! Nevertheless, it is also true that the further development and deepening of European integration, including most notably EMU, will very much depend on the ability of member states to manage economic change, and some are bound to be more successful than others. This may sound paradoxical, although it is certainly not new. On the other hand, the EU could help to influence the economic environment, and in the process make the management of change easier for member countries. Some policy options do exist, others may be only theoretical or too costly or both.

Commercial policy is conducted at the EU level. Yet, trade protectionism is hardly a viable option, despite the relatively high degree of self-sufficiency for the Union as a whole. Europe cannot and should not try to cut itself off from the process of economic globalization/internationalization. The effects of the latter are mainly transmitted through the financial markets. There are strong arguments, in the name of stability in large part, militating in favour of a closer prudential regulation of financial markets. EMU, and the rapidly increased mobility of capital within the euro area which will follow, are bound to raise the question of effective regulation for the area as a whole. Uncoordinated national regulatory systems will prove grossly inadequate. On the other hand, the EU may increasingly tend to adopt, after the establishment of monetary union, an attitude of benign neglect with respect to the exchange rate of the euro, because of its much reduced vulnerability to exchange rate fluctuations. It would then simply follow the American example. Globalization in financial markets provides a powerful argument in favour of EMU.

There are also the more daring (and unorthodox) among economists who go further by calling for the imposition of a small tax on transactions (the so-called Tobin tax) which would raise much needed revenue, while also helping to reduce the mobility of short-term speculative capital. However, for such measures to work, international cooperation would be necessary; and this hardly seems to be forthcoming. Free riders are plenty, while others may need to experience more crises before they are convinced about the inherent instability and the myopic vision of international financial markets.

More attention needs to be paid to macroeconomic policy. The time may have come for supply-side measures to be complemented with action on the macroeconomic front, which would be intended to stimulate demand. The EU can provide the framework for coordinated action in this area, especially if/when the current economic recovery begins to recede, independently or not of the Asian adjustment. Reflationary measures will only be possible, if they are coordinated at the EU level; and this will become easier with EMU. Admittedly, such action would not be consistent with the prevailing economic orthodoxy; and even talk of reflationary measures could ignite the fears of many stability-minded Germans (and others) about EMU. The persistence of high unemployment, coupled with the difficulties and limitations of supply-side measures, may help to change attitudes before not too long. Otherwise, we will end up with too narrow an implementation of the stability and growth pact, thus concentrating exclusively on stability which is also the only constraining part of the pact. And this would have negative consequences for the real economy, including the level of unemployment.

Equity and Redistribution

Article 2 of the Treaty of Rome referred to the objective of a 'harmonious development of economic activities, a continuous and balanced expansion', while in the preamble the contracting parties went even further by calling for a reduction of 'the differences between the various regions and the backwardness of the less favoured regions'. There were, however, very few provisions in the treaty for the creation of instruments which could contribute towards this 'harmonious development' and the reduction of regional disparities.

The original European package deal made little room for explicit redistributive instruments on an inter-country basis. It was too early for that. Instead, the highly complicated package designed by the founders was meant precisely to bring about a fairly equal distribution of gains and losses among member countries; and this is what really counted at the time. As for internal distribution, it was left to national governments to care about.

Redistributive instruments at the European level have been developed in relation to successive rounds of widening and deepening. The EC/EU has become bigger, with wider economic disparities. Meanwhile, new liberalization measures, such as the internal market programme, and the decision to proceed to an EMU, which means abandoning an important adjustment instrument at the national level, are leading to a qualitatively new phase of economic integration. They have been accompanied with bigger transfers to the weaker countries and regions. As a means of enabling the latter to take better advantage of the internal market and EMU, or rather as a more or less crude way of buying off potential opposition? Perhaps, intentions do not really matter much; what counts are results.

The crucial turning point came in 1988, following the adoption of the Single European Act, when a substantial reform of the Structural Funds was combined with the doubling of the resources available. The Maastricht revision of the treaties, containing most importantly the provision for the creation of EMU, offered almost a repetition of the same story, thus reinforcing the link between further economic integration on the one hand and redistribution and cohesion (now an established term in the European vocabulary) on the other.

