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Economic Challenges Ahead of the European Union — An Overview

By Fritz Franzmeyer

Summary

This article deals with the most recent developments, open questions and policy options in the top-priority fields of EU economic integration. The top issues are (1) Monetary Union (EMU), (2) coping with unemployment, (3) restructuring the Community's financial system, (4) reforming the Common Agricultural Policy and the Structural Funds, and (5) Eastern enlargement. EMU will come and a strict stability orientation will be ensured, but it will bring about questions of legal as well as economic and political relation between the "ins" and the "outs". The Union has no major tools to affect directly the labour market, but can (in the future) exert much indirect influence on employment via macroeconomic policy and policy coordination. Financial resources will be scarce in the next decade and the Member States will supplement these funds by increased contributions instead of a Union's tax. Internal policy reforms that lead to budgetary expenditure reductions need to be implemented even without Eastern enlargement, but the latter will benefit from such reforms. The outcome of the "Maastricht-II" IGC in terms of effectual decision making may turn out to be poor forcing the EU to change towards a "variable geometry".

1. The agenda

In hardly any former phase of the European integration process have there been so many large-scale problems to be solved in quick succession than in the four or five years to come. This is all the more true if the political, economic, financial and institutional problems are taken together. This article concentrates only on the economic and financial issues, leaving such important topics as reforming decision-making, extending EU rules to external policy and completing the "freedom of mobility for persons" out of consideration. Among the urgent economic issues those are not made a subject of this overview which are no longer heavily debated. This is, above all, the case with the Single Market. In sections 2 to 5 of this article, the most recent developments, the open questions and policy options in the top-priority fields enlisted below will be discussed. Special attention is given to the German debate. In section 6, some conclusions with regard to the overall direction of European integration will be drawn.

The main issues in the economic and financial field are:

- entrance into European Monetary Union (EMU) and successfully mastering its delicate first phase by those Member States who satisfy the strainful convergence criteria, and creation of monetary rules vis-à-vis the rest of the Member States;

- coping with growing unemployment by way of creating Common responsibilities and launching Common initiatives based on the ideas laid down in the Commission's White Paper on Growth, Competitiveness and Employment;
- restructuring the Community's financial system including the role of "own sources", the distribution of national contributions and the medium-term development and structure of expenditures;
- definition and promotion of corresponding internal reforms in policy areas with a heavy financial impact — especially the Common Agricultural Policy (CAP) and the Structural Funds — given foreseeable constraints on the one hand and additional pressure for action on the other;
- enlargement by those countries in Central and Eastern Europe (CEECs) most successfully mastering transformation and most urgently pushing towards full membership.

2. Economic and Monetary Union

EMU which had been prepared on the basis of recommendations elaborated by a special committee under the presidency of Jacques Delors, became the key issue of the

Maastricht Treaty. The Single Market '92 would be "coronated" by means of a centralized monetary policy making use of a single currency and executed by the European Central Bank System (ECBS) which would have a strong statutory commitment to price stability. Transaction costs shall be further reduced. Absence of exchange rate risk vis-à-vis the partner countries is supposed to stimulate investment and growth. It is also argued, that EMU stimulates "innovative solutions"¹ for internal economic problems (as compared to defensive solutions like devaluation).

Monetary Union is planned to be completed in three steps. The first step started not later than mid-1990, before the Maastricht Treaty was negotiated, the second by January 1, 1994. These two steps have a preparatory character in technical terms (i.e. institution-building, design of procedures, hard- and software equipment by actors and users) and in economic terms (full capital mobility, economic policy coordination on the basis of national convergence programmes underlying supranational guidelines and controls). The third step will bring about the definite fixing of mutual exchange rates by January 1, 1999, followed by the successive substitution of the designated common currency, the "Euro", for national currencies until mid-2002.

The start of the third step is made dependent on satisfying certain conditions. Key targets are five "convergence criteria": a high degree of price stability, a low level of long-term interest rates, absence of exchange rate problems within the European Monetary System (EMS), a low level in the current public deficit as well as in total public debt. In the Treaty and the added protocols, figures for the criteria have been denominated, either in absolute or in relative terms.

The two fiscal criteria have so far been subject to passionate political and public debate, for three reasons:

- Budgets at all levels of government show high deficits and nearly all Member States are thus bound to try and consolidate them. This implies heavy expenditure cuts and/or tax increases.
- Despite obvious attempts of consolidation it is only a small number of countries which are supposed to qualify for EMU membership even by 1999.
- The Maastricht Treaty allows for a "soft interpretation" — especially of the two fiscal criteria.

