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**Article**

## Integrated Guidelines for Growth and Jobs, 2005-2008: A Shift in EU Economic Policy?

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## **Integrated Guidelines for Growth and Jobs, 2005–2008: A Shift in EU Economic Policy?**

*Marica Frangakis\**

### *Introduction*

The 2005 Broad Economic Policy Guidelines (BEPGs) are part of a broader policy package that also includes the Employment Guidelines pertaining to the four-year period 2005 to 2008. The two sets of guidelines constitute the »Integrated Guidelines for Growth and Jobs« which were endorsed by the European Council in June 2005. The Integrated Guidelines further represent the culmination of two review processes which were concluded by the European Council in March 2005, namely the review of the Lisbon Agenda and the reform of the Stability and Growth Pact (SGP). These were largely prompted by the continuing underperformance of the EU-15 making the attainment of the Lisbon objectives by 2010 unlikely. Therefore, in order to gain an insight into the new Guidelines, it is necessary to discuss both the changes that have been made to the Lisbon Agenda and the SGP as well as to take a closer look at macroeconomic developments in Europe over the period 2000–2005.

Overall, we shall be arguing that the present ills of the European economy are largely endemic in the paradigm on which current economic and social policy is based. However, the governing European elites appear determined to carry on with this paradigm even when it is evidently failing to fulfil its objectives. To the extent that this is the case, the new elements introduced by the Integrated Guidelines are not likely to signify a shift in policy even though they may mitigate certain aspects of it.

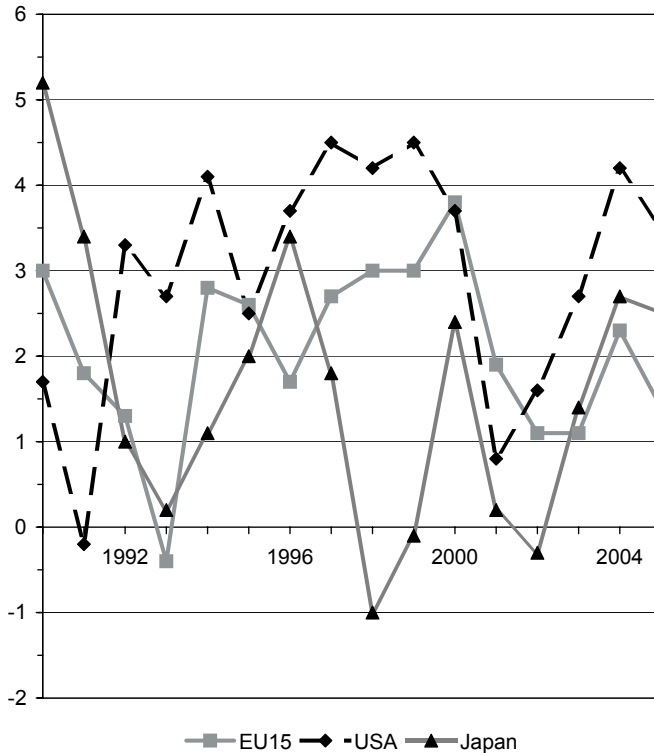
More specifically, the first section of this article examines macroeconomic developments over the past decade with particular emphasis on the past few years. The next section looks at the institutional developments that took place in 2005, while it is argued that the fundamentals of the Lisbon Agenda largely account for its failure. The so-called Kok Report – its conclusions and recommendations – are also discussed. Furthermore, the changes brought about to the SGP and their implications for fiscal policy are reviewed to the extent that these have a direct impact on strategic elements of the Lisbon Agenda. The third section analyses the new guidelines, while the fourth section is given to the discussion of the economic governance cycle launched by them, with special emphasis on the democratic legitimacy of economic policy formulation. The last section concludes.

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### *Macroeconomic Developments*

In 1990, the annual rate of GDP growth in the EU-15 was three percent, as opposed to 1.7 percent in the USA and 5.2 percent in Japan. In the decade that followed, the EU economy went through one full cycle while it is currently working its way through yet another which started in the early years of the present decade (figure 1).