Structural policies constitute the most important redistributive instrument at the EU level. They represent approximately 35 per cent of the budget and most of that money goes to the less developed countries and regions (with GDP of less than 75 per cent of the EU average). Net annual transfers to Greece, Ireland and Portugal usually exceed 3 per cent of their respective GDP, while the corresponding figure for Spain, the fourth member of the so-called cohesion group, is smaller. Structural policies are therefore no longer a cosmetic exercise; and they have a real economic effect on those who are on the receiving end, even though EU programmes often leave considerable room for improvement in terms of economic efficiency (European Commission, 1997*c*; Begg, Gudgin, and Morris, 1995).

On an inter-country and inter-regional basis, EU transfers are already quite substantial, although still far below the corresponding transfers inside member countries. For the Eastern *Länder*, admittedly a rather extreme example, annual budgetary transfers corresponded for several years following German unification to more than 50 per cent(!) of their per capita income; and the current figures are still not far below. So much for the German trust in market forces as a means of dealing with regional disparities.

The emphasis of EU structural policies remains on the reduction of inter-country and inter-regional disparities, concentrating on investment, while national policies and welfare systems are meant to take care of inter-personal disparities, including the subsidization of incomes and consumption. Indirectly EU structural policies do have an effect on income distribution inside countries and regions, but this is not meant to be their main function. Other EU policies, and especially the CAP, also have some redistributive effect; and in the case of the CAP, with a significant regressive dimension in terms of inter-personal disparities (Tarditi and Zanias, forthcoming). Even after the reform European taxpayers will most likely continue to pay for generous subsidies which go mainly to large landowners; and all this will be happening in the name of social justice and the protection of rural life!

Does market integration lead to the widening of disparities? This has always been one of the key questions in international trade theory, and not only. Regional integration schemes in other parts of the world have often foundered precisely because of the failure to deal effectively with the problem of equitable distribution of gains and losses among participants. Since equity and redistribution have been central elements of the European mixed economy at the national level, it would have been very surprising if this had not become increasingly true of the EU as well. In my student days, theories of centre and periphery, which were particularly popular among the left-leaning members of the academic profession, predicted the widening of disparities as a result of integration, especially since the EC-9 at the time was preparing to take in the economically less developed countries of the European South (Seers, Schaffer and Kiljunen, 1979; for a more recent and different account, see Bliss and Braga de Macedo, 1990). New theories of international economics and regional economics, which place the emphasis on economies of scale, imperfect competition, differentiated products and innovation, at least do not find either any strong reasons to expect the elimination of regional/country problems through the free interplay of market forces (Krugman, 1986).

The European experience until now has been mildly encouraging. There seems to be a positive correlation between economic growth and the reduction of inter-country and inter-regional income disparities inside the EC/EU. They were reduced during the boom years of the 1960s and early 1970s. The trend was reversed during the long recession which followed, and then again growth rates in the less developed countries picked up during the second half of the 1980s (European Commission, 1997*c*). During the more recent period, when the implementation of the internal market programme coincided with the operation of Structural Funds, less developed countries and regions of the EU have tended to grow faster than the EU average, thus contributing to greater economic cohesion. There is naturally a whole range of different economic performances hidden behind this general statement: from the spectacular growth of the Republic of Ireland to the relative stagnation of the Mezzogiorno and Northern Ireland. EU redistributive instruments have contributed to this generally positive performance of the less developed countries and regions; but they have not been the only, and often not even the most decisive, factor. For example, FDI inflows into Ireland were for several years a multiple of transfers through the Structural Funds.

The basic operating rules of the Structural Funds, the total sums of money involved, and their distribution have been decided for the period extending until the end of the decade. Important decisions will therefore need to be taken before the end of 1999 about the future direction of EU structural policies; and those decisions will have an important effect for EMU and further enlargement. What kind of redistributive mechanisms, and of what size, will be needed in the context of a monetary union; and what kind of structural policies in an enlarged Union where the new members will have income levels which are only a fraction of that of the poorest member of the EU of Fifteen?