In any case, the third stage of EMU will not come automatically, that is, by just reaching the date envisaged, but has to be introduced through a political decision by the European Council. This decision does not have to be based on a unanimous vote. Rather, a "qualified majority" of 62 out of 87 voices will be sufficient. As the Council did not — as opposed to what it should have done according to the Treaty — examine national convergence performance by mid-1996 with the possible consequence for EMU to be started in 1997 by "a majority of Member States", this early starting date has definitely become obsolete. Now, the Council cannot but decide before July 1998 "which

Member States", irrespective of whether or not they form a majority, meet the criteria and are hence obliged to enter into the third stage. The due examination of performance upon which the decision must be based will have to take into account not only the convergence criteria but all other information on the overall economic development and policy stance. To this end, the Council must make use of the reports of the European Monetary Institute (EMI), the European Commission and the European Parliament. However, the Heads of State and Government need not stick to the recommendations of these bodies.

Nevertheless, at least some members of the European Council are bound by domestic rules and mandates. This, for instance, holds true for Germany where the Bundestag as well as the Bundesrat have passed respective resolutions by which they claim the ex ante right to agree on German entrance into EMU or to reject it even if the government's voting is affirmative. Their self-commitment demands a "strict interpretation" of the Treaty. This policy stance is backed by the Federal Constitutional Court which even pleads for a future exit from EMU in case EMU should fail to realise the aim of price stability.

In Germany, there are two main but contradictory lines of fundamental opposition against EMU. The first represents the majority of academic economists as well as a considerable part of the media. It rejects the idea of EMU by fear of inflation. The arguments are that

- only little "societal consensus on stability"² has developed in most Member States, given their traditional institutional structure (i.e. dependence of the central bank on government) and political behaviour (i.e. long-lasting inflationary trends in the past); this can only be overcome by competition of currencies which exposes devaluations to punishment by the electorate³;
- there will be a high probability of "softening" the criteria because otherwise no "critical mass", i.e. a sufficient number of starting countries, can be reached;
- EMU will not be an "optimal currency area"⁴ with the consequence that because of inevitable "asymmetric external shocks" like a weak Dollar, an explosion of raw material prices or a world-wide economic recession the better-performing countries would have to help the rest via high transfer payments;
- almost all monetary unions in the past eventually failed if they were not, sooner or later, accompanied by a political union⁵.

The second line of fundamental opposition in Germany is centred on the reproach that the preparation of EMU tackles the wrong question: not inflation but growing

¹ Pauer (1996), p. 87.

² Ohr (1993a), p. 33.

³ Vaubel (1990), p. 937.

⁴ Ohr (1993b).

⁵ Theurl (1992).

unemployment is the future challenge for the European Union — an objective to which EMU is said to be counter-productive. This view can be found with some prominent representatives of German academia⁶. In politics, a strong variant of the view is mainly represented by a minority of left-wing and "green" politicians⁷. But a softer variant is gaining ground (although it can be heard much more often in other Member States) which demands special action by the Union in social and employment policy without questioning EMU in its entirety⁸.

There are two intellectual counter-currents against fundamental opposition to EMU. The first is the call for the Treaty to be enforced as it is because, firstly, the inflationary concern is unfounded and, secondly, EMU and a higher level of employment in Europe are compatible instead of contradictory goals. According to this opinion, inflation will not be brought about by EMU, because

- contrary to public perception, economic policy in Germany's main partner country for EMU, France, has been unambiguously stability oriented for years; the performance was, at times, even better than in Germany;
- there does already exist a de-facto EMU between Germany, the Netherlands, Austria and Belgium/Luxembourg;
- with regard to the "critical mass", five or six starting countries are supposed to be a sufficient number;
- it is argued that EMU cannot be compared with any of the historical currency unions given the new phenomenon of global financial markets which render small-scale currency areas at a national level an anachronism⁹;
- therefore, the theory on optimum currency areas which is fully based on shocks from the flows of goods and services and excludes those from capital and speculative money, is not applicable on the EU where the majority of asymmetric shocks used to emerge from the very sphere of money¹⁰.

In this line of thinking it is, of course, believed that monetary policy must be supported by fiscal discipline. But contrary to inflation-concerned thinking, the Treaty's weapons are considered sufficient. The Maastricht Treaty calls for

- independence of the ECB to an extent which has never been reached by any national central bank including the Deutsche Bundesbank and the Federal Reserve System of the United States;
- no government to have privileged access to financial institutions;
- prohibition of monetizing public deficits by the ECB;
- prohibition of an indebted government being "bailed-out" by other governments.