*Figure 1: GDP growth EU-15, USA, Japan 1990–2005 (in % p.a.)*



*Source: Statistical Annex of European Economy, Autumn 2005*

In particular, by the mid 1990s, the EU growth rate had dipped to its lowest point – -0.4 percent in 1993 – while it reached its highest one – 3.8 percent in 2000 – at the end of the decade. Since that time, the EU economy appears to have entered a new cycle as growth slowed down to levels comparable to those of the early 1990s. In 2004, this trend was interrupted as GDP growth picked up to an annual rate of 2.3 percent only to fall back to 1.4 percent in 2005.

By comparison to the USA and Japan, the other two major centres of the advanced capitalist world, the economic cycles the EU economy has been going through have been deeper than those of the USA, albeit not as deep as those of the Japanese economy. Espe-

cially after the year 2000 – when both the USA and the EU economies recorded a boom while the Japanese economy registered an increase after many years of low or negative growth rates – all three economies followed a downward path. In 2002, however, this was succeeded by a steeper increase in both the USA and Japan as opposed to the EU which thus appears to be lagging behind.<sup>1</sup>

In terms of growth components, EU growth is mainly export-led as shown in table 1. On average over the period 1991–2000 exports provided a significant stimulus to production. As the world economy and especially the USA declined, the significance of exports for the EU economy declined too, partly explaining its prolonged trough. In 2004, exports resumed their primary position as a component of demand and thus of growth of the EU economy, a trend which appears to have continued into 2005. Including the ten new member states accentuates further the significance of exports for EU growth.

*Table 1: EU GDP Growth Components (annual % change)*

|                               | EU-25         |      |      |      |      |      | EU 15         |      |      |      |      |      |
|-------------------------------|---------------|------|------|------|------|------|---------------|------|------|------|------|------|
|                               | 1991<br>–2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 1991<br>–2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
| GDP                           | na            | 1.8  | 1.1  | 1.0  | 2.4  | 2.0  | 2.1           | 1.7  | 1.1  | 0.9  | 2.3  | 1.9  |
| Private consumption           | na            | 2.0  | 1.4  | 1.5  | 1.8  | 1.9  | 2.0           | 2.0  | 1.2  | 1.4  | 1.7  | 1.8  |
| Government consumption        | na            | 2.5  | 3.1  | 1.9  | 2.0  | 1.7  | 1.7           | 2.5  | 3.2  | 1.9  | 2.1  | 1.7  |
| Gross fixed capital formation | na            | 0.3  | -1.4 | 0.1  | 3.0  | 3.6  | 2.0           | 0.4  | -1.5 | -0.1 | 2.8  | 3.3  |
| Exports                       | na            | 3.3  | 1.8  | 1.2  | 6.2  | 5.9  | 6.6           | 3.1  | 1.6  | 0.6  | 5.7  | 5.6  |

2004: estimates; 2005: forecasts; na: not available.

*Source: Statistical Annex of European Economy, Autumn 2005*

By contrast, the other demand components have remained sluggish. In particular, after a near stagnation and decline in 2001–2003, investment – gross fixed capital formation – picked up in 2004, although not by as much as expected, in spite of the fact that most economic policy measures – such as tax concessions, labour market flexibility and wage moderation, product and service market integration – aim at creating an investment-friendly environment. During the same period, private consumption continued to provide a posi-

<sup>1</sup> Including the ten new member states in the EU figures does not change the trend observed in relation to the EU-15, albeit the annual rate of growth becomes slightly higher, as the new member states have been growing at higher rates due to their lower initial levels. For example, the annual rate of GDP growth in 2004 was 2.4 percent in the EU-25 and 2.3 percent in the EU-15, while it is estimated at 1.5 percent and 1.4 percent, respectively, for 2005.

tive, albeit small, stimulus to growth, as did government consumption, which has tended to move along with the tide rather than against it. Generally, government finances have moved on the border of the limits set by the SGP as shown in table 2, page 64.