Will there be a further large increase in the total amounts spent or will the present beneficiaries accept a substantial reduction of EU transfers in order to allow a reallocation of funds in favour of the new members? Will the goalposts (for example, the 75 per cent GDP indicator for the less developed countries and regions which are now the main beneficiaries) be shifted in order to adjust for the increased number of players? Here there is also a problem of moral hazard: should the least successful among the existing players be allowed to stay in the game, while the better performers (such as Ireland) are taken off the field? Should more emphasis be placed on innovative policies rather than simply throwing money at problems, which is the way EU structural policies are viewed by some of the net contributors to the budget? And should conditionality be strengthened, not only in terms of the macroeconomic policies pursued by the recipient countries but also in terms of efficiency in the use of the resources made available to them through the Structural Funds? These are some of the questions which will require political answers before the EU enters into a new phase of integration.

Delivering politically acceptable answers will be mostly an exercise in reconciling the interests of the North, the South and the East; in other words, reconciling the interests of major contributors to the EU budget, and most notably Germany which is by far the biggest net contributor in both absolute and relative amounts (expressed as a percentage of GDP); the present beneficiaries from EU structural policies, including Ireland as an honourary (for how long?) Southern member; and those waiting outside to join the feast. The *Agenda 2000* constitutes the first, albeit highly ingenuous, attempt made by the Commission to sketch the broad outlines of such a compromise. The proposals submitted in March 1998 go further in this direction.

To Germany and the other net contributors, the Commission offers the unchanged upper ceiling of own resources which is therefore proposed to remain at 1.27 per cent of the Union's GNP. Thus, additional real resources for structural policies and EU expenditure in general should come only from whatever margin will have been left in 1999 in relation to the above ceiling adopted at Maastricht and through the resources created by new economic growth. The Commission's forecast for the period until 2006 is for an annual growth rate of 2.5 per cent for the Fifteen and 4 per cent for the applicant countries. Based on the experience of the 1990s, this forecast leans on the optimistic side, although it may not be completely unrealistic. Given the sensitivity of the issue and the need to make commitments which will extend over a period of seven years, it can be fairly safely predicted that the real negotiations on overall sums for the EU budget for the period after 1999 will not start before German federal elections scheduled for September 1998. The paymaster of Europe now appears less willing to dig in his/her collective pockets.

On the basis of the above assumptions, and also assuming that the EU structural policies will continue to represent 0.46 per cent of the Union's GNP, the Commission has estimated that there will be a total amount of ECU 275 billion (at 1997 prices) for structural operations, under the Structural Funds and the Cohesion Fund, for the period 2000-2006, as compared with ECU 200 billion for 1993-1999. The Commission proposes to spend 210 billion for the existing members through the Structural Funds, while 45 billion will be earmarked for the new members, expected to join some time before the end of the period (2000-2006), and including 7 billion in the form of pre-accession aid for all the candidates. The remaining amount will be spent through the Cohesion Fund. The Commission also proposes a greater concentration of resources, by reducing the percentage of the population of the Union eligible for structural aid, a simplification of the objectives used, and a gradual phasing out of structural aid given to those countries and regions which, precisely because of having done well, should no longer qualify under the GDP criterion (below 75 per cent of the EU average). The latter is meant to deal mainly with the problem(?) of Ireland which continues to register very high rates of growth.

In view of the much lower level of economic development of the candidate countries, the proposed distribution between present and future beneficiaries of structural policies may sound rather surprising. It is based on the following reasoning: first, the Commission assumes that the first round of enlargement will not take place before the year 2002 (which may in the end prove to be an optimistic target); second, it assumes that there will be a gradual phasing in of new members in terms of common policies, including their access to funds; and third, it sets a ceiling for transfers through structural aid at 4 per cent of GDP for each country, which is in turn justified in terms of the capacity of beneficiary countries to absorb efficiently and also to match EU funds with their own funds.

The figure of 4 per cent, like any other figure in this case, is, of course, entirely arbitrary; but it is also crucial for the Commission's calculations. It happens to be close to the figure representing current flows to the poorest countries of EU-15, which in turn means that, if adopted, the absolute amounts to be transferred in the future to the new members will be significantly smaller because of their lower levels of GDP per capita. A question of absorptive capacity, for sure. But it can also serve as further confirmation of the old maxim of political behaviour: 'Blessed are those who have a seat around the table'

There will be, undoubtedly, long and difficult negotiations before any agreement can be reached on the new financial framework, including the overall ceiling for revenue and the specific items of expenditure, of which structural operations are the second biggest, after the CAP. Blessedly, the habit of multi-annual agreements on the EU budget, and also structural policies, has now become firmly established, thus sparing the Union of the annual ritual of budgetary battles which used to paralyze the old Community in the not too distant past, while also allowing for some medium-term planning which is not always bad for public health.