Moreover, in the light of a loss of autonomy in fiscal policy due to a growing share of interest payments in their current

budgets, almost all of the Member States should have a strong interest in reducing their public debt burden. In addition, the fiscal convergence criteria are held to be obviously defined rather arbitrarily, without any sound theoretical foundation. Some observers even claim that fiscal policy has nothing to do with monetary union at all¹¹. This is said to be seen from, for instance, the empirical fact that Belgium, the Member State with the highest accumulated government debt, has one of the lowest inflation rates in the EU. The rigorous attempts of fiscal consolidation are even regarded as procyclical and self-destroying in the present phase of weak recovery from the economic slow-down in Europe — an evidence which made the six German economic research institutes demand a "cyclical adjustment" of the deficit criterion¹². This would not at all be out of line with the requirements of the Maastricht Treaty which allows for "temporary deviation". For without such an adjustment, hardly any country would be able to meet the budget criteria by end-1997, thus forcing the Union to postpone the starting date for EMU. According to this opinion, there has been too much investment of goodwill, political prestige and information campaign in the sharply-timed start of EMU as that a delay should not have a disastrous effect on the whole further integration process¹³.

The second counter-current to the fundamental opposition against EMU welcomes monetary integration but fears that once EMU has started, Member States can no longer be punished for a permissive budgetary stance (at present, the potential punishment being exclusion from access to stage three). The basic idea is that governments are to be confronted with automatic sanctions which escape political debate. The main proposals are that

- the Treaty should be supplemented by a special agreement on extra endeavour for fiscal discipline on the Member States' side (stability pact);
- forfeitable deposits depending on the size of the "excessive" deficit are assigned in the agreement;
- compliance with the convergence criteria should be given priority to compliance with the starting date scheduled;
- the concept of multi-tier monetary integration should consequently be made use of in order for a softening of the criteria to be avoided.

⁶ Hankel (1995).

⁷ Wolf (year of publ. n.i.). Wolf is Member of the Greens faction of the EP.

⁸ Sterzing et al. (1996).

⁹ Bofinger (1995), p. 45.

¹⁰ Bofinger (1996), p. 79.

¹¹ Krugman (1994), p. 191.

¹² DIW (1995).

¹³ Krupp (1995).

These proposals represent mainstream political thinking in Germany. They mark the position predominant with the Federal Government — which was the first to suggest the stability pact¹⁴ —, the Bundesbank and the pragmatic section of academia¹⁵. The European Council, in its meeting in Florence, agreed with this view in principle. The Council of Ministers of Economic Affairs and Finance (ECOFIN) even succeeded in elaborating the fundamentals. They were the basis of a proposal presented by the European Commission¹⁶ in October 1996. According to this draft of a Council regulation

- a country which is neither hit by an "unusual event" outside its control nor by a "severe economic downturn" but suffers nevertheless from a budgetary deficit of more than 3 per cent of GDP, has to deposit, within a period of ten months, a non-interest-bearing amount of money which is calculated as a percentage of nominal GDP (between 0,2 and 0,5 per cent, depending on the relative size of the deficit);
- the country will definitely lose this money after two years if it does not reduce the deficit to the limit of 3 per cent of GDP;

However, it is most uncertain whether this regulation draft will receive the necessary unanimity in the Council. Especially the German government criticizes that the draft falls short of important principles which allegedly had already been agreed upon. These were:

- an automatism of sanctions,
- a clear-cut definition of a "severe economic downturn" which leaves no scope for political debate.

The automatism of sanctions was replaced by a qualified majority vote in the Council (but only "as a rule", thus leaving some room for doing nothing). This procedure was programmed at the moment when the Commission chose to base the regulation on art. 104c of the EC Treaty in order to keep the legislation hurdles low. Among the various possibilities¹⁷ two others would have been either — according to a proposal by the Italian budget minister Masera¹⁸ — codification in the Member States' constitutions, or an agreement bound by international instead of European law among those Member States which first qualify for EMU and are ready to start. Such a club solution was obviously the original idea the German government had in mind¹⁹ and which it now, in response to the Commission's initiative, may not hesitate to revitalise. This approach would, however, cause serious problems in Community Law because followers of the second or third tier that are not willing to sign the supplementary treaty cannot be confronted by an increased "acquis communautaire" which had been established without their participation.

Independent of whether EMU will start with or without a supplementary agreement, it can be taken for granted that not all Member States will be among those who start. This fact gave rise to a heavy debate which goes far beyond its application on monetary integration. There are two opposite assessments:

- The multi-tier approach is indispensable for a future continuation of dynamic integration in a Union of 25 or even more Member States;
- The multi-tier approach will split the Union into "core members" (the winners) and "peripheral members" (the losers).