In particular, the second half of the 1990s (for which there is comparable data only for the EU-15) was dominated by the drive to apply the convergence criteria of the Maastricht Treaty in preparation for the single currency. As a result, the public deficit fell from 5.1 percent of GDP in 1995 to 0.7 percent in 1999 on average in the EU-15. Following the introduction of the euro, as the EU economy slid onto a downward path, the public deficit started rising mainly as a result of the play of automatic stabilisers.

At the same time, the constraints of the SGP meant that EU fiscal policy tended to act in a pro-cyclical fashion, thus intensifying the declining performance of the EU economy. The contradictory factors at work are reflected in the level of public debt (as a percentage of GDP), which started rising in 2003, after a long decline, in the EU on average. Including the new member states in the average budgetary position of the EU does not alter significantly the overall figures, although there are significant divergences across countries.

Over the period under discussion, monetary policy – run independently by the European Central Bank (ECB) – concentrated on the central goal of preserving price stability. Thus, on 1 December 2005, the ECB increased its policy rates by 25 basis points. This was the first change of policy rates since June 2003 and the first interest rate hike since October 2000. The rationale of this change was officially explained as follows:

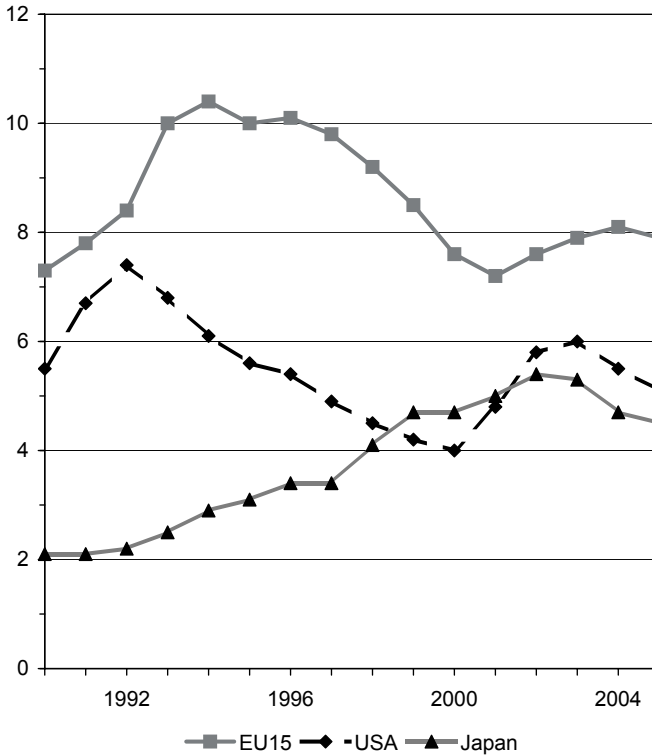
»By increasing interest rates, the ECB intends to withdraw some of the accommodation embedded in the monetary policy stance, though it will remain accommodative. This move intends to keep medium- to long-term inflation expectations in the euro area solidly anchored at levels consistent with price stability.« (CEE 2005: 12)

Overall, the combination of fiscal policy – run by member state governments within the confines of the SGP – and of monetary policy – run independently by the ECB on the basis of its statutory mandate – has accentuated the downside of the economic cycle most EU member states find themselves in.

The weak growth trend displayed by the EU economy throughout the 1990s is reflected in a persistently high rate of unemployment. For example, on average over the decade 1991–2000, unemployment was 9.2 percent in the EU-15, as opposed to 5.6 percent in the USA and to 3.3 percent in Japan. Following the boom year of 2000, when it fell to 7.6 percent, it reached 8.1 percent in 2004, by comparison to 5.5 percent in the USA and 4.7 percent in Japan (figure 2).