The Commission's proposals seem to provide a realistic basis (is it also equitable?) for the launching of negotiations at the Council level. There are, however, some important and yet unanswered questions. Is it realistic to argue that no major changes will be required for the Union budget in the context of EMU and further enlargement? Such an argument, of course, avoids opening the Pandora's box about own resources and new taxes, rebates and net contributions, not to mention the subject of new expenditures in times of fiscal consolidation. But can it work in the medium and long run? With low labour mobility, limited flexibility of labour markets, and small budgetary transfers, is EMU economically viable?

And if the economic and political integration of candidate countries in the European system is indeed meant as a high priority of the EU as a whole, can this be realistically achieved with transfers which will only begin to have an impact several years ahead and only for those lucky enough to make it to Brussels before the year 2006? Countries like Bulgaria and Romania would have to wait very long before their economies can benefit on any significant scale from EU structural assistance. The provision for pre-accession aid for all candidate countries certainly constitutes a step forward in comparison with the much smaller sums of money spent until now, mostly on technical assistance, under the PHARE programme. But is it all the EU can deliver? The kind of overall policy on enlargement proposed by the Commission runs the risk of contributing to the further widening of the gap which already separates different groups of European countries.

There is yet another important question which links with the discussion on globalization and liberalization. Redistributive instruments at the European level will continue to concentrate on inter-country and inter-regional disparities; perhaps with a sense of realism, since welfare policies have always been an important part of state-building. But will member governments prove able to compensate, retrain or reemploy the significant number of losers in this period of rapid economic restructuring? And if not, what consequences would the political and social reaction of the losers, or potential losers, have on the momentum of European integration?

The Legitimacy Deficit

The gap between economic and political integration has been constantly growing wider. Economic issues have become increasingly European and international under the influence of autonomous market forces, technological change, and the lowering of barriers. Yet, politics remains predominantly national and the political discourse generally implies that national units are much more independent economically than they actually are. Symbols and public money are still very much in the hands of national governments and this largely determines the direction of loyalties and expectations of their citizens. But there is also a clear time-lag in the perception of change by large sections of the national political elites and the public at large. National political discourse often has a striking sense of unreality.

Malinvaud (1989: 374) has argued that 'achieving European unification while maintaining national autonomy' is like a tragedy in the spirit of Corneille. National governments, together with their citizens, have been the main protagonists in a tragedy which is more and more about the expectations gap in terms of what national governments can actually deliver. The latter have proved increasingly unable to deliver the same quality of goods to which their citizens had become accustomed: steady growth, effective solidarity mechanisms for the reduction of inequalities, insurance against risks, and a wide collection of public goods. These are all functions which European states acquired during the long period of economic boom after the Second World War. And they were added to the more traditional functions of the state, such as the provision of security as well as acting as the embodiment of national identity.

This increasing difficulty in delivering the economic goods is, of course, directly related to the weakening of state control over the national economy coupled with rapid changes in the international economic environment. In the words of Streeck (1996: 312), 'As the gap between formal and effective sovereignty widens and the purchasing power of national citizenship deteriorates ... popular beliefs in the lasting efficacy of national democracy are bound to give rise to distorted expressions of collective preferences, perverse political alliances and self-defeating definitions of interest'. Populism and xenophobia would then be just around the corner. Assuming that the change in the relation between the state and the market is of a more permanent nature, then this will require a corresponding change in the political discourse, accompanied by some adjustment in popular expectations. It will also require policy reforms and a realignment of political forces, which may be just beginning.

On the other hand, European integration had for long been largely an affair of elites, while relying on some kind of wider permissive consensus. 'Enlightened administration on behalf of uninformed publics, in cooperation with affected interests and subject to the approval of national governments' is how W.Wallace and Smith (1995:143) describe the initial compromise which for many years subsequently provided the political foundations of the European construction. These foundations no longer seem particularly solid; and this became, for the first time, painfully obvious during the ratification of the Maastricht treaty. Things have not really improved since then.