Meanwhile, the issue of a "flexible structure" has become a main topic on the "Maastricht II" Intergovernmental Conference (IGC) aimed at an amendment of the Maastricht Treaty. In particular, the principle that late-comers must be given access provided they wish so and have qualified for it (multi-tier), will be superseded by the rule that no country shall have the right to prevent others from going ahead in a policy field even if there is no consensus on the goal per se (variable geometry). This approach is a potential substitute for decision-making procedures based on a broadly applied majority vote. Either the one or the other of the two principles will be sufficient for the "handling" of a Union with 25 or even more members. Broader application of majority voting would be the logical consequence of the integration concept laid down in the original EC Treaty. Only acceptance of a more general recourse to majority voting could disprove the assumption that a further deepening and a further enlargement of the European Union are mutually exclusive. However, a mere "formal deepening" can eradicate the acceptance basis of integration when, in the presence of strong discrepancies between national interests, majority voting produces high "priority costs". As presumably the fear of being "overrun" will be judged as being more serious than the gradual erosion of Common Law (through differentiated exceptions, options and intermediary rules), the IGC will probably bring about the second-best solution in the form of variable geometry, rather than majority voting.

The first application of the multi-tier principle is EMU. The argument is that the ECB can be more credible, the less countries — these, however, having to be without exception highly stability-oriented — form the group to start in 1999. However, in order to make such use of the inherent dynamics of a core EMU without ignoring those (more inflation-prone) countries which would need (the disciplinary pressure of) EMU most urgently²⁰, monetary and monetary-policy relations between the "ins" and the "outs" (or "pre-ins", in politically correct terminology) as well as rules to their enforcement need to be elaborated and decided on. This can be done in the framework of an "EMS II" which could bring about three main advantages:

¹⁴ Bundesfinanzministerium (1995).

¹⁵ See for example Lehment/Scheide (1995).

¹⁶ European Commission (1996).

¹⁷ Seidel (1996), pp. 14-17. A political decision might result from the December 1996 meeting of the European Council.

¹⁸ Handelsblatt, 20.9.95, p. 10.

¹⁹ Bundesfinanzministerium (1995), p. 8.

²⁰ Mayes (1995), p. 21.

- The "outs" would enjoy a certain support for their exchange rates enabling them to keep their interest rates relatively low so that the monetary environment for catching up will be better than before.
- The "ins" would enjoy relatively stable real exchange rates vis-à-vis the "outs" so that the Single Market would not be disturbed by "competitive devaluation".
- The countries being considered for Eastern enlargement would enjoy the perspective of a long initial period of membership in the Union without facing the constraints of the full *acquis*.

Initially, the ideas how to shape EMS II differed very much. Whereas the potential "outs" pleaded for voluntary membership, unlimited as well as "symmetric" intervention (which would not charge their own central banks with the bulk of intervention in the exchange market) and additional support through higher transfers, the "ins" suggested just the opposite²¹. Moreover, the latter demanded a depolitization of realignments by giving the ECB the right of initiative. Meanwhile, the ECOFIN Council concluded that (1) ECB intervention will be confined to amounts compatible with the preservation of price stability within EMU, and (2) the normal exchange rate band width between the Euro and the currencies of the "outs" shall be +/-15 per cent, with narrower margins being allowed in promising cases, and (3) an ECB right of initiative for realignment will indeed be established.

Still, despite there being only little time left till the scheduled starting date for EMU, there are major questions unanswered: Who will qualify? When will EMU really be started? Will it be possible to contain speculative volatility as the starting date comes closer? Will there be a full final consensus on the interpretation of the convergence criteria? Which will be the stance and the instruments of the ECB's monetary policy? And, above all, will the decisions to be taken find a broad political acceptance in all Member States, be they "ins" or "outs"?

3. Coping with unemployment

Contrary to in the USA, the unemployment rate has increased in most European Countries from one economic recession to the next. The dimension of this problem is right on the way of endangering social stability as well as the government's scope for action. So far, national governments have failed to find effective remedies. This seems to be due to a variety of reasons, namely

- inadequate analysis resulting in wrong therapies;
- lack of coordination in economic policy, within a country as well as between the countries;
- differences in social paradigms as compared to the U.S. who cares much for the level of employment but little for income distribution and social support.

In 1993, the European Commission therefore tried to analyse the causes of unemployment and to combine na-

tional activities to cope with it. The Commission's (1993) White Paper was aimed at creating 15 million new jobs in the EU-12 until the year 2000 (the current figure of unemployment in the EU-15 being 18 million). Most of the Commission's recommendations followed supply-side oriented rationales: intensification of internal and external competition; abolition of macroeconomic "disequilibria" (mainly fiscal consolidation and sub-productivity wage increases); reduction of the fiscal and parafiscal burden on — especially unqualified — labour; flexibilisation of working times and labour-market structures (without abandonment of the European type of social systems); creation of more human capital, more infrastructure and modern technology thus accelerating structural change; deregulation and privatisation.

