

In the infancy of societies, the chiefs of the state shape its institutions; later the institutions shape the chiefs of state.

Baron de Montesquieu

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2

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INTRODUCTION

The members of the EU are economically and politically integrated to an extent that is historically unprecedented. In many ways, the EU is already more integrated than loosely federated nations such as Canada and Switzerland. This integration is maintained and advanced by a cocktail of economic, political, historical and legal forces shaped by European institutions, laws and policies. This chapter presents the background information on these institutional features that are essential to the study of European economic integration.

The chapter starts by detailing the extent of European economic integration, before turning to more institutional issues – EU organization (the three pillars), EU law, EU institutions and the legislative process. The chapter then presents basic facts on EU members (population, incomes and economic size), which are essential for understanding the subsequent topic, the EU budget. The final section covers the Constitutional Treaty and how it would change EU institutions.

2.1 Economic integration in the EU

If markets are so integrated, you can't cook a different soup in one corner of the pot.

Andres Sutt, deputy governor of the Bank of Estonia, on why Estonia wanted to join the eurozone

The post-war architects of the Europe had radical goals in mind when they established the European Economic Community with the 1957 Treaty of Rome. The Treaty's main architect, Jean Monnet, headed an influential pan-European group that was bluntly called the Action Committee for the United States of Europe. Having failed with their plans for a European Political Community and a European Defence Community in the early 1950s (see Chapter 1), they switched to economic integration as the means of achieving their lofty goal.

Indeed, the Treaty of Rome cannot be fully understood without reference to the founders' intentions. The various elements of economics integrated in the Treaty were not subject to individual cost–benefit calculations. The idea was to fuse the six national economies into a unified economic area.¹ This fusion was expected to launch a gradual process that would draw the nations into an ever closer union. Economic integration was to be the means of achieving the 'finalité politique'.

¹ A clear statement of this can be found in the so-called Spaak Report, *Rapport des chefs de délégation aux ministres des Affaires étrangères, Bruxelles, 21 avril 1956*, the outcome of the expert group set up by the Messina Conference. See www.ena.lu.

This section reviews the economic integration in today's European Union, organizing the main features according to the logic of a unified economic area.

2.1.1 Treaty of Rome – fountainhead of EU economic integration

The Treaty of Rome was a radical and far-reaching document. It laid out virtually every aspect of economic integration that Europe has implemented over that past half-century. In a sense, the Treaty of Rome was the bud whose leaves unfolded over fifty years into today's European Union.

The Treaty's first article establishes the European Economic Community. Articles 2 and 3 set out the main economic goals and integration initiatives among the original six members.² Students of European integration should read parts of at least one Treaty as an essential part of their training. Articles 1, 2 and 3 of the Treaty of Rome are a good place to start since the subject matter is clear and the style is much less legalistic than that of later treaties (see Box 2.1 for the text verbatim).

² The Treaty of Rome, or Treaty establishing the European Community (TEC) as it is now known, has been modified many times and its articles renumbered. Here we use the current numbering even though it may change if the Constitutional Treaty passes. Interested readers can find a complete correspondence between the old and new TEC numbering in the appendix of the freely downloadable *The ABC of Community Law* (search for it with Google on <http://europa.eu.int/> since the pages sometimes change URLs). For new numbering in the Constitutional Treaty, see Jens-Peter Bonde's reader-friendly version at www.bonde.com.

Box 2.1

Articles 1, 2 and 3 of the Treaty of Rome

ARTICLE 1. By this Treaty, the High Contracting Parties establish among themselves a EUROPEAN ECONOMIC COMMUNITY.

ARTICLE 2. The Community shall have as its task, by establishing a common market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it.

ARTICLE 3. For the purposes set out in Article 2, the activities of the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein:

- (a) the elimination, as between Member States, of customs duties and of quantitative restrictions on the import and export of goods, and of all other measures having equivalent effect;
- (b) the establishment of a common customs tariff and of a common commercial policy towards third countries;
- (c) the abolition, as between Member States, of obstacles to freedom of movement for persons, services and capita;
- (d) the adoption of a common policy in the sphere of agriculture;
- (e) the adoption of a common policy in the sphere of transport;
- (f) the institution of a system ensuring that competition in the common market is not distorted;
- (g) the application of procedures by which the economic policies of Member States can be coordinated and disequilibria in their balances of payments remedied;
- (h) the approximation of the laws of Member States to the extent required for the proper functioning of the common market;
- (i) the creation of a European Social Fund in order to improve employment opportunities for workers and to contribute to the raising of their standard of living;
- (j) the establishment of a European Investment Bank to facilitate the economic expansion of the Community by opening up fresh resources;
- (k) the association of the overseas countries and territories in order to increase trade and to promote jointly economic and social development.

Note: Articles 2 and 3 of the current version of the Treaty of Rome, more formally known as the Treaty Establishing the European Community (TEC), are quite similar. Article 2 includes a number of new goals (environment protection, etc.) and Article 3 includes some new activities (strengthening of consumer protection, etc.). You can download a scanned version of the original and current, i.e. consolidated version, from <http://europa.eu.int/lex/lex/en/treaties/index.htm>

2.1.2 How to create a unified economic area

As far as economics goes, the Treaty of Rome's intention was to create a unified economic area. An area where firms and consumers located anywhere in the area would have equal opportunities to sell or buy goods throughout the area. An area where owners of labour and capital would be free to employ their resources in any economic activity anywhere in the area. The steps necessary to establish this are presented below, along with references

to the relevant articles in the current consolidated version of the Treaty of Rome (formally known as the Treaty establishing the European Community, or TEC for short).

Free trade in goods

The most obvious requirement is to remove trade barriers. Article 3a removes all tariffs and quantitative restrictions among members, thus establishing a free trade area for all goods. Tariffs and quotas, however, are not the only means of discriminating against foreign

goods and services. Throughout the ages, governments have proved wonderfully imaginative in developing tariff-like and quota-like barriers against foreign goods and services. To remove such 'non-tariff' barriers, and to prevent new non-tariff barriers from offsetting the tariff liberalization, the Treaty rules out all measures that act like tariffs or quotas (in Article 3a).

Common trade policy with the rest of the world

Trade can never be truly free among nations if those nations do not harmonize their trade policy towards non-members. If members have different external tariffs, trade among the Six would have to be closely controlled to prevent 'trade deflection', i.e. imports from non-members pouring into the area through the member with the lowest external tariff. Since such controls would themselves be barriers to intra-EU trade, Article 3b requires the Six to adopt a 'common commercial policy', in other words, identical restrictions on imports from non-members. With these in place, every member can be sure that any product that is physically inside the EU has paid the common tariff and met any common restrictions on, for example, health and safety standards. Tariffs are one of the most important restrictions on external trade, so a common commercial policy with respect to tariffs is referred to with the special name 'customs union'.

Ensuring undistorted competition

Even a customs union is not enough to create a unified economic area. Trade liberalization can be offset by public and private measures that operate inside the borders of EU members. For example, French companies might make a deal whereby they buy only from each other. The Treaty therefore calls for a system ensuring that competition in the area is undistorted (in Article 3g). This general principle is fleshed out in a series of articles that: (i) prohibit trade-distorting subsidies to national producers, (ii) create a common competition policy, (iii) harmonize national laws that affect the operation of the common market, and (iv) harmonize some national taxes. Why are all of these necessary to ensure undistorted competition?

★ *State aids prohibited.* Perhaps the most obvious distortions to competition stem from production subsidies or other forms of government assistance granted to producers located in a particular nation. Such subsidies (called 'state aid' in EU jargon) allow firms to sell their goods cheaper and/or allow uncompetitive firms to stay in business. Both effects put unsubsidized firms in other nations at a

disadvantage. Most forms of state aid are prohibited by the Treaty although a list of exceptions is specified.

- ★ *Anti-competitive behaviour.* Discrimination from a private agreement operating within a Member State – e.g. a cartel or exclusive purchasing deal – can distort competition. The Treaty prohibits any agreement that prevents, restricts or distorts competition in the area. The focus is on restrictive business practices and abuse of a dominant position (see Chapter 11). Restrictive business practices include a host of unfair practices undertaken by private or state-owned firms. For example, the Treaty explicitly outlaws: price-fixing agreements; controls on production, marketing, R&D or investment; and allocation of exclusive territories to firms in order to reduce competition. The Treaty also requires government monopolies of a commercial character to avoid discrimination based on the nationality of suppliers or customers.
- ★ *Approximation of laws (EU jargon for harmonize).* Another source of discrimination stems from product standards and regulations since these can have a dramatic impact on competition and indirectly favour national firms. Moreover, since many product standards are highly technical, so national firms are typically involved in writing a nation's rules. These firms, quite naturally, advise the government to adopt rules that discriminate in favour of their products.
- ★ *Taxes.* Taxes applied inside Member States can distort competition directly or indirectly by benefiting national firms. On countering this type of discrimination, the Treaty is weak, requiring only that the Commission consider how taxes can be harmonized in the interest of the common market. Of course, if a particular tax provision clearly benefits a well-identified firm or sector within one Member State, then it could be considered as a subsidy and thus directly forbidden.

Unrestricted trade in services

Right from the Treaty of Rome, the principle of freedom of movement of services was embraced, although fleshing this into reality has been hard. Services are provided by people, and governments have to regulate the qualifications of service providers (e.g. medical doctors). The problem has been to separate prudential regulation of qualifications from protectionist restrictions. Box 2.2 provides the example of ski instructors where the roles of protecting consumers and protecting French ski instructors is thoroughly intermingled.

Box 2.2

British ski instructors arrested on French slopes

To flesh out the free movement of people and services, the EU adopted a general system for the recognition of professional education and training in 1992. This ensured that people who got their training in one EU nation could get a job in another EU nation without having to redo their training. The system is based on the principle of mutual trust. If a Briton who has the diploma necessary to teach skiing in Britain wants to teach in France, then France should recognize the British diploma since it should trust the British government's ability to certify ski teachers, just as Britain trusts France to certify its doctors.

French ski-instructor training, however, is difficult, and good jobs are relatively scarce in mountainous regions, so the French government faced pressure to protect the jobs of its ski instructors. Indeed, France used to arrest ski instructors teaching in France without a French diploma. Pressure from the European Commission forced France to justify this practice by asking for an exception from the general system for five jobs: ski instructors, high-altitude mountain guides, diving instructors, parachuting instructors and potholing instructors. French authorities claimed that due to the dangerous nature of the activities concerned, they should have the right to require prospective instructors to pass a test (based on French standards). The effect of such a test could, of course, be equivalent to forcing people to redo their training in France.

The Commission's decision was to allow France to impose the test for two more years, but to cease the practice thereafter. An independent website for snowboarding fans wrote the following in 2004: 'EU nationals won't need a visa to work in France, however, France is the worst country in the world to get a job as a snowboard instructor. The authorities are very protective of their own. If you're caught teaching on the slopes and don't hold the French ski instructor's certificate, you will be arrested and jailed. However, more mundane forms of work such as bar work are permitted' (www.worldsnowboardguide.com).



Figure 2.1: *Ski instructors and the free movement of services*

Labour and capital market integration

If it works properly, a customs union with undistorted competition allows firms and consumers to buy and sell goods throughout the area without facing discrimination based on nationality. This is sufficient to create a unified economic area as far as the trade in goods is concerned. It is not, however, sufficient to fuse national economies into a unified economic area. Accomplishing this also requires integration of capital and labour markets.

Article 3c extends integration to factor markets by instituting a common employment and investment area. It does this by abolishing barriers to the free movement of workers and capital. The basic principles of labour and

capital mobility are elaborated in subsequent articles. For instance, the freedom of movement for workers means the elimination of any form of discrimination based on nationality regarding hiring, firing, pay and work conditions. The Treaty also explicitly allows workers to travel freely in search of work.

As for capital mobility, the Treaty focuses on two types of freedom. The first is the right of any Community firm to set up in another Member State. These 'rights of establishment' are essential to integration in sectors with high 'natural' trade barriers, e.g. in sectors such as insurance and banking, where a physical presence in the local market is critical to doing business. The second type

concerns financial capital, and here the Treaty goes deep. It states that all restrictions on capital flows (e.g. cross-border investments in stocks and bonds, and direct investment in productive assets by multinationals) shall be abolished. It applies the same to current payments related to capital flows (e.g. the payment of interests and repatriation of profits). Very little capital-market liberalization, however, was undertaken until the 1980s since the Treaty provided an important loophole. It allowed capital market restrictions when capital movements create disturbances in the functioning of a Member State's capital market. Moreover, it did not set a timetable for this liberalization. Capital market liberalization only became a reality thirty years later with the Single European Act and the Maastricht Treaty.

Exchange rate and macroeconomic coordination

Fixed exchange rates were the norm when the Treaty of Rome was written, and throughout the late 1940s and 1950s nations occasionally found that the level of their fixed exchange rate induced their citizens to purchase a value of foreign products and assets that exceeded foreigners' purchases of domestic goods and assets. Such situations, known as balance of payments crises, historically led to many policies – such as tariffs, quotas and competitive devaluations – that would be disruptive in a unified economic area. To avoid such disruptions, the Treaty of Rome called for mechanisms for coordinating members' macroeconomic policies and for fixing balance of payments crises. This seed in the Treaty of Rome eventually sprouted into the euro, the Stability Pact and the European Central Bank. See Chapters 13 and 17 for details.

Common policy in agriculture

From a logical point of view, it might seem that a unified economic area could treat trade in agricultural goods that same way as it treats trade in services and manufactured goods. From a political point of view, however, agriculture is very different from the manufacturing and service industries and the EU has explicitly recognized this right from the beginning.

In the 1950s, Europe's farm sector was far more important economically than it is today. In many European nations, 20 per cent or more of all workers were employed in the sector. Moreover, national policies in the sector were very important and very different across nations. In reaction to the great economic and social turmoil of the 1920s and 1930s, most European nations had adopted highly interventionist policies in

agriculture. These typically involved price controls teamed with trade barriers (Milward, 1992). Moreover, in the 1950s, the competitiveness of the Six's farm sectors differed massively. French and Dutch farmers were far more competitive than German farmers. If the Six were to form a truly integrated economic area, trade in farm goods would have to be included. However, the sharp differences in farm competitiveness among the Six would have meant that free trade would have massively negative effects on many farmers, although, as usual with free trade, the winners would have won more than the losers would have lost.

These simple facts prevented the writers of the Treaty of Rome from including more than the barest sketch of a common farm policy. They did manage to agree on the goals, general principles and a two-year deadline for establishing the common policy. The Common Agricultural Policy came into effect in 1962 (see Chapter 9).