Including the ten new member states increases EU unemployment further. Thus, for 2005 unemployment is estimated at 7.9 percent in the EU-15 and at 8.7 percent in the EU-25. By comparison, it is estimated at 5.1 percent of the labour force in the USA and at 4.5 percent in Japan.

The »weak growth-high unemployment« nexus constitutes what Hufschmid (2005) has called the »small vicious circle« as opposed to a »wider vicious circle« which includes not only weak growth and high unemployment, but also a falling wage share for workers.

*Figure 2: Unemployment EU-15, USA, Japan (in % of Labour Force)*

Source: *Statistical Annex of European Economy, Autumn 2005*

More specifically, according to Hufschmid, low growth leads to high unemployment, thus weakening the bargaining position of unions and workers so that low wages are more easily imposed on them.

In fact, throughout the 1990s as well as in the present decade the annual rate of increase in real compensation per employee has consistently been below that of inflation with the exception of 1999 and 2000 – at the peak of the boom – when it exceeded inflation by 0.6 percent (table 3, page 64). Not surprisingly, the share of wages in GDP has been falling continuously since the early 1990s, reaching 67.1 percent in the EU-15 in 2005. This is slightly increased, to 67.3 percent, when the new member states are included.

Generally, the EU economy appears to be working its way through the downside part of a cycle, the starting point of which may be placed in 2000. Fiscal policy – largely defined by the confines of the SGP – has tended to have a pro-cyclical effect, thus prolonging the trough the EU economy finds itself in. As a result, it appears to be lagging behind the USA as well as Japan. The social cost of the EU macroeconomic malaise is depicted in the high and rising rate of unemployment as well as in the declining share of wages in GDP, an indicator of increasing social inequality. In view of the bleak macroeconomic developments,

Table 2: EU Average Government Budgetary Position (in % of GDP)

| EU15   |      |      |      |      |      |      |      |      |      |      |      |      |      |      |      |      |
|--|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
|  | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
| Net borrowing (-)/lending (+)<br>by general government | na   | na   | na   | na   | na   | -5.1 | -4.2 | -2.5 | -1.7 | -0.7 | 1.0  | -1.2 | -2.2 | -2.9 | -2.6 | -2.7 |
| General government<br>consolidated gross debt          | na   | 54.8 | 57.2 | 64.1 | 66.4 | 70.7 | 72.6 | 70.8 | 68.7 | 67.8 | 63.9 | 63.1 | 62.5 | 64.0 | 64.3 | 65.1 |

na: not available.

Source: Statistical Annex of European Economy, Autumn 2005

Table 3: EU Prices and Wages (annual % changes)

| EU-15                            |      |      |      |      |      |      |      |      |      |      |      |      |      |      |      |      |
|----------------------------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
|                                  | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
| GDP deflator                     | 5.3  | 5.0  | 4.1  | 3.3  | 2.5  | 2.6  | 2.1  | 1.6  | 1.7  | 1.1  | 1.4  | 2.3  | 2.6  | 2.2  | 1.8  | 1.8  |
| Real compensation/<br>employee   | 1.9  | 2.0  | 3.1  | 1.0  | 0.6  | 0.9  | 0.8  | 0.9  | 0.7  | 1.7  | 2.2  | 0.9  | 0.4  | 0.9  | 0.9  | 0.7  |
| Adjusted wage share <sup>1</sup> | 70.0 | 70.2 | 70.5 | 70.4 | 69.0 | 68.4 | 67.9 | 67.5 | 67.4 | 67.9 | 68.1 | 68.0 | 67.8 | 67.6 | 67.1 | 67.1 |

<sup>1</sup> Compensation/employee as % of GDP at factor cost per person employed.

Source: Statistical Annex of European Economy, Autumn 2005

it is not surprising that midway through the Lisbon Agenda decade, 2000–2010, the EU is far from attaining the Lisbon objectives, as shown in table 4.