Much of the Member States' economic policy is obviously in the spirit of the White Paper (albeit not caused by it). This holds true for wage and fiscal policy, for the continuation of deregulation and privatisation as well as for the flexibilisation of the labour market. Nevertheless, the White Paper had only a small echo, with governments as well as in public debate. Apparently, this was the case because

- the report was based on problem descriptions and opinions which national governments themselves had provided²²;
- the Commission's declared intention was not to start a new legislation programme as it had been the case with its White Paper on the Single Market but just to offer a bunch of instruments from which national policy makers should choose according to their perception of the nature of unemployment problems in their respective countries;
- for this very reason the result was an eclectic collection of facts and findings without a stringent and thorough line of argumentation²³;
- the White Paper included proposals which seemed to be contradictory either in themselves (e.g. search for growth-oriented vs. labour-absorbing structures) or in relation to national policies (e.g. consolidation vs. Euro Bonds for Trans European Networks).

Consequently, part of national economic policy does not at all draw on the Commission's recommendations. In Germany, for instance, fiscal consolidation is to the very detriment of education, R&D and infrastructure expenditures²⁴. This, however, is by no means the result of a better insight in priorities but of an inability to cut expenditures where vested interests are at stake. For it is exactly these parts of the Commission's analysis which are not questioned at all in the literature.

²¹ Duijm/Herz (1996), p. 238-39.

²² Franzmeyer (1995), pp. 253-259.

²³ Franzmeyer/Jaedtke (1994).

²⁴ DIW (1996).

The lack of explicit response to the White Paper from national governments, the inability to reduce unemployment on a national level, and the small if not — in some countries — negative employment effects of the Single Market made the European bodies look for new and more effective instruments. Several meetings of the European Council dealt with the issue. An Action Programme on Employment Policy was passed²⁵. The Swedish delegation to the IGC proposed that the IGC should decide on an amendment of the EC Treaty which introduces a new chapter on employment policy, as well as the establishment of a new Employment Committee responsible to the Council²⁶. And the Commission pleads for giving job creation a much higher priority in the EU structural policy than has been done so far.

But all these activities cannot hide the fact that the EU is unable to exert any significant direct influence on the level of employment in the Member States taken together. Even an amendment of the EC Treaty and the scheduled reform of structural policy would not change the situation. This is because

- employment is affected by many branches of economic policy and
- it is the Member States which are responsible for the most important of these branches.

One of the most important fields of action which bears severely on employment is macroeconomic policy consisting of monetary, fiscal and wage policy. As has been seen from above, future monetary policy will be centralized with the ECB, supplemented by an EMS II. But the commitment of the ECB is to price stability. Even the Swedish proposal for an amendment of the Treaty insists that one should not "modify in any way the Economic and Monetary Union". Of course, there is not necessarily a conflict between price stability and a higher level of employment. But this is only the case if the different branches of macroeconomic policy are well coordinated. Empirical evidence shows that only in times of a long-lasting economic upswing unemployment declines significantly.

One of the most important requirements for employment to rise is therefore that Unions make only little use of their increasing bargaining power when the business cycle turns to be favourable. Otherwise the ECB would feel obliged to restrict monetary expansion and raise interest rates. Clearly, this part of coordination is the task of national institutions (i.e. employers and trade unions). But also fiscal policy has to fit in. If governments draw heavily on the capital market, the ECB will react in the same way as if wage claims fired inflation. On the other hand, fiscal consolidation will be made easier if wage claims allow for a monetary policy supporting the upswing. In this case the tax yield is high, low interest rates disburden the current budget, and structural expenditure cuts would face less political opposition. If, however, the overall level of economic activity is low, then fiscal policy has to play an active part in the attempts at recovery. At least, "automatic

stabilizers" should be in operation which means that growing social benefits and shrinking tax receipts should be tolerated. "Excessive consolidation" would be self-destroying in such a situation.

The responsibility for fiscal policy is divided into both the European and the Member States level. Member States have to plan and execute the budgets and give sound structures to both revenues and expenditures. The EU has (1) to enforce containment of the deficits in boom times, but it should also (2) allow for actively overcoming a recession and (3) try to avoid, by means of minimum fiscal harmonisation, a race in tax reductions which forces the Member States to excessive expenditure cuts.

So far, only the first of the three demands is being met by the European Union. Adherence to the other two would contribute much more to a recovery of employment than would a complete new policy chapter in the Treaty. Community rules would allow for this, as Member States, according to article 103 of the EC Treaty, are held to regard economic policy as a matter of Common concern requiring coordination.