2.1.3 Omitted integration: social policies

The Treaty of Rome was enormously ambitious with respect to economic integration, but it was noticeably silent on the harmonization of social policies (the set of rules that directly affects labour costs such as wage policies, working hours and conditions, and social benefits). Subsequent treaties have not pushed social integration anywhere near as deep as economic integration. This section considers the economic and political logic behind this omission.

The difficult politics of social harmonization

Social harmonization is very difficult politically for at least two reasons. First, nations – even nations as similar as the original six members of the EEC – held very different opinions on what types of social policies should be dictated by the government. Moreover, social policies very directly and very continuously touch citizens' lives, so these opinions are strongly held; much more strongly than, for example, opinions on the common external tariff or the elimination of intra-EEC quotas. The second reason concerns the difficulty of viewing social harmonization as an exchange of concessions.

With tariffs, all Six lower their tariffs against each other's goods. Although the tariffs might not have been identical to start with, there is a certain balance to the notion that we eliminate our tariffs and they eliminate theirs. With social policy, harmonization tends to be viewed as either an upward harmonization (e.g. all adopt a 35-hour

working week) or a downward harmonization (e.g. all have to allow shops to open on Sundays). Since social policies in each nation are the outcome of a finely balanced political equilibrium, changes that are 'imposed' by the EU are easy to characterize as undue interference by foreigners, rather than as a two-way exchange. For instance, it would be hard to view as 'balanced' a demand that Germans allow Sunday shopping in the name of social policy harmonization. The same could be said if France were forbidden to impose the 35-hour working week in the name of European integration.

In addition to social harmonization being significantly more difficult politically than economic integration, there are economic arguments suggesting that it is not necessary.

The economics: two schools of thought

Does European economic integration demand harmonization of social policies? This question has been the subject of an intense debate for decades. It arose when the Benelux nations formed their customs union in 1947, when the OEEC was established in 1948, when the European Coal and Steel Community was created in 1953, and when the Treaty of Rome was negotiated.

From the very beginning of this debate there have been two schools of thought. One school of thought – the harmonize-before-liberalizing school – holds that international differences in wages and social conditions provide an 'unfair' advantage to countries with more laissez-faire social policies. In contrast, the no-need-to-harmonize school argues that wages and social policies are reflections of productivity differences and social preferences – differences that wages adjustments will counter. This school rejects calls for harmonization and notes that, in any case, social policies tend to converge as all nations get richer.

The harmonize-before-you-liberalize school is easier to explain. If nations initially have very different social policies, then lowering trade barriers will give nations with low social standards an unbalanced advantage, assuming that exchange rates and wages do not adjust.

The other school of thought (i.e. the school whose ideas prevailed in the Treaty of Rome) points out that wages do adjust. The economics of this is explained in depth in Chapter 8, but here it is in a nutshell. Roughly speaking, firms hire workers up to the point where the total cost of employing workers equals the value they create for the company. As far as the firm is concerned, it is not

important whether the cost of the worker stems from a social policy or from wages paid directly to the worker. Different nations have different productivity levels and this is why wages can differ. Now if one nation has more expensive social policies, the workers in that nation will end up taking home (in the form of wages) a lower share of the value they create for the firm. The reason is that the firm pays the costs of the social policy out of the value that workers themselves create for the firm. In short, French workers in our example would be implicitly trading off lower take-home pay for workplace rules that made their lives better. This line of thinking requires an understanding of how markets work, so it is less easily grasped.

2.1.4 Quantifying European economic integration

Recent research by economic historians permits us to quantify the progress of economic integration in Europe. A careful reading of the timing with which various policies were implemented allows the economic historian to quantify (somewhat subjectively) the extent of integration. The indices developed by two different groups are shown in Fig. 2.2. Although the two indices differ in details, they show that European economic integration has been a 'work in progress' for half a century. The DFFM index, which has finer detail on EU integration, clearly shows the main phases:

- ★ Customs union formation, 1958–68
- ★ Euro-pessimism, 1973–86
- ★ Single market, 1986–92
- ★ EMU, 1993–2001

The BN index makes the useful point that European economic integration started well before the Treaty of Rome. The OEEC produced important trade and payments liberalizations across Europe before 1958 and the ECSC produced deep integration in the coal and steel sectors of the Six (see Chapter 1 for details).

2.2 EU organizational structure: three pillars and a roof

The integration described above did not occur overnight. The decades since 1958 produced a steady stream of new EU laws. Most of these strengthened integration in areas where integration had already begun. Some of the

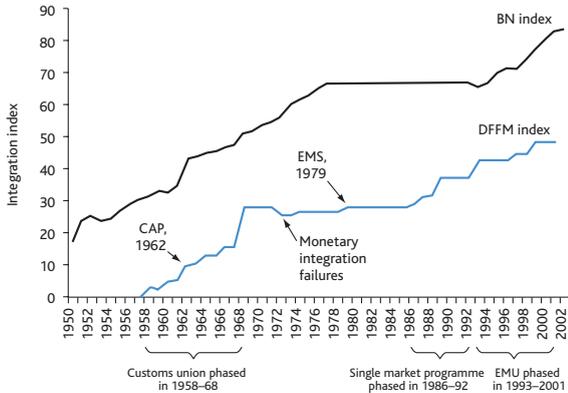


Figure 2.2: *Indices of European economic integration*
 Source: DFFM index from Dorrucci *et al.* (2003); BN index from Berger and Nitsch (2005).

new laws, however, extended EU integration to new areas, such as immigration policy, environmental policy, police cooperation, and foreign and defence policy.

2.2.1 Ever closer? Creeping competences

Up to the 1992 Maastricht Treaty, all of this integration was subject to the Treaty of Rome’s supranational decision-making procedures. For example, the rules governing the detailed implementation of deeper economic integration (called ‘completion of the internal market’) were adopted by majority voting of EU members. This meant that all Member States had to comply with such rules, even those Member States that voted against them. Moreover, the European Court of Justice was the ultimate authority over disputes involving all such rules and the Court’s rulings occasionally had the effect of boosting integration (see the *Cassis de Dijon* case in Chapter 4 for a famous example).

This supranationality created two related problems, given Member States’ diverse attitudes toward deeper and broader integration. The first concerned the old schism between federalists and intergovernmentalists (see Chapter 1). On the one hand, some EU members – the ‘vanguard’ – wished to spread European integration to areas that were not covered in the original treaties (Germany is a good example of a vanguard member). On the other hand, another group of members – call them the ‘doubters’ – worried that supranational decision-making procedures were producing an irresistible increase in the depth and breadth of European integration and that this was forcing the citizens of some nations to accept more integration



Figure 2.3: *Schengen Accord, deeper integration outside the EU framework*

Note: The passport-free travel zone of Schengen includes two non-EU nations (Iceland and Norway), and two EU members are not in it (the UK and Ireland).

Source: Photo: Audiovisual Library of the European Commission; map: Swedish airport services.

than they wanted (the UK is a good example), an effect called ‘creeping competences’. Particularly worrisome was the ability of the European Court of Justice to interpret the Treaty of Rome and subsequent amendments. The Treaty of Rome says that the EC could make laws in areas not mentioned in the Treaty, if the Court rules that doing so was necessary to attain Treaty objectives. The objectives of the Treaty of Rome were radical and far-reaching; its first line says that the members are ‘determined to lay the foundations of an ever closer union among the peoples of Europe’. Doubters worried that the combination of the Treaty’s ambitious objectives and the Court’s ability to sanction law making in areas not explicitly mentioned in the treaties put no limit on how much national sovereignty might eventually be transferred to the EU level. (See Factsheet 1.2.2. at www.europarl.eu.int/factsheets/ for more discussion of this point.)

The second problem concerned integration that was taking place outside of the EU’s structure due to differences between the vanguard and the doubters. The Schengen Accord is the classic example. While the free movement of people is an EU goal dating back to 1958, some members (the UK in particular) held up progress towards passport-free travel. In 1985, five EU members signed an agreement ending controls on their internal frontiers. This was completely outside of the EU’s structure and many observers feared that such ad hoc arrangements could undermine the unity of the single market and possibly foster tensions among EU members.

Both concerns were addressed when EU members adopted a second keystone treaty – the Treaty on European Union (Maastricht Treaty).

2.2.2 Maastricht and the three pillars as firebreaks

The Maastricht Treaty drew a clear line between supranational and intergovernmental policy areas by creating the 'three-pillar' organizational structure. In a nutshell, the deeper integration policies up to the Maastricht Treaty are in the first pillar and continue to be subject to the Treaty of Rome's supranationality. The intergovernmental policy areas are in the second and third pillars. The European Union is the 'roof' covering the three pillars (see Fig. 2.4).

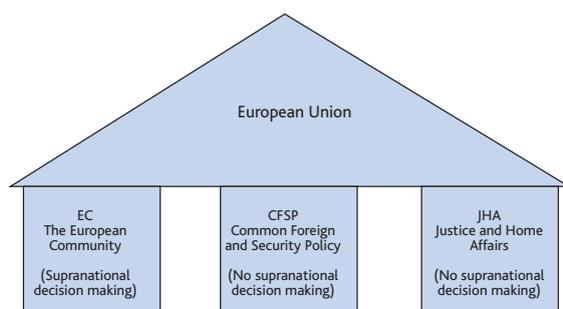


Figure 2.4: The three-pillar structure

Note: Some find the following cynical phrase to be useful in remembering the numbering: 'In the EU, economics comes first, justice comes last and security is in the middle.'

The three-pillar structure solved the two related problems since the clear distinction between supranational and intergovernmental cooperation allowed initiatives like Schengen to be brought under the EU's wing without forcing every member to join. This greatly reduced the resistance of the UK and other intergovernmentalists to discussing closer integration in areas such as police cooperation and foreign policy cooperation. The key, as far as these nations are concerned, is that Maastricht puts Member States clearly in control in second and third pillar areas. There is no possibility of the Court or Commission using its authority to force deeper integration on reluctant members in pursuit of the duties assigned to them by the Treaty of Rome.

Details of the three pillars

The first pillar, which encompasses the vast majority of EU activity, is called the European Community (formerly known as the European Economic Community, or

European Communities). Its issues include the Common Market, the Single Market Programme, Competition Policy, the Common Agricultural Policy, etc. It also includes the Economic and Monetary Union (EMU) and thus comprises the European Central Bank, the single currency, and all the attendant rules and procedures.

The second pillar consists of the Common Foreign and Security Policy, and the third pillar of Justice and Home Affairs. Integration efforts in second- and third-pillar areas are intergovernmental in the sense that such efforts are undertaken by direct negotiation among Member States and any agreement requires unanimity. Amendments to the Maastricht Treaty in the Treaties of Amsterdam and Nice moved some specific policy areas from the second and third pillars into the first pillar.

Saying 'EU' logically implies that one is talking about all three pillars, but because 'European Union' sounds better, the term EU is used almost universally in the media and by politicians even when they are talking about purely first-pillar issues.

The key distinctions

Supranationality in the EU arises in three main ways:

- ★ First, the Commission can propose new laws that are then voted on by the Member States (in the Council of Ministers) and the European Parliament. If passed, these new laws bind every Member State, even those that disagree with them. See Box 2.3 for a current example.
- ★ Second, the Commission has direct executive authority in a limited number of areas, the most prominent being competition policy. For instance, the Commission can block a merger between two EU companies even if their governments support the merger. (See Chapter 11 for details.)
- ★ Third, the rulings of the European Court of Justice can alter laws, rules and practices in Member States, at least in limited areas. (See the *Factortame* case discussed in section 2.3 for an example.)

The Maastricht Treaty states that these forms of supranationality continue to apply to first-pillar issues. It also defines quite precisely the limited role of the Commission, Court and Council in the second and third pillars.

2.2.3 The two key treaties: TEC and TEU

The upshot of all this is that today's European Union is based on two main treaties: the 'first pillar' treaty, the

Treaty establishing the European Community (also called the TEC or Treaty of Rome) and the 'encompassing treaty', the Treaty on European Union (also called the TEU or Maastricht Treaty). There is a raft of other treaties, but these either modify the two main treaties (Single European Act, Treaty of Amsterdam, Treaty of Nice, etc.), or are important only in very specific areas (Treaty establishing the European Atomic Energy Community, etc.). As usual, the full picture is more complex. Interested readers will find Borchardt (1999) very helpful in filling in the details. Also the European Parliament's Factsheets 1.1.1 to 1.1.3 provide a detailed but highly readable history of the treaties' developments (www.europarl.eu.int/factsheets/default_en.htm).

The Constitutional Treaty (which is unlikely to come into force before the third edition of this book appears and maybe never) would remove the three-pillar structure. Since the three-pillar system was set up in part to ensure that only first-pillar issues were subject the Court's rulings, this aspect could have important long-run effects on the evolution of European integration.

2.3 EU law

Implementing and maintaining a unified economic area requires a legal system of some kind since disputes over interpretation and conflicts among various laws are inevitable. One of the most unusual and important things about the EU is its supranational legal system. By the standards of every other international organization in the world, this system is extremely supranational. For example, even the highest courts in EU Member States must defer to decisions by the EU's Court of Justice on matters concerning the interpretation of EC law. The EU is very much like a federal state in this respect. Just as the decisions of lower courts in France, Germany and Italy can be overturned by those nations' supreme courts, the EU's Court of Justice has the ultimate say on questions concerning European law.

The topic of EU law is as intricate as it is fascinating. This section presents the barest outlines of the subject, focusing on the elements that are essential for understanding the decision-making process in particular,

Box 2.3

The UK and the Working Time Directive

The 1993 Working Time Directive aimed to protect employees against working excessively long hours. Specific groups of people were not covered by the directive (e.g. managers and family workers) and some activities were excluded (e.g. transport workers, sea fishermen and trainee doctors). When the directive was formulated, the UK insisted on an opt-out allowing individual workers to waive the directive's limit of 48 hours per week. This has been used almost exclusively in the UK, but when the Court ruled that some of the 'on call' time of doctors should be counted in the 48 hours, other Member States have shown heightened interest in using the opt-out (hiring more doctors would cost Member State governments dearly).

The European Commission became concerned that individual workers were being coerced into 'volunteering' for longer hours. Despite opposition from the UK government, the Commission proposed a change

that would allow workers to exceed 48 hours only if employers and unions reached a collective agreement.

The UK government argued that the change would make labour markets less employment-friendly. The leader of the British employers' association said: 'The issue was about freedom of choice. ... People who just do five hours a week overtime and use the money for a holiday. All I want to know is who's going to pay them for the money they lose.'

In May 2005, the European Parliament approved the Commission's proposed change, so the matter moves to the Council of Ministers. If sufficient Member States vote for the change, the UK must implement it despite its objections. At the time this book went to print, the UK was trying to line up allies to block the changes in the Council.

and the economics of European integration more generally. Note that this section is largely based on the freely downloadable book by Borchardt (1999), *The ABC of Community Law* (use a search engine such as Google to find it on <http://europa.eu.int/> since the Commission occasionally reorganizes its website). Note on notation: in legal matters, it is important to distinguish between the European Community (first pillar) and the European Union (all three pillars together), so in this section we use EU and EC to mean different things.