The rapid expansion of the European agenda, coupled with the progressive deterioration of the economic environment, has brought with it what can be called a crisis of legitimacy in the EU (Dehousse, 1995). Regional integration now covers a very wide range of issues and policy areas, thus also having a direct impact on an increasing number of citizens. Usually covered in their technocratic cloak, European issues remain out of bounds for the ordinary citizen. Furthermore, Europe tends more and more to be identified with rapid change which is in turn perceived by many people (and often rightly so) as an immediate threat. Under these circustances, popular support (even in the form of permissive consensus) for further European integration is bound to suffer.

Although admittedly affected by the adverse economic climate and the meteoric rise of unemployment in the 1990s, the rather lukewarm popular support for EMU, as registered in the regular surveys of public opinion published by Eurobarometer, is perhaps indicative of this new state of affairs. On this important issue, Southern Europe appears to be generally more sympathetic, but also less informed, while sizeable negative majorities are registered in several member countries, including Germany and the UK. Surely, public opinion can easily swing either way; and a successful EMU, coupled with a more favourable economic environment, should be a most convincing argument. But will it be so?

European monetary union will operate within a highly decentralized political system and with a highly decentralized fiscal policy. The latter will remain essentially a national responsibility, with a further high degree of decentralization in the case of federal political systems within the Union, while a system of constraints and economic sanctions has been provided for, through the treaty and subsequently through the adoption of the stability and growth pact, in order to deal with large national deficits. The combination described above will not be easily sustainable.

Monetary policy will be transferred to the ECB which will be independent and largely unaccountable. Since the ECB will have no history and reputation to rely upon, there is a strong possibility that the newly appointed European central bankers will try to gain credibility for the ECB in the markets by leaning on the restrictive side of monetary policy. This is precisely the contrary of fears often expressed in the financial press about a weak euro. Although hardly anybody would doubt the value of price stability (the real question is how much and what, if any, is the trade-off), the greater emphasis placed on it in recent years may also have something to do with demography and more precisely with the increasingly ageing populations and the rentier culture associated with this phenomenon. Retired people need stable prices more than others in order to protect their savings and their pensions. Price stability is in turn linked directly to the independence of monetary institutions, which means independence from political control. For many countries, EMU thus implies a double transfer of power: from the national to the European level and from politicians to technocrats, thus following the precedent set by the Bundesbank, although actually going even further because of the weakness of the European political system, which in turn means weak political accountability of the ECB.

Here lie some fundamental political questions. How much economic policy should remain in the hands of elected representatives? This question is, of course, not confined to the EU level. And can there be a central bank without a corresponding political authority? This is, indeed, a question specific to the EU. There is hardly any historical precedent for that. What will be the political reactions if and when the ECB takes decisions which may be widely perceived (even erroneously, according to some economists) as having a direct impact on unemployment in Lille, Naples or Athens ? Who will people demonstrate against in the streets? The so-called faceless technocrats in Frankfurt? German values and history are not automatically exportable to other European countries. There is also a more general question of legitimacy which is not yet for sale in the European market-place. A newly independent

Banque de France, for example, can always draw on the reservoir of legitimacy of the French state in the conduct of national monetary policy. But there is no equivalent as yet at the European level.

Provisions made for the operation of the economic arm of EMU are not likely to make things easier. The long experience of fiscal laxity in some European countries and the evident inability of financial markets to act as effective and efficient constraints on sovereign actors have been used as arguments in favour of some central discipline on national deficit financing. The relevant treaty provisions and subsequent decisions by the Council are aimed essentially against 'free riders' in the context of monetary union. Their effectiveness in political terms remains to be tested. But this is far from the whole story. The stability and growth pact may end up imposing too much rigidity on national fiscal policies, while on the contrary, more flexibility may be needed inside a monetary union. When most founding members of EMU will be starting with public deficits at or close to 3 per cent of GDP in the upswing of the business cycle, the provisions of the pact will leave little room for the operation of the so-called automatic stabilizers at the national level. This may be translated into more unemployment when the European economy goes on the downswing.