4. Developing the EU's financial system

Maastricht-bound fiscal consolidation is peaking at a time when the guidelines for the rules are being scheduled which connect the present system of "own resources" as well as of "medium-term financial forecast" with those for the year 2000 and after. The development of the EU's financial system has always been strongly correlated with the discussion on the "finalité" of the Community. At the beginning it was only logical that the Member States payed matricular contributions according to their economic weight. The overall size of these contributions followed the overall volume of expenditures which, in turn, were determined by Community legislation and decision making. Each Member State was jealous of making sure that, grosso modo, its returns from expenditures were not less than its contribution. With higher integration, marked by the end of the transition period in 1968/70 as well as by the conferences of The Hague (1969) and Paris (1972) when the idea of a Monetary Union was developed (Werner-Plan) and federalist thinking flourished, this attitude of "juste retour" was more and more incriminated. At the same time the Community was endowed with own revenues accruing from duties, variable payments on agricultural imports, special payment on sugar imports, and a uniform part of the assessment base for value added tax which for this purpose had to be harmonised. Later in the seventies, the MacDougall Report (1977) presented elaborate ideas on a "pre-federal" and "federal budget" which were characterised by the assignment of costly tasks such as defense and part of

²⁵ European Council (1994).

²⁶ Swedish Government (1996).

infrastructure to the federal level but also by a sophisticated system of fiscal income equalisation between countries and between regions. To this equalisation, not only the expenditure side of the budget should contribute but also a "redistributive tax-sharing" on the revenue side²⁷. Federalist thinking culminated in 1984 when the European Parliament passed a draft of a federalist constitution for the Community.

This far-reaching vision was not picked up by the Member States. Instead, it was explicitly rejected by Britain and some other countries. Meanwhile, agricultural expenditures had exploded. After regional policy had been upgraded in the Treaty as a consequence of southern enlargement (Single European Act) and strongly supported by the Community budget (Delors Package 1988), it was clear that the latter had to be stocked up. As a part of the Delors Package a "fourth source of own financial means" was defined according to which the Member States had to contribute the remainder in line with their relative GDPs up to a certain ceiling which was to be raised year by year, the value for 1992 being fixed at 1.2 % of the Common GDP. The budgets for 1988-1992 were given respective plafonds by a binding "medium-term financial forecast". At the summit of the European Council in Edinburgh, December 1992, a second medium-term forecast was defined which on the revenue side was based on a slight increase of the overall plafond for the year 1999 and which formed, together with other measures to be dealt with in the next section, the so-called Delors-II Package.

The representatives of federalist thinking viewed the establishment of a "fourth source" as a considerable step backwards since the Union did not progress towards a Union's own right of taxation, but chose, like in its early times, additional funding through matricular contributions. The turn around became even clearer by the Edinburgh decision to substitute, step by step from 1995 till 1999, part of the Union's share in value added by growing contributions from the fourth source.

Meanwhile, the idea of a federal European Union can be regarded as having been buried by the Maastricht Treaty. The proposal of chancellor Kohl for a political union was rejected explicitly. The German Constitutional Court has claimed that Article F of the Maastricht Treaty cannot be interpreted as enabling the Union to introduce a tax of its own. Rather, in the case of such intentions, the Court demands an ex ante approval by both Bundestag and Bundesrat. A tax on energy (CO₂-emission) which the Commission has proposed to be introduced on a Community level has no chance of being passed by some of the national parliaments. Moreover, a debate on "just burden sharing" has emerged as fiscal constraints increased in the Member States. The main target of criticism is the "British rebate" which the country had negotiated in 1980 as a compensation for the poor financial use it can make of the Common Agricultural Policy.

This is the political environment in which the governments of the Member States have to find a solution for the

Union's future financial system. In particular, a sufficient flow of funds must be guaranteed and the Member States' concerns need to be borne in mind. In other words, the system must include an element of continuity as well as of innovative reform. It does not make any difference whether the IGC as such or a successive summit of the European Council will tackle the problem. In any case, a solution needs to be found in the remaining course of this decade. By now, some predictions can already be dared:

- A Union's own tax will not be introduced.
- The "contribution component" in the Union's own revenues will be strengthened.
- National contributions will not be "progressive" but follow the respective shares in overall GDP.
- The British rebate will not be tolerated any longer, namely by Germany as the main net payer, Britain being the only Member State to contribute sub-proportionally as measured by GDP.
- In the framework of the "third medium-term financial forecast", expenditures will be increased much more slowly.

5. Eastern enlargement and policy reforms

Given these trends and restrictions, the question arises for the European Union how to design and execute new policies but keep costs low. The most urgent task is the integration of the CEE countries. All of them have insisted to become members of the West European family of democratic market economies (and their military alliance). Also, all their political and economic endeavours point into this direction. The European Union has much reason to lend these wishes an ear. Not only would this create a zone of political stability east of Germany and Austria, but also would the internal market be enlarged by some 105 million consumers thus giving the EU more economic independence from the rest of the world.