2.3.1 'Sources' of EU law

Where did the EU's legal system come from? The legal systems of most democratic nations are based on a constitution. At the time this book went to press, the EU did not have a constitution, and in any case, the legal principles in the European Constitutional Treaty merely codify principles that have been in place for decades. So where did these principles come from? As is true of so many things in the EU, a complete answer to this question would fill a book or two, but the short answer can be given in a few paragraphs. Again, history provides the best organizing principle for the answer. We start with the Treaty of Rome.

The Treaty of Rome commits Member States to a series of general economic and political goals. It also contains a number of highly specific commitments, e.g. on equal pay for men and women. The Treaty transfers important elements of national sovereignty to the European level, for example, after 1958, Member States no longer had the right to control their trade policy individually. The Treaty was meant to be a dynamic and adaptive agreement, so it also created ways of making new laws and modifying old ones. Most importantly for the subject at hand, it established a Court to adjudicate the disputes and questions of interpretations that were bound to arise.

The Treaty was not very specific when it came to setting up the legal system. The Treaty establishes the Court of Justice and states that its general task is to 'ensure observance of law and justice in the interpretation and application of this Treaty' (Article 164 in the original Treaty). It then goes on to define the Court's composition and to assign the Court a few specific tasks. For example, the Commission can take a Member State before the Court for non-compliance with Treaty obligations, and the Court was charged with interpreting the Treaty.

The Treaty was not specific enough to deal with the



Figure 2.5: Working session of the Court of Justice

Source: European Parliament.

many issues that came before the Court. The Court reacted to the lack of specificity in the Treaty by creating the Community's legal system via case law. That is to say, it used decisions relating to particular cases to establish general principles of the EC legal system.

In short, the Treaty of Rome is the wellspring of EC law. The Treaty created the Court and the Court created the EC legal system. EC law is now an enormous mass of laws, rules and practices that have been established by Treaties (primary law), EU laws (secondary law), and decisions of the Court (case law). See Box 2.4 for further details on the types of secondary legislation.

2.3.2 EC legal system: main principles

Since the EC legal system was not created by any single document, its principles have never been officially proclaimed. The 'principles' of EC law are thus general patterns that various jurists have discerned from the thousands of pages of primary, secondary and case law, and different jurists list different principles. Three principles that always are mentioned are 'direct effect', 'primacy of EC law', and 'autonomy' of the EC legal system. These were first established in two landmark cases in 1963 and 1964 (see Box 2.5).

'Direct effect'

'Direct effect' is simple to define: it means that a treaty provisions or other forms of EU law such as directives can create rights which EU citizens can rely upon when they go before their domestic courts. This is radical. It means that EC laws must be enforced by Member States' courts just as if the law had been passed by the national parliament. A good example is the case of a Sabena air stewardess (as they called female flight attendants in the 1970s) who claimed that she was paid less and had to

Box 2.4

Secondary legislation: 'Acts of Community Law'

There are five main types of EU legislation other than the Treaties.

A *regulation* applies to all Member States, companies, authorities and citizens. Regulations apply as they are written, i.e. they are not transposed into other laws or provisions. They apply immediately upon coming into force.

A *directive* may apply to any number of Member States. However, directives only set out the result to be achieved. The Member States decide for themselves, within a prescribed time frame, what needs to

be done to comply with the conditions set out in the directive. For instance, one Member State may have to introduce new legislation, whereas another may not need to take any action at all if it already meets the requirements set out in the directive.

A *decision* is a legislative act that applies to a specific Member State, company or citizen.

Recommendations and *opinions* are two other types of legislative instruments. They are not legally binding.

Box 2.5

Two cases that established the EC legal system

The EC legal system was not explicitly established in any treaty, so the Court used some early cases to establish three key principles. Since these principles arose in the course of real-world cases, it can be difficult to distinguish precisely among the three principles in the two cases.

Van Gend & Loos v Netherlands, 1963

In this case, the Dutch company Van Gend & Loos brought an action against its own government for imposing an import duty on a chemical product from Germany which was higher than duties on an earlier shipment. The company claimed that this violated the Treaty of Rome's prohibition on tariffs hikes on intra-EC trade. The Dutch court suspended the case and asked the EC Court to clarify. The EC Court ruled that the company could rely on provisions in the treaties when arguing against the Dutch government before a Dutch court.

Plainly, this case has an element of direct effect and

primacy. The Dutch government had one rule – the higher tariff rate – whereas the Treaty of Rome had another (no increase allowed). The EC Court said the Treaty provision trumped the national provision. Moreover, the EC Court said that the Dutch court should consider the Treaty directly rather than, for example, the Dutch parliament's transposition of the Treaty's principles into Dutch law. In effect, the Court said that the Treaty was Dutch law as far as the Dutch court was to be concerned. This was new since, normally, a national court can consider only national law when judging a case.

The European Court also took the opportunity to write down its thoughts on the fundamental nature of the EC legal system. In its *Van Gend & Loos v Netherlands* decision, it wrote: 'The Community constitutes a new legal order of international law for the benefit of which the States have limited their sovereign rights, albeit within limited fields, and the subjects of which comprise not only Member States but also their nationals.'

continued**Costa v ENEL, 1964 decision by the European Court of Justice**

The next year, the Court expanded its view of the EC legal system in a case involving a dispute over one euro! In 1962, Italy nationalized its electricity grid and grouped it under a national electricity board (ENEL). Mr Flaminio Costa, a shareholder of one nationalized company, felt he had been unjustly deprived of his dividend and so refused to pay his electricity bill for two thousand lira. The non-payment matter came before an arbitration court in Milan but since Mr Costa argued that the nationalization violated EC law, the Milan court asked the European Court to interpret various aspects of the Treaty of Rome.

The Court took the opportunity to go way beyond the question at hand. In its judgment, the Court stated the principle of autonomy and direct effect:

By contrast with ordinary international treaties, the EEC Treaty has created its own legal system which ... became an integral part of the legal systems of the Member States and which their courts are bound to apply.

Member States have limited their sovereign rights, albeit within limited fields, and have thus created a

body of law which binds both their nationals and themselves.

Relying on the logic of what the Treaty of Rome implied – at least implicitly – the Court established the principle of primacy:

[T]he law stemming from the Treaty, an independent source of law, could not, because of its special and original nature, be overridden by domestic legal provisions, however framed, without being deprived of its character as Community law and without the legal basis of the Community itself being called into question. The transfer by the States from their domestic legal system to the Community legal system of the rights and obligations arising under the Treaty carries with it a permanent limitation of their sovereign rights, against which a subsequent unilateral act incompatible with the concept of the Community cannot prevail.

The Court's justification was that if EC law were not supreme, the objectives of the Treaty could not be met: 'The executive force of Community law cannot vary from one State to another in deference to subsequent domestic laws, without jeopardising the attainment of the objectives of the Treaty.'

retire earlier than male flight attendants. Although this was not a violation of Belgian law at the time, the EC Court ruled in 1976 that the Treaty of Rome (which provides for equality of pay between the sexes) had the force of law in Belgium, or in legalese it had direct effect. The stewardess won the case.

The principle of direct effect is quite unique. For example, when New Zealand ratifies the Kyoto Protocol, it is agreeing to certain obligations, but New Zealand courts ignore these obligations unless they are implemented by a law passed by the New Zealand parliament. Even more unusual is that this direct effect notion applies to EU laws passed by majority voting, e.g. directives. This means that even if a Member State government votes against a particular law, that law automatically has the force of law, so its national courts must treat the EU law as if it were a national law. Importantly, there are complex conditions for a treaty provision to have direct

effect, so not everything in every treaty is automatically enforceable in Member States.

The logical necessity of this principle is straightforward. If laws agreed in Brussels could be ignored in any Member State, the EU would fall into shambles. Each member would be tempted only to implement the EU laws it liked. This would, for example, make it impossible to create a single market or to ensure the free movement of workers.

Primacy of EC law

The principle of the primacy of EC law, which means that Community law has the final say, is not in the Treaty of Rome and indeed appears explicitly for the first time only in the Constitutional Treaty. It is, nonetheless, a principle that is now generally accepted by all EU members. It has repeatedly been used to overturn Member State laws.

One classic example of this is the 1991 *Factortame* case which confirmed the supremacy of EC law over UK law. The UK's Merchant Shipping Act 1988 had the effect of forbidding a Spanish fishing company called Factortame from fishing in UK waters. Factortame asserted in UK courts that this violated EC law, and asked the UK court to suspend the Merchant Shipping Act until the EC Court could rule on the matter (this often takes a couple of years). Under UK law, no British court can suspend an Act of Parliament. The EC Court ruled that under EC law, which was supreme to UK law, a national court could suspend laws which contravened EC law. Subsequently, the highest UK court did strike down the Merchant Fishing Act.

The logical necessity of this principle is just as clear as that of direct effect. Simplifying for clarity's sake, 'direct effect' says that EC laws are automatically laws in every Member State. Primacy says that when EC law and national, regional or local laws conflict, the EC law is what must be enforced.

Autonomy

Most European nations have several layers of courts, local, regional and national. The lower courts, however, do not exist independently of the higher courts, and often the higher courts depend upon the lower courts (e.g., in some nations, the high court can rule only after the case has been tried at a lower level). The EC legal system, however, is entirely independent of the Member States' legal systems according to the principle of autonomy.

2.4 The 'Big-5' institutions

There are many EU agencies, bodies and committees, but one can achieve a very good understanding of how the EU works knowing only the 'Big-5': the Council of the European Union (often called by its old name, the Council of Ministers), the European Council, the European Commission, the European Parliament and the European Court of Justice. (There are many more institutions; interested students should see http://europa.eu.int/institutions/index_en.htm.)

The Constitutional Treaty would change the Big-5 in important ways, but since the Constitution is a long way from coming into force, we present the current facts on the Big-5, grouping together the Constitution's changes for all five in a separate section.

2.4.1 Council of the European Union

The Council of the European Union – also known as the Council of Ministers or 'the Council' for short – is the EU's main decision-making body. Almost every piece of legislation is subject to approval by the Council. The Council consists of one representative from each EU member. The national representatives must be authorized to commit their governments to Council decisions, so Council members are the government ministers responsible for the relevant area – the finance ministers on budget issues, agriculture ministers on farm issues, etc. The Council is the institution where Member States' governments assert their influence most directly.

Since all EU governments are elected (democracy is a must for membership) and the Council members represent their governments, the Council is the ultimate point of democratic control over the EU actions and law making.

The main task of the Council is to adopt new EU laws (directive, regulations, rules, etc.). Most of these laws concern measures necessary to implement the treaties, but they also include measures concerning the EU budget and international agreements involving the EU. The Council also is tasked with coordinating the general economic policies of the Member States in the context of the Economic and Monetary Union (EMU). The famous 3 per cent deficit rule, which has caused Germany and France so much trouble in recent years, is part of this coordination effort. On most issues, passing new laws also requires approval of the European Parliament, so on these issues, the Council's legislative power is shared with the Parliament.



Figure 2.6: *Meeting of the Council of Ministers in Brussels*

Source: European Commission



Figure 2.7: *Artemis Joint Combined Military Support Base, Entebbe*

Source: Council of the European Union

In addition to these first-pillar tasks, the Council takes the decisions pertaining to Common Foreign and Security Policies and measures pertaining to police and judicial cooperation in criminal matters. To the average European, these are some of the most visible actions of the Council. For example, the EU launched a peacekeeping operation in the Democratic Republic of Congo (Artemis) in accordance with a United Nations Resolution asking for the deployment of an interim emergency multinational force in Bunia (a region in the Congo). The EU force, working closely with the United Nations Mission, sought to stabilize security conditions and to improve the humanitarian situation. France led the mission.

The Council has two main decision-making rules. On the most important issues – such as Treaty changes, the accession of new members and setting the multi-year budget plan – Council decisions are by unanimity. On most issues (about 80 per cent of all Council decisions), the Council decides on the basis of what is known as ‘qualified majority voting’ (QMV). These rules are extremely important for understanding how Europe works, so they are the subject of extensive analysis in Chapter 3.

Presidency of the EU

One EU member holds the presidency, with this office rotating among EU members every six months. The Council of Ministers is chaired by the presiding member and generally meets in Brussels (April, June and October meetings are held in Luxembourg). (For more details see the Council’s website at <http://ue.eu.int>). Although the Council is a single institution, it follows the somewhat confusing practice of using different names to describe

the Council according to the matters being discussed. For example, when the Council addresses EMU matters, it is called the Economic and Financial Affairs Council, or ECOFIN to insiders.

2.4.2 The European Council

The European Council consists of the leaders of each EU member plus the President of the European Commission – the EU phraseology is the ‘heads of state and government’. The European Council provides broad guidelines for EU policy and thrashes out the final compromises necessary to conclude the most sensitive aspects of EU business, including reforms of the major EU policies, the EU’s multi-year budget plan, Treaty changes, and the final terms of enlargements. This body is by far the most influential institution because its members are the leaders of their respective nations.

The European Council is chaired by the country that has the presidency of the EU. This position can be powerful since it gives the President some power to set the agenda. However, since the Council operates on a basis of consensus, the agenda-setting power can be quite limited.

The European Council meets at least twice a year (in June and December), but meets more frequently when the EU faces major political problems. The highest-profile meetings are those held at the end of each six-month term of the EU presidency. These June and December meetings are important media events – the one aspect of the EU that almost every European has seen on television. The reason for this is that the European Council’s decisions determine all of the EU’s major moves. For example, the bitter budget battle between the UK and France occurred at the June 2005 summit and the decision to adopt the Constitutional Treaty was made at the June 2004 summit. One particularly historic Council meeting was the 2002 Copenhagen summit at which the ten central and eastern European nations were admitted to the EU (see Fig. 2.8).

The most important decisions of each presidency are contained in a document known as the Conclusions of the Presidency, which is published at the end of the each European Council meeting. For example, the decision to accept the ten new members in the 2004 enlargement was announced in the Conclusions released after the December 2002 European Council in Copenhagen. All recent Conclusions are on the Council’s website (<http://ue.eu.int/>).

One peculiarity of the EU is that the European Council has



Figure 2.8: Group photo with the soon-to-be new members of the EU

Source: Council of the European Union.

no formal role in EU law making even though it is the most influential body in the process. The political decisions of the European Council have to be translated into law following the standard legislative procedures that we review below. These procedures involve the Commission, the Council of Ministers and, in most areas, the European Parliament.

Confusingly, the European Council and the Council of Ministers are often both called 'the Council'. Moreover, the Council of Ministers and the European Council should also not be confused with the Council of Europe (an international organization entirely unrelated to the EU).