At the European level, what is at stake is about who and how will determine the macroeconomic priorities for the EU as a whole, assuming, of course, that there is still such a function to perform for elected representatives. And there is as yet no mechanism for this. The EU budget is very small and with no provision for a stabilization function. On the other hand, the present system of policy coordination cannot be expected to deliver the goods. The broad guidelines adopted by ECOFIN every year are likely to remain too broad to have any real effect on national economic policies. This means that the future European economic system will tend to be 'under-stabilized' against both common and asymmetric shocks (Allsop, Davies and Vines, 1995). Do we expect the whole burden of internal adjustment to fall on our still highly inflexible labour markets? And how much flexibility of this kind are European political systems likely to deliver in the near future? These are, of course, meant as largely rhetorical questions.

The latest IGC, formally concluded in Amsterdam in June 1997, had been called to deal with the unfinished business of political union left by the drafters of the Maastricht treaty. The Germans had been entirely logical in insisting on a close link between EMU and political union. They did not, however, remain consistent until the end for their own domestic reasons. The meagre results of the new Amsterdam treaty suggest that the business of political union will remain very much unfinished even after the establishment of EMU; and most probably, at least until the next round of enlargement. On the other hand, it is highly doubtful whether the kind of institutional reform discussed during the latest IGC would have helped much to deal with the legitimacy problem described above. Would, for example, the change in the number of Commissioners and the reweighting of votes as well as the extension of majority voting in the Council of Ministers make decisions of the ECB (and lack of decisions of the Council for that matter) more legitimate in the eyes of European citizens?

The French have, instead, concentrated their efforts on the creation of a strong political counterpart to the ECB, *un pôle économique*, which has finally taken the shape of the newly-formed (and much disliked by those who will remain outside) Euro-X Council. French policy rests on the assumption that the strengthening of intergovernmental organs, and hence state (or indirect) legitimacy within the EU, would be an adequate way of dealing with an independent ECB. In any case, their conversion to the principle of independence of the central bank is very recent and perhaps only half-hearted (this is precisely what many Germans, and others, suspect).

French policy on the inter-institutional balance inside the EU, and also indirectly on the question of legitimacy of European institutions, has been at least consistent all along. However, the fundamental premise on which it rests has become increasingly questionable. Is indirect legitimacy (H.Wallace, 1993), emanating from the states which constitute the Union, really sufficient for the stage of integration we have reached? This would be more questionable, and even inconsistent, if at the same time we were to accept that, in an enlarged EU, intergovernmental institutions (call me Council) will have to resort more to (qualified) majority voting, irrespective of whether there is a reweighting of national votes or not.

Plans for political union (the term union covers a very wide range in terms of the intensity of the link to be established in this polygamous affair) invariably include proposals for a further strengthening of the powers of the directly elected European Parliament. Both the Maastricht and now the Amsterdam treaties include some transfer of additional powers to the Parliament. The direct legitimation of the EU, as one of the two pillars (the other being state legitimacy) on which the European construction will have to rest, necessarily goes through the strengthening of the powers of elected representatives of the European peoples. The Union will need to go further along this road, although always bearing in mind that the EU is not and will most probably not become for a long time like its national constituent units; hence the need for innovative solutions.

The transfer of additional powers to the European Parliament (like, for example, the power of electing the President of the Commission?) may not be enough. Some such transfer, although arguably inadequate, has already taken place, and yet the real power (and influence) of the European Parliament leaves a great deal to be desired. Political parties, still very much national in their outlook and internal organization, have largely failed until now to act as two-way transmission belts between European institutions and the ordinary citizen, while transnational party organizations remain loose coalitions. Not surprisingly, election campaigns for the European Parliament have always been dominated by national issues; and there is still precious little public debate about Europe-wide issues.

All this refers back to the gap between economic reality and political perception. It seems therefore that the legitimacy deficit of the EU is something much wider than the often repeated democratic deficit which relates to the limited powers of the European Parliament. Can we have democracy without a *demos*; and is it mainly a question of time for a shared European identity to develop? These are big questions generally left out of official documents, but which naturally attract much more attention from academics (Laffan, 1996; Weiler, 1997).

Conclusion

In this paper, some of the main items of the Union's current long agenda have been used as a starting point for the discussion of broader issues which, having lurked for long in the background, are now coming rapidly into the open as European integration enters a new and qualitatively different phase.

Globalization is often used as an excuse for policy inaction. It is crude economic determinism to argue that the process of internationalization of economic forces, reinforced by technological developments, leaves no room for political choices. Politics cannot be replaced by the market, although the latter does impose constraints, while also offering opportunities. The process of what is generally called globalization has an important effect on labour markets and welfare policies, which is precisely where European societies have differentiated themselves most from other advanced industrialized countries. This in turn raises the question of the survival and/or adjustment of the European economic and social model.