*Table 4: Lisbon Structural Indicators, 2003*

| Levels  | EU-25 | EU-15 | USA   | Target<br>2005 | Target<br>2006 |
|---|-------|-------|-------|----------------|----------------|
| GDP/capita; PPS <sup>1</sup> , EU 15=100                          | 91.2  | 100.0 | 140.3 | –              | –              |
| Labour productivity/person employed; PPS <sup>1</sup> , EU 15=100 | 93.1  | 100.0 | 121.6 | –              | –              |
| Employment rate (%)   | 62.9  | 64.4  | 71.2  | 67.0           | 70.0           |
| Employment rate females (%)                                       | 55.1  | 56.0  | 65.7  | 57.0           | 60.0           |
| Employment rate older workers (%)                                 | 40.2  | 41.7  | 59.9  | –              | 50.0           |
| R&D expenditure (% GDP)   | 1.9   | 2.0   | 2.8   | –              | 3.0            |
| Business investment (% GDP)                                       | 16.8  | 16.7  | –     | –              | –              |

1 Purchasing Power Standards.

Source: Kok 2004: 48

The indicators included in the above table come from the Kok Report which employed them by way of depicting the rate of implementation of the Lisbon Agenda. The picture which emerges is one of primacy of the USA over the EU as well as one of the EU falling considerably short of the objectives it set itself in 2000. In spite of the haziness of many of these objectives as well as the lack of appropriate policy measures for their implementation, the ineffectiveness, at best, and the counter productivity, at worst, of EU economic policy is illustrated by the failure of the Lisbon Agenda which we shall discuss in the next section.<sup>2</sup>

### *Institutional Developments*

The Lisbon Agenda was set by the European Council in March 2000, with the express strategic goal of turning the EU economy into

»the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion.« (European Council 2000: § I.4)

It is universally accepted that the Lisbon Agenda has failed to realise its objectives. For example, the Kok Report states that »much needs to be done in order to prevent Lisbon from

2 Mencinger has noted that »[a]fter some years of mantras on strategy, actual developments and the report of the Wim Kok Committee [...] brought soberness and admittance that EU was not only far from the Lisbon goals for 2010, but also heading in the opposite direction.« (Mencinger, 2005: 3)



becoming a synonym for missed objectives and failed promises.« (Kok 2004: 10) Similarly, the European Commission noted in its last Spring Report that

»the Lisbon Agenda has never managed to capture the popular imagination – it is perceived as a business agenda. There is a lack of concrete delivery and clear political message.« (CEE 2005b: 50)

What is this attributable to? A cursory look at some of the main points of the Lisbon Agenda, as these stand out with the hindsight of time, may provide some answers.<sup>3</sup>

The working hypothesis of the Lisbon Agenda was that the economy would grow at an average annual rate of three percent. This was considered to be a realistic prospect while the macroeconomic outlook of the period was described as the »best for a generation«. In view of the severe stock market downturn that gained momentum in 2000, it may be argued that the Lisbon Agenda was set in an overly exuberant mood, explained both by the boom of the late 1990s and the introduction of the single currency in 1999.<sup>4</sup> The Kok Report is also explicit in its criticism in this respect: »The Lisbon strategy [...] [is] a creature of heady optimism of the late 90s about the then trendy knowledge economy« (Kok 2004: 9).

The actual goals of the Lisbon Agenda were broad-ranging, albeit not far reaching, to the extent that practically no means were specified for their implementation, while there was a heavy reliance on the private sector to deliver as well as on public-private partnerships. In only a few instances was Community action deemed necessary and/or the support of the European Investment Bank.

The familiar EU asymmetry between the economic and social aspects of policy further characterised the Lisbon Agenda, whereby economic stability and sustainability, as specified by the SGP, were taken to be the overriding principles of policy formulation and implementation. For example, in the long-run social protection systems – mainly pensions – should be »modernised«, i.e. curtailed, in the name of economic sustainability.