For years, the Council met in the country that had the rotating presidency of the EU. Since 2004, however, all summits are held in Brussels.

2.4.3 The European Commission

The European Commission is at the heart of the EU's institutional structure. It is the main driving force behind deeper and wider European integration. This body, which is based in Brussels, has three main roles:

- ★ to propose legislation to the Council and Parliament;
- ★ to administer and implement EU policies;
- ★ to provide surveillance and enforcement of EU law in coordination with the European Court.

As part of its third role, the Commission is considered to be the 'guardian of the treaties', i.e. the body that is ultimately charged with ensuring that the treaties are implemented and enforced.

The Commission also represents the EU at some international negotiations, such as those relating to trade

and cooperation with non-member nations. The Commission's negotiating stances at such meetings are closely monitored by EU members.

Commissioners and the Commission's composition

Before the 2004 enlargement, the European Commission was made up of one Commissioner from each EU member, with an extra Commissioner from the Big-5 nations in the EU15 (Germany, the UK, France, Italy and Spain). This included the President (Romano Prodi up to 2005), two Vice-Presidents and 17 other Commissioners. In the enlarged Union, each nation has one Commissioner since, in an attempt to keep Commission to a manageable size, the big nations agreed to give up their extra Commissioner in the Treaty of Nice. The current Commission, which is presided by former Portuguese Prime Minister José Manuel Barroso, has 25 Commissioners (see Fig. 2.9).

Commissioners are in effect chosen by their national governments, but the choices are subject to political agreement by other members. The Commission as a whole, and the Commission President individually, must also be approved by the European Parliament. Note, however, that Commissioners are not supposed to act as national representatives. They should not accept or seek instruction from their country's government. In practice, Commissioners are generally quite independent of their home governments, but since they have typically held high political office in their home nations, they are naturally sensitive to issues that are of particular concern in their home nations. This ensures that all decisive national sensitivities are heard in Commission deliberations.



Figure 2.9: The 25 member Barroso Commission

Note: See http://europa.eu.int/comm/commission_barroso/index_en.htm for notes on each Commissioner.

Source: European Commission.

Commissioners, including the President of the Commission, are appointed all together and serve for five years. This is why people often refer to each Commission by the President's name, e.g. the Prodi Commission or the Santer Commission. The appointments are made just after European Parliamentary elections and take effect in January of the following year. The Barroso Commission's term ends in January 2009.

The Commission has a great deal of independence in practice and often takes views that differ substantially from those of the Member States, the Council and the Parliament. However, it is ultimately answerable to the European Parliament since the Parliament can dismiss the Commission as a whole by adopting a motion of censure. Although this has never happened, a censure motion was almost passed in 1999, triggering a sequence of events that ended in mass resignation of the Commission led by President Jacques Santer (the Prodi Commission's predecessor).

Each politically appointed Commissioner is in charge of a specific area of EU policy. In particular, each runs what can be thought of as the EU equivalent of a national ministry. These 'ministries', called Directorates General or DGs in EU jargon, employ a relatively modest number of international civil servants. The Commission as a whole employs about 17 000, which is fewer than the number of people who work for the city of Vienna. Just as in national ministries, Commission officials tend to provide most of the expertise necessary to administer and analyse the EU's complex network of policies since the Commissioners themselves are typically generalists.

Legislative powers

The Commission's main duty is to prepare proposals for new EU decisions. These range from a new directive on minimum elevator safety standards, to reform of the Common Agricultural Policy (CAP). Neither the Council nor the Parliament can adopt legislation until the Commission presents its proposals, except under extraordinary procedures. This monopoly on the 'right to initiate' makes the Commission the gatekeeper of EU integration. It also allows the Commission to occasionally become the driving force behind deeper or broader integration. This was especially true under the two Delors Commissions that served from 1985 to 1994.

Commission proposals are usually based on general guidelines established by the Council of Ministers, the European Council, the Parliament or the treaties. A proposal is prepared by the relevant Directorate-General

in collaboration with other DGs concerned. In exercising this power of initiative, the Commission consults a broad range of EU actors, including national governments, the European Parliament, national administrations, professional groups and trade unions. This complex consultation process is known in EU jargon as 'comitology'.

Executive powers

The Commission is the executive in all of the EU's endeavours, but its power is most obvious in competition policy. Chapter 13 explains in more detail how the Commission has the power to block mergers, to fine corporations for unfair practices and to insist that EU members remove or modify subsidy to their firms. The Commission also has substantial latitude in administering the Common Agricultural Policy, including the right to impose fines on members that violate CAP rules.

One of the key responsibilities of the Commission is to manage the EU budget subject to supervision by a specialized institution called the EU Court of Auditors. For example, while the Council decided the programme-by-programme allocation of funds in the EU's current multi-year budget ('Financial Perspective' in EU jargon), it was the Commission that decided the year-by-year indicative allocation of Structural Funds across members.

Decision making

The Commission decides, in principle, on the basis of a simple majority. The 'in principle' proviso is necessary because the Commission makes almost all of its decision on the basis of consensus. The reason is that the Commission usually has to get its actions approved by the Council and/or the Parliament, so unless the proposal gains the approval of a substantial majority of the Commissioners, it is likely to fail in the Council and/or Parliament.

2.4.4 The European Parliament

The European Parliament has two main tasks:

- ★ sharing legislative powers with the Council of Ministers and the Commission;
- ★ overseeing all EU institutions, but especially the Commission.

The Parliament, on its own initiative, has also begun to act as the 'conscience' of the EU, for example condemning various nations for human rights violations via non-binding resolutions.

Organization

The European Parliament (EP) has 732 members who are directly elected by EU citizens in special elections organized in each Member State. The number of Members of European Parliament (MEPs) per nation varies with population, but the number of MEPs per million EU citizens is much higher for small nations than for large. For example, in the 1999–2004 Parliament, Luxembourg had 6 MEPs and Germany had 99, despite the fact that Germany's population is about 160 times that of Luxembourg.

MEPs are supposed to represent their local constituencies, but the Parliament's organization has evolved along classic European political lines rather than along national lines (Noury and Roland, 2002). The EP election campaigns are generally run by each nation's main political parties, and MEPs are generally associated with a particular national political party. Although this means that over one hundred parties are represented in the EP, fragmentation is avoided because many of these parties have formed political groups. As in most EU Member States, two main political groups – the centre-left and the centre-right – account for two-thirds of the seats and tend to dominate the Parliament's activity. The centre-left grouping in the EP is called the Party of European Socialists, the centre-right group is called the European People's Party.

National delegations of MEPs do not sit together. As in most parliaments, the European Parliament's physical, left-to-right seating arrangement reflects the left-to-right ideology of the MEPs. In the 1999–2004 Parliament, the left flank was occupied by the radical left (communist, former communist, extreme left parties and the Nordic Green Left parties). Continuing left to right, the next is the Party of the European Socialists, the Greens and allies (e.g. regional parties from Spain), the European Liberal Democrat and Reformists group and the European People's Party. On the far right flank are the Euro-sceptic Gaullists and other rightist groups. Details on the size and national composition of the European Parliament can be found on www.europarl.eu.int. These party groups have their own internal structure, including chairs, secretariats, staffs, and 'whips' who keep track of attendance and voting behaviour. The political groups receive budgets from the Parliament.

Statistical analysis of MEPs' voting patterns shows that they vote more along party lines than they do along country lines. Indeed, cohesion within European political groupings is comparable to that in the US Congress,



Figure 2.10: *Debate in the European Parliament*

Source: European Commission.

whereas cohesion of country delegations is significantly lower and is declining, as Noury and Roland (2002) show.

Location

The Parliament is not located in Brussels, the centre of EU decision making, but in Strasbourg owing to France's dogged insistence that it remain in France (the Parliament's predecessor in the European Coal and Steel Community, the Common Assembly, was located there to be near the heart of the coal and steel sectors). Equally determined insistence by Luxembourg has kept the Parliament's secretariat in Luxembourg. Since Brussels is where most of the political action occurs, and is also the location of most of the institutions that the Parliament is supposed to supervise, the Parliament also has offices in Brussels (this is where the various Parliamentary committees meet). The staffs of the Parliament's political groups work in Brussels. It is not clear how much this geographic dispersion hinders the Parliament's effectiveness, but the time and money wasted on shipping documents and people among three locations occasionally produces negative media attention. This shifting location may also help to account for the fact that many MEPs do not attend all sessions. In the third Parliament, an average of 17.6 per cent of the MEPs were absent and 35.5 per cent were physically present but did not vote; this improved in the fourth Parliament where the respective figures were 16.8 per cent and 21.6 per cent (Noury and Roland, 2002).

Democratic control

The Parliament and the Council are the primary democratic controls over the EU's activities. The MEPs are directly elected by EU citizens, so European Parliamentary elections are, in principle, a way for Europeans to have their voices heard on European issues.

In practice, however, European Parliamentary elections are often dominated by standard left-versus-right issues rather than by EU issues. Indeed, European Parliamentary elections are sometimes influenced by pure national concerns with the voters using the elections as a way of expressing disapproval or approval of the incumbent national government's performance. Moreover, in many Member States, participation in European Parliamentary elections tends to be fairly modest. By contrast, the elections by which national governments are chosen see a much greater level of turnout by the electorate.

2.4.5 European Court of Justice

In the EU, as in every other organization in the world, laws and decisions are open to interpretation and this frequently leads to disputes that cannot be settled by negotiation. The role of the European Court of Justice (ECJ), or sometimes known as the EU Court or EC Court) is to settle these disputes, especially disputes between Member States, between the EU and Member States, between EU institutions, and between individuals and the EU. As discussed above, the EU Court is the highest authority on the application of EU law.

As a result of this power, the Court has had a major impact on European integration. For example, its ruling in the 1970s on non-tariff barriers triggered a sequence of events that eventually led to the Single European Act of 1986 (see Chapter 4 for details). The Court has also been important in defining the relations between the Member States and the EU, and in the legal protection of individuals (EU citizens can take cases directly to the EU Court without going through their governments).

The European Court of Justice, which is located in Luxembourg, consists of one judge from each Member State. Judges are appointed by common accord of the Member States' governments and serve for six years. The Court also has eight advocates-general whose job it is to help the judges by constructing 'reasoned submissions' that suggest what conclusions the judges might take. The Court reaches its decisions by majority voting. The Court of First Instance was set up in the late 1980s to help the EU Court with its ever growing workload.

2.5 Legislative processes

As mentioned, the European Commission has a near monopoly on initiating the EU decision-making process. It is in charge of writing proposed legislation, although it



Figure 2.11: Headquarters of the European Court of Justice in Luxembourg

Source: Audiovisual Library of the European Commission.

naturally consults widely when doing so. The next step is to present the proposal to the Council for approval. Most EU legislation also requires the European Parliament's approval, although the exact procedure depends upon the issue concerned. (The treaties specify which procedure must be used in which areas.)

The main procedure, called the codecision procedure, gives the Parliament equal standing with the Council. This procedure is used for about 80 per cent of EU legislation, including that dealing with the free movement of workers, creation of the single market, research and technological development, the environment, consumer protection, education, culture and public health.

The codecision procedure is highly complex, but simplifying for clarity's sake, it starts with a proposal from the Commission and then goes through two readings by the Council and the Parliament. Passing the act requires a 'yes' vote from the Council and Parliament. The Council decides by qualified majority whereas the Parliament decides by a simple majority. If the Council and Parliament disagree after the second reading, a conciliation procedure is started. If this does not produce agreement, the act is dropped. For details see Box 2.6.

The other common legislative procedures include:

- ★ The *consultation procedure*. This is used for a few issues – e.g. the Common Agricultural Policy's periodic price fixing agreements – where the Member States wish to keep tight control over politically sensitive decisions. Under this procedure, the Parliament must give its opinion before the Council adopts a Commission proposal. Such opinions, when they have any influence, are

The codecision procedure

The procedure starts with a Commission proposal. The Parliament then gives its 'opinion', i.e. evaluates the proposal and suggests desired amendments, by simple majority. After seeing the Parliament's opinion, the Council adopts a 'common position' by a qualified majority, except in the fields of culture, freedom of movement, social security and coordination of the rules for carrying on a profession, which are subject to a unanimous vote. The Parliament then receives the Council's common position and has three months in which to take a decision. If the Parliament expressly approves it, or takes no action by the deadline, the act is adopted immediately. If an absolute majority of Parliament's Members rejects the common position, the process stops, and the act is not adopted. If a majority of MEPs adopts amendments to the common position, these are first put to the Commission for its opinion and then returned to the Council. The Council votes by a qualified majority on Parliament's amendments, although it takes a unanimous vote to accept amendments that have been given a negative opinion

by the Commission. The act is adopted if the Council approves all Parliament's amendments no later than three months after receiving them. Otherwise the Conciliation Committee is convened within six weeks.

The Conciliation Committee consists of an equal number of Council and Parliament representatives, assisted by the Commission. It considers the common position on the basis of Parliament's amendments and has six weeks to draft a joint text. The procedure stops and the act is not adopted unless the Committee approves the joint text by the deadline. If it does so, the joint text goes back to the Council and Parliament for approval. The Council and Parliament have six weeks to approve it. The Council acts by a qualified majority and the Parliament by an absolute majority of the votes cast. The act is adopted if Council and Parliament approve the joint text. If either of the institutions has not approved it by the deadline the procedure stops and the act is not adopted.

intended to influence the Council or to shape the Commission's proposal.

- ★ The *assent procedure* is another procedure in which the Parliament plays a subsidiary role. For example, on decisions concerning enlargement, international agreements, sanctioning Member States and the coordination of the Structural Funds, the Parliament can veto, but cannot amend, a proposal made by the Commission and adopted by the Council.
- ★ The *cooperation procedure* is a historical hangover from the Parliament's gradual increase in power. Specifically, before the codecision procedure was introduced in the Maastricht Treaty, the cooperation procedure was the one that granted the most power to the Parliament. It is best thought of as a codecision procedure in which the Parliament's power to amend the proposal is less explicit. Also, the Council can overrule a Parliamentary rejection by voting unanimously.

2.5.1 Enhanced cooperation

The tension between the 'vanguard' members, who wish

to broaden the scope of EU activities, and the 'doubters', who do not, led to the introduction of a new type of integration process called 'closer cooperation' in the Treaty of Amsterdam and 'enhanced cooperation' in the Treaty of Nice. The process allows subgroups of EU members to cooperate on specific areas while still keeping the cooperation under the general framework of the EU.

Subgroups of Member States have long engaged in closer intergovernmental cooperation. What the Treaty of Amsterdam did by creating closer cooperation was to allow such subgroups to proceed while at the same time keeping them under some form of EU discipline and coordination.