Indeed, some decisive steps of mutual integration have already been done. The "Europe Agreements" have brought about full liberalisation of mutual trade except for trade in agricultural products. In the preamble to the agreements the Union gives the CEECs the perspective of full membership albeit without a concrete date. Meanwhile, chancellor Kohl promised the Polish government to mobilize all his influence towards realizing the country's membership before the year 2000. This self-commitment can be interpreted as a signal towards other CEE countries as well. At the 1994 summit of the European Council in Essen a "Strategy for leading CEECs to the EU" was formulated. The European Commission presented a White Paper on integrating CEECs into the Single Market²⁸. To put it in a nutshell: Refraining from eastern enlargement

²⁷ MacDougall (1977), p. 65.

²⁸ Europäische Kommission (1995a).

would mean the destruction of a huge amount of political, administrative and economic capital which has been invested in on both sides during the last six years.

Yet, as time goes by, more and more sceptical voices arise. Either they plead for postponement of CEEC entry or for sub-acquis membership. The most common-place argument claims that premature membership would blow up the EU's financial system. This can be heard in both the richer and the poorer Member States. The richer ones fear that it is them who would have to raise the additional funds. The poorer ones fear that they could be deprived from part of their inflows of transfer payments. Besides this financial objection, some Member States are concerned that the EU's external policy relations might run into disequilibrium if priority is given to eastern over southern relations thus also upgrading the interests of Germany, Austria and the Scandinavian countries as compared to those of France, Italy and the Iberian countries. In the end, this political argument, too, has its financial side aspects. This could already be noticed at the 1995 Barcelona "Mediterranean Conference" and — shortly after that — at the European Council of Madrid, where a sharp increase in financial transfers to the countries south and east of the Mediterranean was decided upon in response to the stock-up of the PHARE programme which, in turn, benefits CEE countries²⁹.

The vagueness of estimates of entry costs clearly encourages their abuse. They vary extremely depending on many assumptions such as number of countries, date of access, speed of transition, length of intermediary period and terms of participation in the different EU policies.

What can be said with certainty is that most of the money needed will not be made available by additional funding but that cost-reducing internal reforms are necessary in the EU³⁰. First, Common Agricultural Policy expenditures have to be brought down far below their scheduled 1999 share of 45 % in total EU expenditure. This implies a strict adherence to the recent GATT/WTO agreement on subsidy reduction and a consequent extension as well as continuation of the 1992 CAP reform steps³¹ — but would, on the other hand, make it easier for Britain to forego her rebate. Second, regional funds which benefit more than half of the EU population and count for one third of total EU expenditures, must be made much more efficient. At the same time, they must be much more concentrated on countries and regions lagging behind. The effect of both measures will be that significant amounts are set free for the new Eastern candidates whose per-capita income is even far below that of the least developed among the present EU countries. Exaggeration of CEEC entry cost estimates might only be helpful if it was aimed at sharpening the openmindedness for reform needs. As it seems, however, it is rather the inability to reform which it is intended to hide.

6. Conclusion

The high-priority issues discussed in the preceding sections proved to be widely interconnected. Nevertheless,

they cannot be solved at once, neither politically nor technically. This is the reason why the Maastricht II IGC, which was opened in March 1996 and is supposed to terminate in Summer 1997, seems to concentrate on institutional reform (and establishing Union responsibility for job creation)³². Already in the preparatory phase of the conference it had been made clear that all the other urgent questions shall be solved step by step.

But independent of whether the open dynamics of the conference will allow for such a careful and rational procedure, the Union cannot afford losing time. For time may work against the European idea. Three factors matter: disappointment and fear, growing contradictions between different goals, and — most dangerous of all — a trend towards renationalisation.

A general *disappointment* in the economic field (in the field of politics the disastrous development in the former Yugoslavia had an even much worse influence) is the result of the Single Market in terms of growth and employment, as measured against the optimistic Cecchini Report. Instead, in high wage countries like Germany the hardships of an extension of competition even to the sphere of social, fiscal and regulatory systems are being sharply felt (e.g. wage cost competition between German and Portuguese or British workers on German construction sites). Also, the present fiscal restrictions which mean less social benefits as well as less net flows to recipients of contractual incomes, are most frequently imputed to the ambitious aim of a Monetary Union (and not to fiscal policy failures in the past). Again, under the influence of "brutal" competition, high unemployment and internationally mobile capital investment, the methods of attracting capital become more violent, too. For the government of Saxonia, for instance, which subsidized Volkswagen by high amounts which the Commission had not approved, there was a clear trade-off between compliance with Community decisions and cultivation of the electoral base. The Prime Minister even took the risk of being blamed for having initiated a "new (negative) German attitude in European integration policy" (Commissioner van Miert).