As Mencinger has argued:

»The Achilles' heel of Lisbon strategies [...] is total neglect of aggregate demand and full reliance on the premises of supply side economics[...] [...] This is all true in a frictionless and timeless world but far less true in reality.« (Mencinger 2005: 12)

Furthermore, the concept of social inclusion was included on a par with other policy areas, which in itself was a positive development. However, it was defined narrowly – in terms of poverty only – while no specific targets were set nor funds set aside in this respect.

Similarly, the rate of employment was considered as central to the further growth of the EU economy, whereby the benchmark was taken to be that of the USA. However, the problem of unemployment was interpreted as one of employability whereby workers need

3 Cf. for further information on the Lisbon Agenda CEE (2005a, 2005c).

4 For example, the Lisbon Agenda has been called the »Lisbon bubble« for the inflated goals and expectations it gave rise to (Gros et al. 2005).

to adjust to the changing conditions of the labour market in order to remain in it. That is, the onus of dealing with unemployment was clearly transferred to the workers and the employees themselves.

Overall, there was a clear divergence between the aims of the Lisbon Agenda, which were ambitious, and the means proposed for their implementation, which were minimal. Furthermore, the social aspects of policy were peripheral to its core, while the assumptions on which the whole edifice rested were shown to be unrealistic. These contradictions are at the heart of the present EU economic paradigm.

The Lisbon Agenda was reviewed in 2004 by a High Level Group, chaired by Wim Kok. The Kok Report formed the basis for the Commission's Spring Report which was adopted by the European Council in March 2005 and, by extension, is the basis on which the Integrated Guidelines have been constructed. The Kok Report is critical not only of the Lisbon exuberance but also of the weight assigned to the information society and to the »new economy« at the expense of the »old« industrial base. Furthermore, it takes a pragmatic view of the EU economy insofar as it recognises the role of the demand side of the economy, the need for job security, and the need for public investment for growth and productivity. However, it is fully streamlined to the current economic orthodoxy. Thus, it accords primacy to macroeconomic stability and to market liberalisation. Similarly, it advocates an increase in the rate of employment, although not necessarily full-time. Also, it expects social cohesion to be dealt with largely, if not exclusively, through growth, while the issue of poverty is not discussed.

The problems of the Lisbon Agenda identified by the Kok Report include the following: an overloaded agenda; conflicting priorities; lack of determined political action, which is in fact considered to be the »key« issue. In order to overcome these problems, the Kok Report proposes the following: increase policy coherence and consistency between policies and participants; increase delivery by involving national parliaments and social partners; increase communication on objectives and achievements. More specifically, it is recommended that:

- the Lisbon Agenda be revitalised through gathering citizens, social partners, stakeholders, and public authorities around the key priorities of growth and employment;
- national plans be drawn up, for greater policy coherence, consistency, and ownership; the European Parliament set up a Standing Committee on the Lisbon Agenda;
- the EU budget reflect the Lisbon Agenda priorities;
- an annual league table be published regarding member state performance in achieving the Lisbon targets (structural indicators).

Overall, the Kok Report is characterised by a clear sense of urgency, while it applies political pressure on EU governing political elites – member state governments »and especially their leaders« – to conform to the requirements and goals of the Lisbon Agenda. The appeal to »growth and jobs« is proposed as a rallying cry for the new policy era. Lastly, a new cycle of economic governance is recommended. As we shall see, the recommendations of the Kok Report have almost entirely been incorporated in the Integrated Guidelines, 2005–2008.

The second institutional review process that was concluded in 2005 and which was instrumental in shaping the present Integrated Guidelines concerns the SGP. Although the SGP does not directly constitute a part of the Guidelines, it is explicitly mentioned in the order of priorities defined by them, whereby macroeconomic stability is not only a primary, but also an overriding aim of policy. In particular, Council Regulations No. 1055/2005 and 1056/2005 have amended Regulations No. 1466/1997 and 1467/1997, relating to the surveillance of budgetary positions and the implementation of the excessive deficit procedure, respectively. The specific changes brought about are shown in summary form in table 5.