However, the conditions for starting new closer cooperations were so strict that no new closer cooperation was established under the Amsterdam rules. The Treaty of Nice made it easier to start such subgroups and relabelled them 'enhanced cooperation arrangements' (ECAs). Although this form of integration has not yet been used, it may come to play a much

more important role in the light of the 2004 enlargement. The point is that the diversity of members' preferences for integration will become even more diverse, so subsets of members may well find that starting an ECA is the only way to get things done. See Baldwin *et al.* (2001) for an analysis of this possibility.

There are potentially serious risks involved in integration led by such clubs-within-the-club schemes. For instance, we may see calls for an ECA with respect to tighter police and intelligence cooperation, especially in relation to terrorism and organized crime. Given the uneven quality of governments in the new Member States, the ECA may seek to exclude nations whose intelligence services are not up to standard. This, of course, would be divisive. Allowing a separation of members into groups risks fragmenting the EU politically. Moreover, ECAs could result in an erosion of existing integration, and in so far as ECAs create diversity in integration, they might erode the consistency of European economic and social integration.

Another example can be found in the meeting of finance ministers of the eurozone nations. Just before the standard Council of Ministers meeting for finance ministers (ECOFIN), the eurozone nations gather to discuss issues. Since these twelve constitute a substantial majority in terms of voting power, the non-eurozone nations can sometimes feel that decisions have been sown up in advance by the eurozone-12.

To guard against these twin risks, the Treaty of Nice gives the Commission a central role in the decision to create and enlarge any enhanced cooperation. Specifically, the Commission can veto ECAs covering deeper economic integration (i.e. first-pillar areas) and it controls subsequent membership enlargements of these. In other areas, the Commission has a strong voice in the process of setting up and expanding ECAs, but less so in the Security and Foreign Policy area (second pillar) than in Justice and Home Affairs areas (third pillar). It can also be the administrator of such groups.

2.6 Some important facts

EU nations are very different, one from another. This simple fact is the source of a large share of EU's problems, so it is important to understand the detail. This section covers the facts on populations, incomes and economic size.

2.6.1 Populations and incomes

There about 460 million EU citizens, a figure that is substantially larger than the corresponding US and Japanese figures (290 and 130 million, respectively).

The EU25 nations and the 'candidate countries' (Bulgaria and Romania scheduled to join in 2007 or 2008, and Turkey) vary enormously in terms of populations, as the lower panel Fig. 2.12 shows. The differences are easier to remember when the nations are grouped into big, medium, small and tiny – where these categories are established by comparison with the population of well-known cities.

★ The 'big' nations are defined here as having 35 million people or more – clearly more people than even the largest city in the world (Mexico City's population is about 20 million). In the EU25 there are six of these – Germany, the UK, France, Italy, Spain and Poland. Germany is substantially larger than the others, more than twice the size of the smallest in the group. The total population of the 'Big-6' accounts for about three-quarters of the

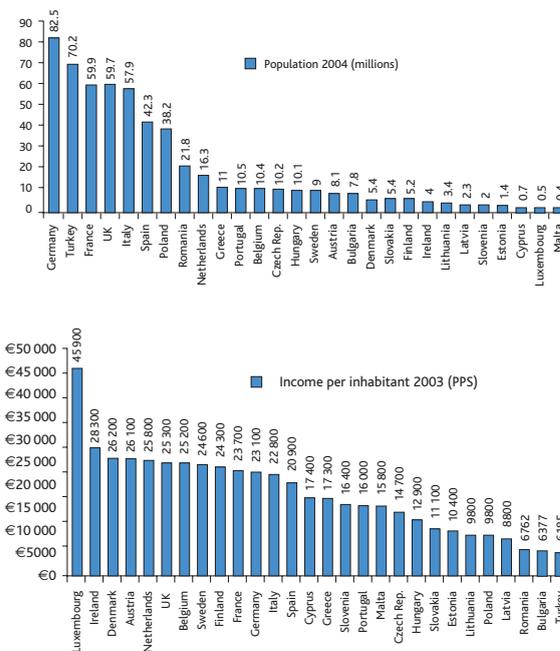


Figure 2.12: Population and income per capita

Note: PPS stands for 'purchase power standard'; it is a measure that corrects euro incomes for national price-level differences (e.g. many goods are cheaper in poor nations, so a euro goes further in, say, Latvia, than it does in Germany).

Source: European Commission.

460 million people in the EU25 nations. Turkey, with whom the EU is supposed to start membership negotiations in October 2005, has over 70 million inhabitants. This exceeds the population of all EU nations except Germany, and given the projected decline in German population and rapid population growth in Turkey, the ordering is likely to be reversed within ten years.

- ★ The 'medium' nations are defined as having populations between 8 and 11 million, something like that of a really big city, say Paris and its surroundings. There are eight medium nations. Seven in the EU25 (Greece, Portugal, Belgium, the Czech Republic, Hungary, Sweden and Austria) and soon-to-join Bulgaria.
- ★ The 'small' nations have populations along the lines of a big city, ranging from Barcelona (4 million) to Lyons (1.4 million). These are Denmark, Slovakia, Finland, Ireland, Lithuania, Latvia, Slovenia and Estonia.
- ★ The 'tiny' nations have population that are smaller than those of a small city like Genoa. The list is Cyprus, Luxembourg and Malta.
- ★ The only nations that fall between these categories is the Netherlands, with its 16 million people, and Romania with its 21.8 million.

Incomes

The average income level of the people in these nations also varies enormously. Again it is useful to classify the nations into three categories: high, medium and low. Luxembourg is in a super-rich class by itself; Luxembourgers are about twice as rich as the French and Swedes. One explanation for this is that Luxembourg is, economically speaking, a medium-sized city and incomes in cities tend to be quite high.

The high-income category – defined as incomes above the EU25 average of €21,400 in 2003 – includes ten of the EU25 nations (Ireland, Denmark, Austria, the Netherlands, the UK, Belgium, Sweden, Finland, France, Germany and Italy in order of decreasing incomes).

In the medium-income category – from €10 000 to €21 000 – there are three relatively poor EU15 members (Spain, Greece and Portugal), and seven new members (Cyprus, Slovenia, Malta, the Czech Republic, Hungary, Slovakia and Estonia).

Defining low-income nations as those with per capita incomes less than €10 000, there are six of these: Lithuania, Poland, Latvia, Romania, Bulgaria and Turkey.

2.6.2 Size of EU economies

The economic size distribution of European economies is also very uneven, measuring economic size with total gross domestic product (GDP). As Fig. 2.13 shows, just six nations, the 'Big-5' (Germany, the UK, France, Italy and Spain) and the Netherlands, account for more than 80 per cent of the GDP of the whole EU25. The other nations are small, tiny or minuscule, using the following definitions:

- ★ 'Small' is an economy that accounts for between 1 and 3 per cent of the EU25's output. These are Sweden, Belgium, Austria, Denmark, Poland, Finland, Greece, Portugal and Ireland.
- ★ 'Tiny' is one that accounts for less than 1 per cent of the total. These are the Czech Republic, Hungary, Slovakia, Luxembourg, Slovenia, Lithuania and Cyprus.
- ★ 'Minuscule' as one that accounts for less than 0.1 per cent of the EU25's GDP: Latvia, Estonia and Malta are the nations in this category.

Figure 2.13 also shows that the 2004 enlargement had very little impact on the overall size of the EU economy; the ten newcomers' economies amount to only about 5

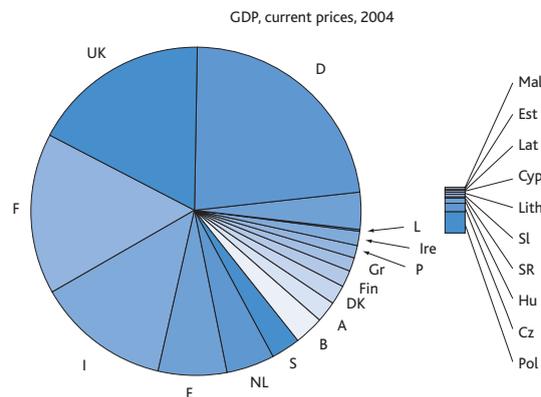


Figure 2.13: Size distribution of EU25 economies

Note: Data for 2004, not adjusted for national cost of living differences since we are interested in the relative size of economies rather than individual income levels.

'Big nations': Germany (D), the UK (UK), France (F), Italy (I), Spain (E) and the Netherlands (NL). 'Small nations' (1–3% of total EU25 GDP): Sweden (S), Belgium (B), Austria (A), Denmark (DK), Poland (PL), Finland (Fin), Greece (Gr), Portugal (P) and Ireland (Ire). 'Tiny nations' (0.1–1.0%): Czech Republic (Cz), Hungary (Hu), Slovak Republic (SR), Luxembourg (L), Slovenia (Sl), Lithuania (Lith) and Cyprus (Cyp). 'Minuscule nations' (less than 0.1%): Latvia (Lat), Estonia (Est) and Malta (Mal).

Source: Eurostat website (a great new development – you can download data).

per cent of the EU15's GDP, with Poland alone accounting for about half of this 5 per cent.

2.7 The budget

The EU budget is the source of a great deal of both solidarity and tension among EU members, so a full understanding of the EU requires some knowledge of the budget. This section looks at the following questions in order. What is the money spent on? Where does it come from? Who gets the most on net? What is the budget process?

2.7.1 Expenditure

Total EU spending is now about €100 billion. While this sounds like a lot to most people, it is really fairly small – only about 1 per cent of total EU25 GDP – just €240 per EU citizen. The first priority is to study how this money is spent. We look first at spending by area and then spending by EU member.

Expenditure by area

As with so many things in Europe, understanding EU spending in all its detail would take a lifetime, but understanding the basics takes just a few minutes. Starting at the broadest level, the EU spends its money on:

- ★ agriculture;
- ★ poor regions;
- ★ other things.

Agriculture takes up about half the budget (47 per cent in 2005) and poor regions take about one-third (31 per cent, but one should add the compensation figure and much of the pre-accession aid to this figure). The rest is split among many different uses. Spending on agriculture and poor regions is so important that this book includes separate chapters dealing with each, so we do not go into further detail here (see Chapter 9 on agriculture and Chapter 10 on poor regions). Figure 2.14 shows spending priorities graphically for 2005.

At a slightly finer level of analysis, we break the 'other things' category into four areas:

- ★ *Other internal policies (7 per cent of budget)*. Here 'other' means other than agriculture and poor regions. As the name suggests, this category is very diverse and includes spending on research and development (R&D), on trans-European transport, energy and telecommunications networks, on

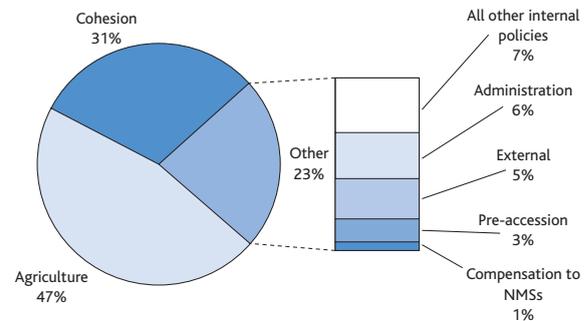


Figure 2.14: The EU's 2003 budget: spending

Note: For details on 'Agriculture' see Chapter 9. 'Cohesion' refers to spending on disadvantaged regions. 'All other internal policies' include R&D, energy and transportation, etc. 'External' refers to spending outside the EU on development aid, etc. 'Pre-accession' is spending on nations that are candidates for members (especially Bulgaria, Romania and Turkey). 'Compensation for NMSs' is money earmarked for the new Member States (NMSs) so that they are not net contributors.

Source: General Budget of the EU for the Financial Year 2005: the figures, European Commission.

training and student mobility, the environment, culture, information and communication, etc.

- ★ *External action (5 per cent of budget)*. This money is spent mainly on humanitarian aid, food aid and development assistance in non-member countries throughout the world. Small amounts are also spent on the Middle East peace process, the reconstruction of Kosovo, the European initiative for democracy and human rights worldwide, international fisheries agreements, and the Common Foreign and Security Policy.
- ★ *Administration (6 per cent of budget)*. This concerns the cost of running the European Commission, the European Court of Justice and all other European institutions. Taken together, they employ surprisingly few people (about 30 000).
- ★ *Pre-accession aid (3 per cent of budget)*. This money goes to modernizing agriculture, establishing transport and environmental structures, and to improving government administrations in nations on the road to membership.

Historical development of EU spending by area

The EU's spending priorities and the level of spending has changed dramatically since its inception in 1958. This is shown graphically in Fig. 2.15.

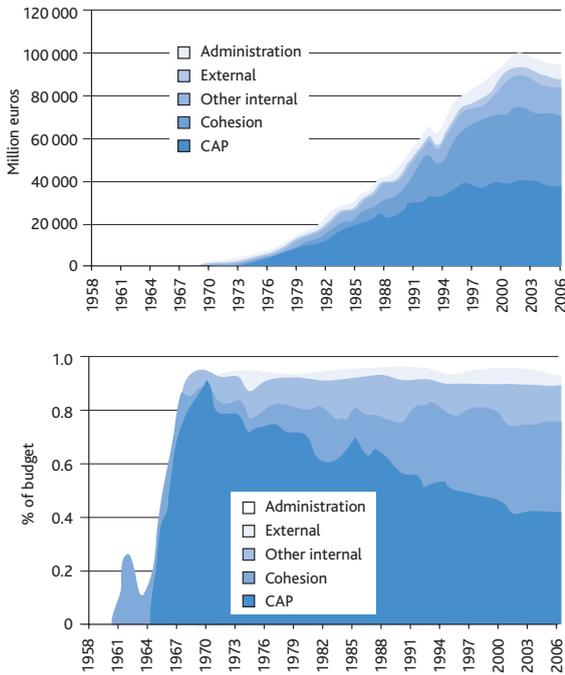


Figure 2.15: *The EU budget spending, 1958–2006*

Source: 1958–99 from *The Community Budget: Facts in Figures*. European Commission, 2000; 2000–06 from the *Financial Perspective 2000–2006*; both downloadable from <http://europa.eu.int.budget>.

As the top panel shows, the budget grew rapidly, but started at a very low level (just 0.08 per cent of the EEC6’s GDP). EU spending was negligible until the late 1960s, amounting to less than €10 per EU citizen. This changed as the cost of the Common Agricultural Policy (CAP) started to rise rapidly in the 1960s and cohesion spending started to rise in the 1980s. From the early 1970s to the early 1990s, the budget grew steadily as a proportion of EU GDP, starting from about 0.8 per cent and rising to 1.2 per cent by 1993. Since the 1994 enlargement, the budget as a share of GDP has remained quite stable at about 1 per cent. (The share of GDP figures are not shown in Fig. 2.15.)