This is a question mainly addressed to national political systems; the role of the EU still being limited to the provision of a forum for discussion, while occasionally acting also as a catalyst, a legitimizer or even a scapegoat for unpopular decisions taken at the national level. What may appear as a paradox, however, given this limited role of common institutions, is that the future of European integration largely depends on whether this problem can be successfully tackled by member countries. The new social question in Europe, manifesting itself in terms of high unemployment, growing inequalities and exclusion, threatens political and social stability at home. It also threatens the further deepening of regional integration. Thus, we come back once again to the old symbiotic relationship between the Union and its member states: a strong EU needs strong states and vice versa. The terms of this symbiotic relationship need, however, to be redefined in a different economic and political context.

Equity and redistribution form an integral part of the European package, both at the national and the EU level. The change in the economic environment requires a redefinition of the package at the national level, a process which is only just beginning in some countries. As regards the Union, two different kinds of questions arise in this respect: first, whether it should gradually acquire some role in terms of inter-personal redistribution and welfare payments as a means of compensating losers from economic liberalization; and second, whether anything more can be done for the countries which may be waiting rather long before they are allowed to cross the gates of paradise in Brussels.

On the first question, the change from the status quo may prove to be very slow, thus leaving the old division of labour between national governments and European institutions virtually untouched. We should at least begin to think about it. On the second question, member governments and EU institutions still refuse to put their money (and their policies) where their mouth is. In view of the enormous challenge created by the collapse of communist regimes and the end of the cold war in Europe, the policy response of the EU and its member governments until now has been characterized by lack of generosity and imagination. The *Agenda 2000* and subsequent proposals made by the Commission constitute a step forward, although arguably still not big enough. If the EU cannot be a global power, it should at least be able to play an important regional role by contributing to economic prosperity as well as peace and stability on the European continent.

Deepening has been given precedence over enlargement; and EMU will dominate the European agenda for several years, thus also determining the overall shape of the Union. The climate has changed dramatically in recent years: there is now little doubt that EMU will happen and on time. The only real question is how to make EMU successful. It is no exaggeration to argue that EMU is both an exercise in high politics and a high risk exercise. Its success will depend on the continuous interaction between governments, societies and markets. In other words, it will depend on whether fiscal policies, labour markets and political systems in general are able to adjust to the exigencies of a centralized monetary policy and a single currency in the context of increasingly global financial markets.

In recent years, national macroeconomic policies in Europe have been determined by the need to comply with the convergence criteria. Luckily, the last and most difficult part of this long race, before the crucial May 1998 decisions, has been taking place in favourable conditions created by an externally driven economic recovery. This may not last for long. The viability of EMU very much depends on whether both the economic arm and political union will follow the monetary lead, even though the existing treaty is very modest on both fronts. A successful EMU will necessitate major structural reforms in member countries, which will cause pain and thus provoke resistance. They will be made much easier under conditions of healthy economic growth. There is scope for macroeconomic policy to influence aggregate demand, especially if such action is taken jointly by European governments; and this should be made easier by EMU.

The success of EMU will require a closer and more effective coordination (not centralization) of national fiscal policies, and eventually a bigger EU budget with a stabilization and redistribution function. Last but not least, it will require a European political system in which common issues are properly debated and in which there is stronger direct legitimation of European institutions and policies. The ECB will not be able to operate in a political vacuum; and neither the intergovernmental Council nor the directly elected Parliament in its present form can fill it adequately.

The latest IGC has offered a rather depressing spectacle of disunity and collective lack of vision. Perhaps, it came too soon after Maastricht. Perhaps, it also lacked the strong leadership which had characterized previous treaty revisions. Many different explanations can be offered for its striking failure. Yet, EMU is scheduled to happen very soon and successive rounds of enlargement are supposed to follow. It is highly doubtful whether the present European system and its constituent units will be able to sustain the pressure resulting from both. We need institutions and policies at the European, national and infranational level which challenge conventional wisdom; in other words, new forms of governance in a dynamic environment. Europe has delivered before, and with much success. Old models do, however, need to adjust when the world around changes so fast.

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