*Table 5: Stability and Growth Pact – Old and New Arrangements*

| Key points                                      | Old  | New  |
|---|--|--|
| Small overshoot of deficit permitted if:        | <ul style="list-style-type: none"> <li>– Exceptional event (natural disaster)</li> <li>– Recession with GDP falling by more than 2%</li> </ul>   | In addition if there are structural reforms or spending on (Regulation 1055/2005): <ul style="list-style-type: none"> <li>– R&amp;D</li> <li>– European political goals</li> <li>– International solidarity</li> <li>– Investment</li> <li>– Pension reform</li> <li>– EU contributions</li> </ul> |
| Excessive deficit possible if:                  | <ul style="list-style-type: none"> <li>– Drop of GDP by more than 2%</li> <li>– Drop of GDP by more than 0.75% if downturn sudden, output gap positive, exceptional circumstances</li> </ul> | In addition if economy is stagnating or growing very slowly (Regulation 1056/2005)   |
| Time to correct excessive deficits:             | One year after establishment   | Additional time when growth is slow (Regulation 1056/2005)   |
| Implementation of fiscal adjustment programmes: | Within 4 months  | Within 6 months (Regulation 1056/2005)   |
| Medium-term fiscal policy goals:                | Balanced budget or surplus   | 1% deficit if low debt or high potential growth, balanced budget or surplus otherwise (Regulation 1055/2005)   |
| Fiscal policy in good times:                    | –  | <ul style="list-style-type: none"> <li>– 0.5% per year deficit reduction</li> <li>– Exceptional revenue earmarked for debt reduction (Regulation 1055/2005)</li> </ul>   |

*Source: Based on Gros et al (2005)*

As we can see, the rules have been relaxed in order to accommodate the fact that a 'one size fits all' type of policy cannot serve the needs of 25 countries with divergent structures and at different points in their economic cycle. Thus, certain types of public expenditures

are especially allowed for in assessing a country's budgetary position, while GDP decline is less rigidly defined. Furthermore, the period of time allowed for the correction of excessive deficits has been moderately increased. Lastly, the medium-term fiscal policy rule has been modified so as to take account of the economic cycle.

Although the relaxation of the rules introduced by the above modifications of the SGP allows for a greater judgemental element in the formulation of fiscal policy, it does not replace the rules-based approach embodied in it. Furthermore, to the extent that the simple numerical rules of the initial SGP have been replaced by more sophisticated ones an element of arbitrariness has been introduced, potentially allowing for manipulation and political games by member state governments. Thus, the challenge of linking the EU's legitimate interest in long-term sustainability with the conduct of short run fiscal policy by member states remains unresolved.

As argued by Fatas et al. (2003), sustainability is a long-run concern with few implications for the actual course of government spending, revenues, and deficits in the short run. Therefore, this linkage is of critical importance. In a world with perfect information and no transaction costs the optimal solution would be to adopt an ex ante fiscal policy rule. In reality, however, the world is too complex and uncertain for that. In this sense, numerical criteria of the type embodied in the SGP do not adequately deal with the needs of fiscal policy as shown by the recent EU macroeconomic performance reviewed above. Therefore, even the new, more relaxed SGP cannot be expected to produce an EU-wide fiscal policy that will meet Europe's pressing economic and social needs. The fact that the philosophy and the operational mode of the SGP constitute critical elements of the present Integrated Guidelines is an important aspect of EU economic and social policy.

### *The Integrated Guidelines for Growth and Jobs, 2005–2008*

As mentioned above, the 2005 BEPGs are part of a broader economic policy package, the »Integrated Guidelines 2005–2008«, that also includes the Employment Guidelines. This is the latest in a series of modifications the BEPGs have undergone since they first appeared in 1993. The nature and evolution of the BEPGs as a policy co-ordination instrument is given in box 1, page 71.