The lower panel of Fig. 2.15 depicts the spending by area in shares to illustrate how the EU’s budget priorities have changed over the past half-century. Until 1965, the budget, tiny as it was, was spent mainly on administration (this was the period when all the European institutions were set up and the customs union was being implemented). CAP spending began in 1965 and soon dominated the budget. For almost a decade, farm spending regularly took 80 per cent or more of

total expenditures; at its peak in 1970, it made up 92 per cent of the budget!

From the date of the first enlargement, 1973, cohesion spending began to grow in importance, pushing down agriculture’s share in the process. Indeed, the sum of the shares of these two big-ticket items has remained remarkably steady, ranging between 80 and 85 per cent of the budget. In a very real sense, we can think of cohesion spending as steadily crowding out CAP spending over the past three decades.

2.7.2 Expenditure by member

By far the most important benefit from EU membership is economic integration. By comparison, the financial transfers involved in EU spending are minor. Remember the whole budget is only about 1 per cent of EU GDP and the net contributions (payments to the EU minus payments from the EU) are never greater than 0.1 per cent. Be this as it may, it is interesting to see which members receive the largest shares of EU spending. As the very public failure of the EU to reach agreement on the next long-term budget in June 2005 shows, money matters.

The amount of EU spending varies quite a lot across members, both in terms of the total amount and its nature, as the left-hand panel of Fig. 2.16 shows. In 2003, Spain was the number one recipient with France close behind. Most of the French receipts came from the CAP, whereas cohesion spending was the most important source for Spain. The post-enlargement figures including the new member states were not available when this book went to press.

The figures, however, are entirely different when we look at receipts per capita (see right-hand panel of the figure). By far the largest receiver per capita is Luxembourg (€2,359 per person) which sounds like a lot, but since incomes are so high in the Grand Duchy – about twice the EU average at over €50 000 per year in 2003 – this EU spending does not have as large an impact as one might think. The Irish are also very large per-capita recipients – about €700 per person – but even this is only one-third of what the lucky Luxembourgers get. The EU average is €216 per person, which means that Finland, France, Spain, Denmark, Portugal, Belgium, Greece, Ireland and Luxembourg are all above-average recipients.

Because the per-capita numbers for Luxembourg are so high (and Luxembourg is the richest member by a long

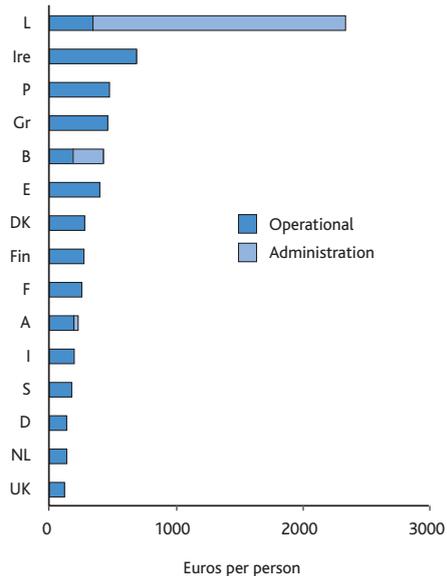
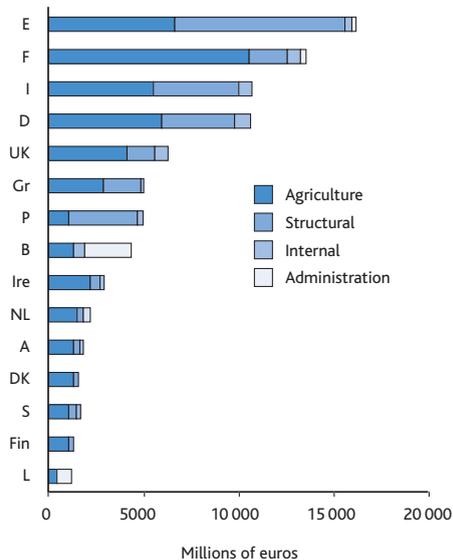


Figure 2.16: The EU spending by member, by type and per capita, 2003

Source: 'Allocation of 2003 EU operating expenditure by Member State', European Commission, downloadable from <http://europa.eu.int>.

way), a political agreement by the European Council directed the European Commission to calculate receipts excluding administrative expenditures. These figures – called 'operational allocated expenditures' – are shown by the dark bars in the right-hand panel of Fig. 2.16.

Readers may find the figures in the right-hand panel rather strange. Why should rich nations like Luxembourg,

Belgium, Denmark, Finland and France be above-average recipients of EU spending? The answer, which lies in the nature of the EU's decision-making process, is pursued in depth in Chapter 3.

2.7.3 Revenue

The EU's budget must, by law, be balanced every year. All of the spending discussed above must be financed each year by revenues collected from EU members or carried over from previous years.

Up to 1970, the EEC's budget was financed by annual contributions from the members. A pair of treaties in the 1970s and a handful of landmark decisions by the European Council established the system we have today in which there are four main sources of revenue (see Box 2.7 for details). According to the EU treaties, the Union is legally entitled to this revenue, so it is known as 'own resources' in EU jargon.

There are four main types of these own resource and Fig. 2.17 shows how their relative importance has varied over the years. Two of the four have long been used, and indeed in the early days of the Union they were sufficient to finance all payments. These 'traditional own resources' are:

- ★ *Tariff revenue stemming from the Common External Tariff.* Although trade within the EU is tariff-free, tariffs are imposed on imports from non-member nations. This money accrues to the EU rather than to any particular member.
- ★ *Agricultural levies.* These are tariffs on agricultural goods that are imported from non-member countries. Conceptually, these are the same as the previous categories (they are both taxes on imports

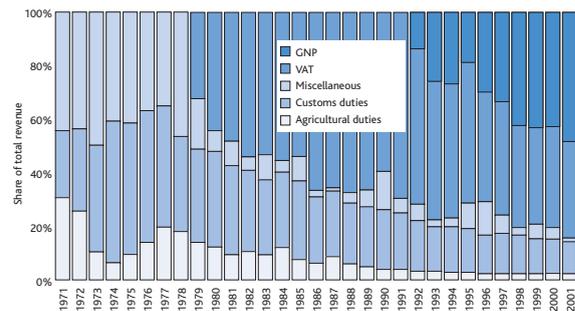


Figure 2.17: Historical sources of EU funding, 1971–2001

Source: *The Community Budget: The Facts in Figures*, European Commission, 2000; downloadable from <http://europa.eu.int/budget/>.

Milestones in the EU budget procedure

1958–70. The EU's budget was financed by contributions from its members.

April 1970. The Luxembourg European Council. The 'own resources' system is introduced. These included customs duties, agricultural levies (i.e. variable tariffs), and a share of VAT revenue collected by EU members. The treaty of July 1975 refined and reinforced the system, establishing the European Court of Auditors to oversee the budget and giving the European Parliament the formal right of rejection over annual budgets.

1975–87. This period was marked by sharp disputes over the budget contributions and ever expanding CAP spending. The UK's Margaret Thatcher in particular complained repeatedly about the UK's position as the largest net contributor.

1984. The Fontainebleau European Council. The VAT-based revenue source was increased and the UK was awarded its famous 'rebate'.

1988. Delors I package. This reform established the basis of the current revenue and spending system. It introduced a fourth 'own resource' based on members' GNPs, established an overall ceiling on EU revenue as a percentage of the EU's GNP, and started reducing the role of VAT-based revenue. The package, decided at the Brussels European Council in June, also

established the EU's multi-year budgeting process whereby a Financial Perspective sets out the evolution of EU spending by broad categories. Substantively, the financial perspective adopted provided for a major reorientation of EU spending from the CAP to cohesion spending; cohesion spending was doubled and CAP spending growth was capped.

1992. Delors II package. The Edinburgh agreement of December 1992 increased the revenue ceiling slightly to 1.27 per cent, further reduced the role of VAT-based revenue. It also adopted a new Financial Perspective for 1993–99 which amplified the shift of EU spending priorities away from the CAP and towards cohesion.

1999. Agenda 2000 package. The Berlin European Council adopted the 2000–06 Financial Perspective. There were no major changes on the revenue side and the only major change on the spending side was the creation of a new broad category, 'pre-accession expenditures', meant to finance programmes in central and eastern European nations and provide a reserve to cover the cost of any enlargements in this period.

Source: The material in this box was drawn from *The Community Budget: The Facts in Figures*, European Commission, 2000. Also see *Financing the EU: Commission Report on the Operation of the Own Resource system*, 1998, especially Annex 1. Both from <http://europa.eu.int/budget/>.

from third nations), but are viewed as distinct since the levies are not formally part of the Common External Tariff. Historically, the level of these tariffs has fluctuated widely according to market conditions (they were part of the CAP's price support mechanism; see Chapter 9).

The importance of these two revenue items has fallen over the years to the point where they are no longer major items (together they make up only one-seventh of the revenue needs). This reduced importance stems from the way that the level of the Common External Tariff has been steadily lowered in the course of World Trade

Organization (WTO) rounds (e.g. the 1986–94 Uruguay Round). Moreover, EU enlargement and the signing of free trade agreements with non-members mean that a very large fraction of EU imports from non-members are duty free. The level of the agricultural levies has also been reduced in the context of CAP reform. The third and fourth types of 'own resources' provide most of the money. They are:

- ★ *VAT resource.* As is often the case when it comes to tax matters, the reality is quite complex, but it is best thought of as a 1 per cent value added tax. The importance of this resource has declined and is set to decline further.

★ *GNP based.* This revenue is a tax based on the GNP of EU members. It is used to top up any revenue shortfall and thus ensures that the EU never runs a deficit.

The other revenue sources – labelled ‘miscellaneous’ in Fig. 2.17 – have been relatively unimportant since 1977. They include items such as taxes paid by employees of European institutions (they do not pay national taxes), fines, and surpluses carried over from previous years. Until the 1970s’ budget treaties came fully into effect, ‘miscellaneous’ revenue included direct member contributions, which were a crucial source of funding in the early years.

Budget contribution by member

On the contribution side, EU funding amounts to basically 1 per cent of each member’s GDP. Some observers find this anomalous since taxation in most nations, especially in Europe, is progressive, i.e. the tax rate that an individual pays rises with his or her income level.

The precise figures are shown in Fig. 2.18. Here we see that the contributions as a share of GDP do not vary

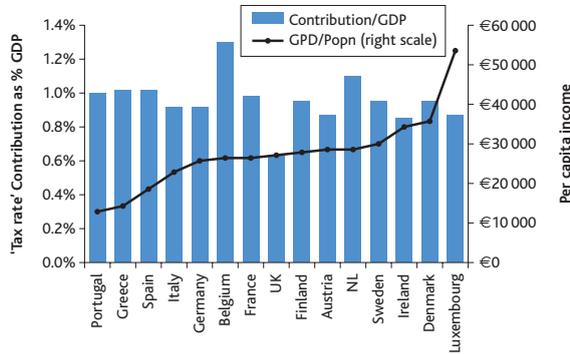


Figure 2.18: Contribution versus GDP by EU members, 2003

Notes: (1) The contributions are net of the UK rebate and include the Netherlands’ usually large payment of tariffs (Rotterdam is the port of entry for non-EU imports for many EU members, so the Common External Tariff is often paid to the Dutch government even when the goods are headed for, say, Germany).

(2) Some budget items, such as reserves held over from previous years, cannot be allocated by member, so the total of contributions from members is less than the total budget.

Source: ‘Allocation of 2003 EU operating expenditure by Member State’, European Commission; downloadable from <http://europa.eu.int>.

much from the median figure of 0.9 per cent. The highest figure in 1999 was 0.99 per cent (for Greece and Ireland). The lowest figure was the UK’s 0.61 per cent due to the UK rebate (see below for more on the rebate). The precise contribution rate varies from year to year by Member State owing to the complexities of the system.

For comparison, the nations are ordered by increasing income (the line in the figure shows the national GDP per capita). The income figures here are not corrected for prices, so the per-capita GDP figures are not measures of material standards of living. For example, the prices of many goods and especially services are systematically higher in, say, Denmark than they are in Portugal. Because of this, the figures overstate the purchasing power of Danes versus Portuguese. This is intentional. When nations set tax rates they do not adjust for price differences. For example, despite the fact that living in a city is systematically more expensive than living in the countryside, national income tax rates are based on income per capita, or income per family without price adjustments. What the line shows is that there is basically no correlation between national income levels and the national ‘tax rates’, i.e. the contribution as a share of GDP.

Figures for the new members are unavailable at the time of going to press; 2003 was the most recent year available.

2.7.4 Net contribution by member

Putting together the receipts by member and the contributions by member allows us to show the net financial contributions in Fig. 2.19. Seven of the EU15 are net contributors (they pay more to the budget than they receive from it), with Germany being by far the largest. Indeed, in 1999, Germany’s net contribution was larger than that of all the other net contributors put together. Other net contributors are the UK, the Netherlands, Sweden, Austria, Italy (in 1999, but not in 2000) and Finland. The net recipients, those with negative net contributions, are led by Spain, Greece and Portugal, followed by Belgium, Luxembourg, France and Denmark.

Note that the net transfers are much smaller than the overall budget. In other words, most of the EU budget can be thought of as staying inside each nation. France paid €12.5 billion to the budget and received €13.1 billion from it in 1999, so we can think of the French government as spending €12.5 billion on EU programmes that directly benefit its own citizens with Brussels sending only €0.6 billion to Paris to add to this.

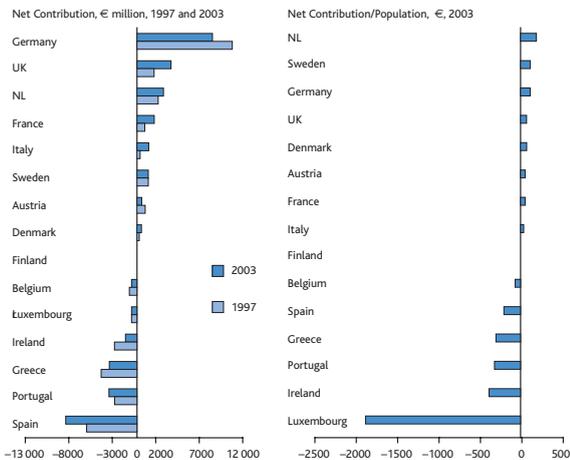


Figure 2.19: Net financial contribution by EU members

Source: European Commission for budget data and Eurostat for population data.

Even for the biggest contributor, Germany, most of its payment can be thought of as being spent on Germans. Of the €18.9 billion that the German government gave to Brussels, €10 billion was spent on Germans.