The *fears* differ depending on the type of country. Peripheral countries fear loss of net receipts from the funds and suffer from the impression that transfers are insufficient for even balancing the centrifugal forces of the Single Market let alone for catching up. In contrast, net-payer Member States feel that the transfer payments to Portugal, Spain and, above all, Greece, which will double twice between 1988 and 1999, have a poor result in terms of cohe-

²⁹ See Europäische Kommission (1995b) and Bulletin of the EU 11/95, pp. 153-164, and 12/95, pp. 9-58.

³⁰ See Weise, in this volume.

³¹ See Henrichsmeyer/Witzke, in this volume.

³² Up to the completion of this article little could be heard about the work of the conference indicating a lack of unanimity in priorities and, consequently, little progress. This danger had already shown up in the over-cautious and unstimulating report of the preceding „group of reflection" (Westendorp Report).

sion policy aims because these countries supposedly waste this "windfall money" from the Funds. There are other concerns specific to the richer Member States. Apart from a worry about an erosion of their high-standard social systems, the fears, as has been shown above, refer to the consequences of EMU: loss of autonomy in monetary and fiscal policy might lead to either higher inflation or an inferior budget-based power to shape the domestic economy and society. In some countries with a relatively strict concern for internal security, the abolition of intra-EU border controls is also regarded as a gate of incidence for organized crime and drugs. But even the expectation of quasi-apocalyptic shocks is no longer excluded: from the Single Market in the form of uncontrolled disease like BSE, from EMU in the form of nothing less than economic (and military!) war³³.

Contradictions seem to arise, for instance, between a further deepening of integration (higher "acquis communautaire") and a further enlargement of the Union, given the institutional rigidities of the EU system; between competition policy and cohesion policy; between the far-reaching objective of creating EMU and the obvious abandonment of the complementary objective of creating a political union which some countries, Germany in front, had regarded as indispensable for sustaining EMU.

Rather, the intergovernmental cooperation model based on the nation state regains appeal. In part, this is a result of German unification: On the one hand, Germany is about to define a new, self-conscious role in external policy and external economic relations for herself, in particular with respect to Eastern Europe. On the other hand, France reacts with the demonstrative claim for national power. Also, the country recurs to her own sphere of influence in

the Mediterranean area whereas Britain continues her traditional course of relative national independence.

Renationalisation might be felt as the most alarming sign of progressing disintegration. This concept must not be mixed up with that of decentralisation. The former describes a political reluctance to integrate and can only be stopped by sound political education on the part of credible political parties on a Member State as well as on a European level. The latter implies the search for optimizing the vertical structure of decision-making and administration including the financing of government tasks. This is not only legitimate but also prudent. In an ever enlarging Union, the European level must be discharged from inferior functions but at the same time given stronger power with regard to superior tasks. The establishment of the principle of subsidiarity in the Treaty provides the basis for the necessary future attempts at this end. It is a pity that its meaning has been left quite unclear, giving instead much room for contradictory interpretation. Nevertheless, well-defined subsidiarity will prove crucial for further integration. A "citizens' Europe", i.e. a Europe with a homogeneous legal structure and still based on approval by the entire population, will only be possible if a convincing vertical division of tasks — accompanied by corresponding fund raising and parliamentary control — can be found. Otherwise, the "variable geometry" model of Europe will become reality the more countries enter the Union. It is true that this must not be the worst solution of all because it allows, in the absence of supranational regimes, at least for club regimes in policy fields where trans-border external effects occur. But it must be clear that this type of Europe will less and less fit into the legal structure of the existing European Union.

³³ Connolly (1995), cited according to Kaletsky (1995).

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Zusammenfassung

Europäische Union vor wirtschaftlichen Herausforderungen — ein Überblick

In diesem Artikel werden die jüngsten Entwicklungen, offenen Fragen und Politikoptionen auf den hochprioritären Handlungsfeldern der EU diskutiert. Priorität haben (1) die Währungsunion (WWU), (2) die Bekämpfung der Arbeitslosigkeit, (3) die Neuordnung des Finanzsystems, (4) die Reform der Agrarpolitik und der Strukturfonds, (5) die Osterweiterung. Die WWU wird kommen, und für ihre Stabilitätsorientierung ist hinreichend Vorsorge getroffen, sie wirft aber Fragen der rechtlichen, wirtschaftlichen und politischen Beziehungen zwischen den „ins“ und „outs“ auf. Den Arbeitsmarkt kann die Union kaum direkt, wohl aber über ihre (künftige) Makrosteuerung wirksam beeinflussen. Die Haushaltsmittel sind im nächsten Jahrzehnt knapp, und sie werden über erhöhte Beiträge statt über eine EU-Steuer aufgestockt. Interne Reformen mit Spareffekt sind auch ohne Osterweiterung dringlich, werden diese aber erleichtern. Das institutionelle Reformergebnis der „Maastricht II“-Regierungskonferenz dürfte mager ausfallen und die EU zwingen, sich in Richtung „variable Geometrie“ zu verändern.