The UK rebate

The basics of the EU spending and contributions were set in 1970, prior to the UK's entry. When the UK joined in 1973 it faced a situation in which it funded a disproportionate share of the EU budget while receiving a less than proportionate share of EU spending. The UK's agricultural situation was the cause of both imbalances. The British agricultural sector was a relatively small share of its economy compared with the agricultural sectors of other members, so the UK got little of the EU's spending on agriculture (which accounted for three-quarters of the budget at the time). The UK also imported a larger share of its food from non-member nations. Since the import taxes charged on such imports are turned over to the EU budget, the UK faced a situation where it was a large net contributor to the budget.

According to some, the 1970 funding system was intentionally aimed at disfavoursing the UK once it entered (the UK's application was first made in 1961 and renewed in 1967). For example, Peet and Ussher (1999) state: 'To an extent the original Own Resources Decision, adopted before Britain joined, was deliberately skewed to Britain's disadvantage.' The budgetary imbalance worsened as CAP spending continued to rise and when a new source of EU funding was added in 1979 – the levy on value added tax (VAT) income.

After years of dispute and complaints from the UK over this imbalance, EU leaders decided at their June 1984 meeting in Fontainebleau to give the UK back part of its contribution. The basic principle was that the UK should be rebated around two-thirds of its net contribution. The EU treats the UK rebates as a negative contribution even though one can think of the UK rebate as EU spending (Mrs Thatcher, being a hard core conservative, preferred a tax cut to a spending increase). Consequently, the agreed formula explicitly allocates the cost of this rebate among the other EU members, making the UK rebate a continual source of contention. This is unusual since, for example, Spain is a big recipient of cohesion spending, but it is not obvious which other members are paying for it. The process that led up to the UK 'rebate debate' is cloaked in folklore and usually described in colourful terms – see Box 2.8.

2.7.5 Budget process

The EU's annual budget is guided primarily by a medium-term agreement on spending priorities, called Financial Perspectives. The current Financial Perspective sets out broad spending guidelines for the annual budgets from 2000 to 2006. Since the Financial Perspective is adopted by all the institutions involved in budgeting (the Commission, the European Parliament and the Council), its existence reduces dispute over each annual budget.

The procedure for drawing up the annual budget (as laid down in the treaties) calls for the Commission to prepare a preliminary draft budget. The Commission's draft is presented to the Council for amendments and adoption. Once it has passed the Council, the budget goes to the European Parliament which has some power to amend it. According to the treaties, the Parliament cannot touch 'compulsory' expenditures (basically agriculture spending), which account for about 40 per cent of the budget, but it can amend the rest. After two readings in the Council and the Parliament, it is the European Parliament which adopts the final budget, and its President who signs it. This formal procedure has been augmented by inter-institutional arrangements between the Parliament, the Council and the Commission that are meant to improve cooperation. For more information see 'The budget of the EU: How is your money spent?' at <http://europa.eu.int>.

The 2007–13 Financial Perspective

At the time this book edition went to press, the European Council was still arguing over the next seven-year budget plan. The failure to agree this plan at the June 2005 summit was viewed by some as a tremendous failure. However, the

Box 2.8

Lady Thatcher's 'hand bagging' and the UK rebate

The British perspective on the budget is succinctly put by Peet and Ussher (1999): 'The European budgetary picture after 1973 was simple enough: the Germans and British would pay, but everybody else would benefit. Thanks partly to residual war-guilt, and also to their relative wealth, the Germans were prepared to live with this. But Britain, relatively low down Europe's prosperity league, was never likely to.' The UK government that negotiated membership in 1971, and the one that renegotiated it in 1973, worried about Britain's position as EU paymaster but did little to redress it. For a while, the net contribution was limited by annual adjustments, but such an approach was unsatisfactory to the new government of Margaret Thatcher.

As Peet and Ussher describe it: 'Her performance at the Dublin summit in December 1979 has become legendary. The patrician Valéry Giscard d'Estaing and the haughty Helmut Schmidt were horrified by her vulgar insistence on getting "my money back". But as she continued to bang the table at subsequent

summits, they and their successors were forced to offer a British rebate: first of all a series of cash sums, but by 1984 a permanent mechanism known as an abatement, which reimbursed 66 per cent of the difference between the British contribution to VAT-based revenue and the amount of EU expenditure in the UK.'

Newspapers described the event in more flamboyant terms, asserting that the rebate was won through Thatcher's handbag diplomacy. 'The former British prime minister, now Lady Thatcher, is remembered for slamming her handbag on the table and yelling at the other leaders, "I want my money!"' (Barry James, *International Herald Tribune*, 8 October 1998).

The exact procedure for calculating the rebate is complex and results in a fairly wide fluctuation in the UK's net contribution.

For more information see Annex 4 of reports_en.htm at <http://europa.eu.int/comm/budget/agenda2000/>.

current seven-year plan was signed just months before it came into effect (in May 1999, taking effect in January 2000). The current plan expires in December 2006, so if a new plan is decided, then early 2006 is the most likely date. Importantly, the 2000–06 plan contains a fallback option. If a new seven-year plan cannot be agreed, the current agreement states that the current spending framework is to be extended mechanically.

2.8 The Constitutional Treaty

The Constitutional Treaty, formally the Treaty establishing a Constitution for Europe, was signed by EU leaders in Rome on 29 October 2004. The Constitution takes effect only if it is ratified by all EU members. French and Dutch voters rejected it in mid-2005 (see Chapter 1), so it seems unlikely that the Treaty will take effect in coming years, if ever.

This section reviews the main changes implied by the Constitution. The changes are important even if the Treaty is abandoned. Many of the changes, especially those reflecting the desire to 'bring the EU closer to the people', can be implemented without a new treaty and so probably will be put into place in coming years. Others represent changes that are absolutely necessary, for example reforming the Council's voting rules; these are likely to be enacted in the future, somehow or other.

2.8.1 Basic constraints

The Constitutional Treaty is an awkward document – 350 pages of legalese and intricate cross references to articles that cross-reference other articles.³ It fails almost

³ Serious students of European integration should at least skim the Constitutional Treaty; see the Commission's excellent site http://europa.eu.int/scadplus/constitution/index_en.htm for the full text and extensive commentary and perspective.

completely in its assigned task of simplification. It is probably fair to say that most law professors, even those specializing in European law, do not really understand the Treaty as a whole or its full implications for Europe.

This outcome, however unfortunate, was unavoidable. The EU cannot have a constitution that looks like a constitution in the traditional sense of the word, i.e. a succinct statement of goals and a description of the allocation of power among decision-making institutions amounting to less than, say, 20 pages. The problem turns on legal logic. A constitution in the standard sense of the word would create a new level of European law. The existing treaties are now the highest level of law, with directives and the like forming secondary law. The new top level of law would pose a threat to legal certainty throughout the EU legal system since one could never be sure when a judicial interpretation of ambiguities between the Constitution and other treaties might alter existing law. The Conventioners realized this almost immediately. A real constitution, they concluded, 'might well prove a permanent source of conflict' (CONV 250/02, quoted in Norman, 2005, p. 64).

In short, legal logic tells us that a constitution is the easiest way to arrange the affairs of an organization like the EU, but such a constitution would have had to have been written at the beginning. Legal logic tells us that writing a constitution (in the standard meaning of the word) is basically impossible for an organization that has been making laws for fifty years without one.

This is why the Constitutional Treaty had to be so long, so complex and so legalist. It had to include every existing treaty, protocol and annex so as to keep all the 'primary law' at the same level. By one estimate, only about one-fifth of the Constitution contains new or substantially amended articles.⁴ This is also why it had to repeal all the existing treaties.

2.8.2 Basic structure of the Constitution

The Constitution begins with a short preamble. The real substance is contained in four parts. These parts are divided into titles which are divided into chapters which are divided into sections and finally into individual

⁴ 'Guide to the New Constitutional Treaty', The Federal Trust for education and research, a 60-year-old British think-tank that 'studies the interactions between regional, national, European and global levels of government'. Much of the section is based on this article.

⁵ These mean the EU should act only to the extent that action by individual members is insufficient to accomplish the goal at hand; see Chapter 3.

articles. Articles are numbered consecutively, 1 to 448, but are usually preceded by the part number. For example, Article II-104, which gives EU citizens the right to petition the European Parliament, can be found in Part II.

The four Parts are outlined below.

Part I: Principles

This is the key part of the Treaty, the part that all students should read. It is a statement of the principles on which the EU's legal and political order is based. Its titles:

- ★ define the goals of the Union;
- ★ define fundamental rights and citizenship of the Union;
- ★ list the areas in which Member States have fully or partially transferred sovereignty to the EU (areas of 'exclusive' or 'shared' competences in EU jargon), and sets out the principles of subsidiarity and proportionality;⁵
- ★ explains the EU's institutions, their powers and interrelationships;
- ★ details the EU's legal instruments and the procedures for adopting them (this basically codifies existing procedures, but reduces the number of instruments).

Part II: Charter of Fundamental Rights

Part II contains the Charter of Fundamental Rights of the Union. This was agreed in the Treaty of Nice, but the Constitution makes it binding on all members. Part II also contains guarantees that the Charter applies only to the institutions and to the Member States when they are implementing EU law. It states explicitly that the Charter does not transfer new powers to the European Union. This messy political compromise helped to overcome the UK government's objections to making the Charter legally binding.

Part III: Policies and Decision-Making Details

Part III is the longest, and the hardest to read. It incorporates most of the Rome and Maastricht Treaty articles as modified by subsequent treaties. Particularly important is Article II-396 since this sets out the 'Ordinary Legislative Procedure', i.e. the standard way of making new laws, which, roughly speaking, is the same as the existing codecision procedure.

Part IV: General and Final Provisions

Part IV defines the procedures for ratification and amendment of the Constitution. One innovation is that it foresees future treaty reforms as starting with a

convention, but ending, as before, with an intergovernmental conference (IGC).

The Constitution ends with a Final Act that gives an overview of the protocols and declarations. Protocols have the same legal status as main Treaty articles, but declarations have no legal value apart from facilitating future interpretations of articles and protocols.

2.8.3 Institutional changes

The Constitution is the third 'scene' in the EU's institutional reform 'play' (Amsterdam and Nice were scenes one and two). It contains important but not radical changes for the Big-5 institutions. The largest changes by far are for the Commission.

Commission

Fierce debate surrounded the Commission reform proposals. Almost everyone realized that a Commission with too many members would be ineffective, but who should sacrifice the right to have a Commissioner? Small members – who view the Commission as an important protector of their rights – felt a Commissioner was critical. Given the skewed size distribution of EU members (see section 2.6), large members felt it essential that there be a Commissioner from each of the six big members who together account for three-quarters of the EU's population.

The compromise was to stick with the Nice Treaty's one-per-member up to 2014, after which the number is capped at two-thirds the number of EU members, with Commissioners rotating equally among Member States. The rotation system is not specified and it might never occur, even if the Constitution takes effect. By 2014, the Commission would have had almost a decade of working with 25-plus members. Critically, the Constitution grants the European Council the power to change the number of Commissioners with a unanimous vote (i.e. without a new treaty), so the Council might well decide to stick with the one-per-member rule.

Council of Ministers

Little change here in terms of organization, except that some Council meetings will be held in public. This is one of the many public relations (PR) changes in the Constitution. The Council, of course, could decide to meet in public with or without a Treaty change, but bundling such 'openness' and 'closer to the people' changes with the changes that really do require a Treaty change was viewed as good PR – a way of showing that

the Constitutional Treaty was meant to bring the EU closer to the people.

The big changes are in the Council's voting rules and in the creation of the European Minister for Foreign Affairs.

Voting

From 2009, the Council has a new majority voting rule, a so-called double majority rule where approval requires a 'yes' vote from members representing at least 65 per cent of the EU's population and at least 55 per cent of Member States. This is widely viewed as essential to guarding the EU's ability to act (see Chapter 3).

This was the most fiercely contested issue in the IGC – the issue over which Spain and Poland vetoed the Italian presidency's draft of the Constitutional Treaty in December 2003 (see Chapter 1). The Constitution's voting rules change the power of various Member States as given by the Nice Treaty rules. For example, they substantially raise Germany's power and substantially lower that of Poland and Spain (see Chapter 3). The compromise was to stick with the Treaty of Nice rules until 2009.

European Minister for Foreign Affairs

One of the most important institutional innovations is the creation of a Minister for Foreign Affairs for the EU. This would almost surely boost the EU's role in world affairs. The new Foreign Minister would conduct Common Foreign and Security Policy (CFSP, i.e. the old third pillar), including European Security and Defence Policy (ESDP). The new minister would represent the EU on CFSP issues, conduct political dialogue with third nations, and express the EU's position in international organizations and at international conferences. This would be an extremely high-profile position – at least as prominent (if not as powerful) as the President of the European Commission, European Parliament and European Council.

Currently, responsibility for the CFSP is split between the High Representative for the CFSP (Javier Solana) who sits with the Council of Ministers, and the European Commission's External Relations Commissioner. Neither currently has much power and each plays, at best, a coordinating function. The new position merges the two posts (so the EU Foreign Minister would sit on both the Council and the Commission). Importantly, the new minister would have the power of initiative in the Council. The Council would still act on a basis of unanimity on most critical CFSP issues – especially military and defence matters – so the Member States

remain firmly in charge. But the power of initiative can matter a great deal. Many initiatives are suppressed by backdoor pressure from reluctant Member States who do not want to say no in public.

European Council

The Constitution makes only one big change here. Up to now, European Council meetings were chaired by the nation holding the EU presidency, which rotates every six months. The Constitution creates a new post, European Council President, to boost stability and coherence of the European Council's work. The President will be elected by members of the European Council for a two and a half year term, renewable once. The election is decided on the basis of qualified majority voting. Again, this post has little direct power since the European Council must approve issues unanimously (by 'consensus'), but the President's 'agenda-setting' power could prove to be important (see Chapter 3). The chair of the Council of Ministers, by contrast, continues to rotate. Since nothing the European Council decides can come into law without passing through the Council of Ministers, rotation of the Council of Ministers' chair dampens the power of the President of the European Council.

European Parliament

The Constitution implies few changes here. The Parliament's powers of EU legislation have been incrementally boosted by every treaty since the Single European Act 1986, and the Constitutional Treaty is no exception. The Parliament gets an equal say in a few more areas, most notably on the annual budget (up to now, the Parliament could not vote on CAP spending since Member States feared that the Parliament would cut or redirect the monies). Also, the number of Members of European Parliament (MEPs) is capped at 750. The allocation of these among members is to be decided before the standing Parliament's term ends in 2008.

European Court

There are no major organizational changes for the Court. However, since the Constitution eliminates the three-pillar structure of the EU, the Constitution substantially widens the range of issues on which the Court should ensure that the law is observed. Article III-376 explicitly says the Court has no jurisdiction over Common Foreign and Security Policy. Such explicit exclusions, however, were not provided for either second-pillar issues or the Social Charter.

Role of national parliaments

One of the closer-to-the-people elements of the

Constitutional Treaty is a commitment by the Commission to send all legislative proposals to the national parliaments who can, in turn, complain to the European Parliament, Council and Commission if they feel the proposal violates the principle of subsidiarity. If one-third of the national parliaments share this belief, the Commission would have to review its proposal.

This is another of the public relations changes made by the Treaty. Currently, the Commission consults with all Member States before making a proposal (after all, the Member States will have to vote on it in the Council), and the Member State governments almost always have a majority in their national parliaments. Thus the fact that the proposal would be formally sent to national parliaments changes little. In fact, the proposal can be downloaded from the web even now. Moreover, the objections of national parliaments have no real legal force under the Constitution. The Commission is supposed only to 'review' its proposal. This is one of the first changes likely to be implemented even without the Constitution.

2.8.4 Legislative processes

The changes in the legislative processes are mainly cosmetic. The Constitution relabels what is the codecision procedure into the 'Ordinary Legislative Procedure'. It eliminates a number of minor legislative procedures that are holdovers from the increasing powers of the European Parliament (Member States have sought to limit that Parliament's power by creating special procedures on sensitive issues). This would make it a little easier to understand the EU, but will change little in practice.

The one big change concerns a new process of modifying the Constitution itself. EU leaders understood that negotiating and ratifying new treaties in a Union of 25-plus members would be extremely difficult. This would have had the effect of slowing, or stopping, the broadening of EU powers to new areas, such as social policy and foreign policy. To avoid this, the Constitution contains 'passerelle' clauses that allow the European Council to change its own decision-making rule from unanimity to the Ordinary Legislative Procedure.⁶ (More on this below.)

⁶ 'Passerelle' is often translated as 'bridge' in English, but it would be better described as an 'overpass', like the aerial walkway between two buildings, since the provision allows EU leaders to avoid the 'busy traffic' of negotiating, signing and ratifying a new treaty.

2.8.5 EU law

The Constitution implies few changes in EU law; however, it codifies existing principles, such as direct effect, primacy and autonomy (see section 2.3).

2.8.6 Motivations and uncertainty

How did the EU Constitution come about? EU leaders never directly asked the Convention to write a constitution: not in the Nice Declaration that set the stage for a new treaty, nor in the Laeken Declaration that set up the Convention, nor in any of the half dozen Conclusions of the Presidency which discussed the Convention's progress. This was due to disagreement among EU members themselves.

The 'federalists' among EU members, such as Belgium and Germany, thought a constitution was a natural destination for the long road to building an ever closer union among the peoples of Europe. More importantly, they felt it was critical to maintaining momentum towards deeper integration in a grouping of more than 25 extremely diverse nations. The 'intergovernmentalists', such as the UK and Denmark, felt that a constitution would be a step too far. The full answer must wait the judgement of history, but the most likely answer is contained in the title of one of the first books on the Constitution, *The Accidental Constitution* by Peter Norman, a journalist for the *Financial Times*. Somehow the Constitution got started, and from then on opposing it was a sure way of reducing a nation's influence over the final document, so everyone supported it.

Given this lack of consensus on the need for a constitution, there was never a clear mandate for what the constitution should accomplish. The result was a lack of major, bold initiatives and an abundance of subtle changes that might or might not have far-reaching effects. This uncertainty allowed the highly federalist former Belgian Prime Minister to declare in June 2004 that 'This constitution marks the passage of the European Union from socio-economic Europe under Maastricht to a more political Europe which will need to be further fleshed out in the years ahead. This is a step along the road.' While British Prime Minister Tony Blair told the House of Commons that the Constitution put clear limits on the degree to which further British sovereignty could be transferred to the EU, and Irish Prime Minister Bertie Ahern said: 'It is not a super state; it's not a federal state. It's about a group of nations, a group of peoples working to a Constitution.'

The subtle, unpredictable changes fall into two categories, the EU's power to extend its own powers, and extension of the EU Court's jurisdiction to new issues.

The power to extend its EU powers: the passerelle and flexibility clauses

The Constitution has two novel provisions that make it possible to broaden EU supranationality without subjecting the changes to national referenda or national parliamentary ratification procedures. First, the passerelle clause (Article 444) would grant the European Council the power to change the law-making procedure from unanimity (intergovernmental) to majority voting (supranational) in many policy areas. Doing this would require unanimous agreement of the European Council. The Constitution also allows any national parliament to veto the switch, and the European Parliament must also approve. However, the leaders on the European Council include all the leaders of national parliaments, and the European Parliament gains power under majority voting, so two additional conditions are unlikely to act as constraints.

For example, under both the current treaties and the Constitutional Treaty, EU laws on corporate taxation must be decided by unanimous vote in the Council of Ministers. Under current practices, this could be changed only with a new treaty that would have to be ratified by all members. Under the Constitution, a unanimous vote by the European Council can change this, making all future laws on corporate taxation subject to majority voting (Ordinary Legislative Procedure). A key effect of these provisions would be to avoid national referenda on initiatives that extend EU supranationality to new areas. Note that the passerelles are one-way; they do not allow EU leaders to switch a policy area from majority voting to unanimity, so they can only deepen EU integration.

This is one of the main reasons why proponents of an ever deeper EU (the German government and the European Commission, for example) are strongly in favour of the Constitution. It is also why opponents of an ever deeper EU (the *Economist* magazine and UK Conservatives, for example) are strongly against it.

The flexibility clause is the second provision. Article I-18 grants the EU the authority to give itself the power necessary to attain its objectives, even if that power is not granted by the Constitution. This clause exists in the Treaty of Rome and was the source of 'creeping

competence' and the main reason the Maastricht Treaty set up the pillar structure. However, under the current system, the pillars limit the flexibility clause to first-pillar issues (basically economic integration). The Constitution would apply to every area mentioned in the Constitution, except those where it is explicitly excluded, notably defence policy and the Charter of Fundamental Rights.

In truth, no one can know what the full implications of the passerelle and flexibility clauses would be. Europhiles have faith that the new powers would be used wisely. Euro-sceptics fear that they would be abused by out-of-touch elites to force through more integration than many EU citizens want.

Extension of the EU Court's jurisdiction

The removal of the pillars and the formal inclusion of the European Council in the EU's institutional framework might or might not have important effects. The crux of the matter is that the Constitution, like any political document, is filled with messy political compromises, but the Court works on the basis of legal logic. More than once in the EU's history, the Court's application of logic has had unforeseen consequences (classic examples of this are the *Costa v ENEL* and *Cassis de Dijon* cases).⁷

The Constitution states that the EU Court 'shall ensure that in the interpretation and application of the

⁷ One of many hypotheticals runs as follows. The fact that it is called a Constitution and explicitly includes the primacy principle, might, logically speaking, make the EU Constitution supreme to national constitutions. While such a conclusion is far-fetched, it is not be extremely far from the reasoning the Court used in *Costa v ENEL* to establish primacy. The Court will eventually have to decide cases where the issue is a conflict between a Member State's constitution and the EU Constitution.

Constitution the law is observed'. Without the pillars explicitly limiting the Court's jurisdiction, the Court gains power over every aspect of EU activity except those where it is explicitly denied, such as the Common Foreign and Security Policy (Article III-376). No one can know what the effect of this will be, especially in the area of social policy.

There are many potential conflicts between the Charter and EU members' social policy laws since the Charter views some workplace issues as fundamental rights. For example, 'protection in the event of unjustified dismissal' (Article II-90) and 'fair and just working conditions' (Article II-91) are framed as fundamental rights. The Constitution says the Charter should not be used to create new laws, but the Court is charged with enforcing the law. What would the Court rule if a British worker complains that some UK law violates her right to working conditions with respect to her health, safety and dignity (Article II-91)? No one can know how the contradictions between the Charter and EU members' national laws would be resolved, but case law could, over time, lead to a significant expansion of EU control of the labour and welfare policies of EU members.

Moreover, the fact that the Constitution makes the European Council an EU institution may give the EU Court some power over the European Council. Currently, the European Council is in essence a voluntary gathering of political leaders that is not directly linked to the EU in the strictest legal sense. This is one of the many ambiguities in the Constitution that would have to be sorted out over time. The EU Court, of course, would be the ultimate arbitrator of such ambiguities, and reversing a Court decision would require a Treaty change.

2.9 Summary

This chapter covered seven very different topics.

Economic integration

The economic integration in the EU was designed to create a unified economic area in which firms and consumers located anywhere in the area would have equal opportunities to sell or buy goods throughout the area, and where, owners of labour and capital should be free to employ their resources in any economic activity anywhere in the area. This is implemented via the 'four freedoms': the free movements of goods, services, people and capital.

EU organization

The EU is organized into three pillars. The first pillar (relating to supranational decision-making and the authority of supranational institutions such as the Commission and EU Court) encompasses economic integration. The other pillars include areas where EU integration proceeds on an intergovernmental basis. The second and third pillars encompass Home and Judicial Affairs, and the Common Foreign and Security Policy respectively. Formally, the European Union is the 'roof' covering the three pillars and the European Community (EC) is the first pillar.

Law

The EU is unique in that it has a supranational system of law. That is, on matters pertaining to the European Community, EU law and the EU Court take precedence over Member States' laws and courts. The key principles covered were direct effect, primacy and autonomy.

Institutions and legislative procedures

While there are many EU institutions, only five really matter for most things. These are the European Council, the Council of Ministers, the Commission, the Parliament and the Court. These five institutions work in concert to govern the EU and to pursue deeper and wider European economic integration. Under the main legislative procedure, the 'codecision procedure', the Commission proposes draft laws which have to be approved by the Council of Ministers and the European Parliament before taking effect. Most EU legislation has to be turned into national law by each Member State's parliament.

Facts

A dominant feature of the EU members is their diversity in size and income levels.

Budget

The EU budget is rather small, representing only 1 per cent of the EU's GDP. It is spent mainly on a set of agricultural programmes known as the Common Agricultural Policy (roughly half the budget), and on cohesion (resources destined for poor regions in the EU – roughly a third of the budget). The budget is funded through four complicated mechanisms but the result is that each EU member pays roughly 1 per cent of its GDP to the Commission, regardless of its income level. The distribution of net contributions (receipts minus contributions) by Member States is quite unequal. The biggest net recipients are Luxembourg (the richest member) and the three poorest members (Greece, Portugal and Spain).

Constitutional Treaty

The Constitution is unlikely to come into force in the near future, but a number of its elements are likely to be implemented since many of the changes do not require a Treaty change and others are essential. The Constitution does not include any major increases in integration and its institutional reforms are modest, the main ones being the creation of the EU Foreign Minister, changes in the Council of Ministers' voting rules, and abandonment of the principle that each member should have a European Commissioner. The most significant changes are the elimination of the three pillars and inclusion of new, easier ways of modifying the Constitution in the future.

Self-assessment questions

1. Draw a diagram that summarizes the connections between the Council of Ministers, the European Commission and the European Parliament when it comes to passing laws. Use the example of the codecision procedure.
2. Draw a schematic representation of the steady deepening of EU economic integration.
3. Draw a diagram that shows the main steps (and dates) in the development of the Big-5 EU institutions. (Hint: You may have to turn to the websites referred to in the text to find the dates.)
4. Develop an easy way of remembering the names of all of the EU15 members (e.g. there are 4 big ones, 4 small ones, 4 poor ones and 3 new ones). Do the same for the 10 newcomers who joined in 2004.
5. Explain in 25 words or less the difference between EC law and EU law.
6. List the main sources of EU revenue and the main spending priorities. Explain how each of these has developed over time
7. Explain why it is important that EU Court rulings cannot be appealed in Member States' courts.
8. Make a table of the major changes to each of the Big-5 institutions implied by the Constitutional Treaty. (Use http://europa.eu.int/scadplus/constitution/index_en.htm to get more details than are provided in the text.)

Essay Questions

1. The general term for the way in which the EU institutions interact is the 'Community Method'. Describe what this is and how it has evolved over time.
2. Analyse the reasons why the harmonization of corporate income taxes have not been part of EU integration effects.
3. Describe the historical origins of the European Council and how its role has evolved over time. Be sure to cover the way it is addressed in the draft Constitutional Treaty.
4. The European Parliament has progressively gained strength since the EU's inception. Describe this process and explain the forces driving it forward.
5. Compare the powers of the European Parliament with those of the parliament in your nation.
6. If the EU Court decides on a matter, is there any way that EU leaders can overrule that decision?
7. Find where the key elements of EU law discussed in this chapter are transcribed into the draft Constitutional Treaty. Do you think it is a good idea to have these principles in the Constitution?
8. Download the publication *The Community Budget: The Facts in Figures* (European Commission, 2000), and illustrate the evolution of receipts and payments of your favourite EU member in recent years.
9. Ireland is the only EU member that is a large recipient of both CAP spending and cohesion spending. Did Ireland gain or lose from the shift in EU spending priorities that have, since 1986, reduced the CAP's budget share at the expense of cohesion's share?
10. Compare and contrast the reasons behind the French and Dutch 'no' votes on the Constitutional Treaty.
11. Is the Constitutional Treaty a 'treaty' or a 'constitution'?
12. Did the EU have a constitution before the Constitutional Treaty in the same sense that Britain has a constitution?
13. Write an essay on the main institutional reforms undertaken to prepare the EU for eastern enlargement.

Further reading: the aficionado's corner

For more economic statistics on Europe see the most recent issue of the *Eurostat Yearbook*. This is well organized and provides directly comparable figures for all EU members. Eurostat, which used to charge for data, now allows free downloads of most data series. Much of the same information can be had for free in the Statistical Appendix of the Commission publication *European Economy* (see <http://europa.eu.int/>). The OECD also provides an excellent statistical overview in its 'OECD in figures'. You can download the latest issue for free from www.oecd.org.

On EU law, an excellent source is *The ABC of Community Law* by Borchardt. This web-book can be freely downloaded from <http://europa.eu.int/eur-lex/en/about/abc/>.

Comprehensive information on EU institutions and legislative processes are provided by Hix (1999) and Peterson and Shackleton (2002).

Good sources for further information on the budget are Peet and Ussher (1999) as well as the Commission publication 'The budget of the EU: How is your money spent?'. Downloadable from <http://europa.eu.int/budget/>.

On the process leading to the Constitutional Treaty, see Peter Norman's *The Accidental Constitution* (EuroComment, Brussels, 2005).

Useful websites

The European Parliament's factsheets provide excellent, authoritative and succinct coverage of EU law, institutions, decision-making procedures and the budget process. These pages are especial useful in that they provide brief accounts of the historical development of

various institutional aspects of the EU. See http://www.europarl.eu.int/factsheets/default_en.htm.

The most exhaustive source for information on EU law is the Commission's excellent website at <http://europa.eu.int/scadplus/>.

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