The Integrated Guidelines 2005–2008 (CEE 2005) consist of 23 main policy recommendations, of which 15 constitute the BEPGs and eight the Employment Guidelines. We shall go on to present the main elements of the Integrated Guidelines. Our objective is to give a general outline of the main tendency of policy rather than an exhaustive account of it.

Economic stability as a short-run concern and economic sustainability as a long-run concern weigh heavily. More specifically, they are mentioned in four out of the fifteen BEPGs as opposed to, e.g., environmental protection and industrial policy, which account for only one each. In particular, the SGP is explicitly taken into account in a number of instances: under guideline 1 – »take necessary corrective measures in line with the SGP« – as well as guideline 6 –

»pursue an annual improvement in cyclically-adjusted budget deficit net of one-offs and other temporary measures of 0.5 percent of GDP, while ensuring higher adjustment effort in good times«.

Furthermore, the goal of economic stability is pursued through other supply side measures such as wage developments which are expected to contribute to »macroeconomic stability and growth and to increase adaptability« (guideline 5), while the achievement of economic sustainability is sought through the reform of pension and health care systems, amongst others (guideline 2). Still on the supply side, flexibility is a major policy element. This is seen as a means of promoting »greater coherence between macroeconomic stability and growth« (guideline 4) as well as of ensuring »open and competitive markets« (guideline 8). Special attention is also given to creating an attractive business environment, with particular emphasis on small and medium sized enterprises (guidelines 8, 9 and 10), to research and development, and information technology (guidelines 12 and 13, respectively).

Overall, the supply side of the economy is prevalent in the economic policy section of the Integrated Guidelines. For example, in the opening section of the Integrated Guidelines the remarkably low growth rate of the EU is attributed to the »heightened uncertainty over the global economy«. This means the reasons for and, by extension, the answer to the continuing underperformance of the EU is sought in the supply side of the economy to the disregard of the demand side. As a result, policy concentrates on furthering product and labour market reforms, even though it is acknowledged that »the emphasis will fall increasingly on domestic demand in the EU to provide greater impetus to the upswing.« (CEE 2005: 3)

Similarly, special attention is paid to the »realisation of a knowledge society, based upon human capital, education, research and innovation policies«. These are valid Lisbon goals, the realisation of which will help the EU economy overcome its present ills. However, the Guidelines stipulate that these are to be achieved through greater market liberalisation and competition so that a »favourable climate to business and enterprise« is provided while an »adaptable and inclusive labour market« is built.

Such policy orientations are not new in the EU. They go back to the 1980s with the onset and strengthening of neo-liberal economic thinking and policy, while their effectiveness has been shown to be highly doubtful.

With regard to the Employment Guidelines, although the concept of full employment is mentioned, the main focus is on raising the level of employment to the 2010 Lisbon goal of 70 percent overall, 60 percent for women, and 50 percent for older workers (55–64). The means proposed in this respect include promoting a life cycle approach (guideline 17), increasing flexibility in the workplace, and reducing labour market segmentation (guideline 20), as well as ensuring »employment-friendly« wage and other labour cost developments (guideline 21). Investment in human capital, education, and training systems is further recommended under guidelines 22 and 23, respectively.

Can the Integrated Guidelines, 2005–2008, be said to constitute a shift in EU policy? We would argue that to the extent that the review process of the Lisbon Agenda has led

*Box 1: The Broad Economic Policy Guidelines (BEPGs) as a Policy Co-ordination Instrument*


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The rationale and legal basis of the BEPGs are directly traced to the EU Treaty. According to Article 4(1), »[f]or the purposes set out in Article 2, the activities of the Member States and the Community shall include [...] the adoption of an economic policy which is based on the close co-ordination of Member States' economic policies«, where Article 2 states that »[t]he Community shall have as its task [...] to promote [...] a high level of employment [...] sustainable and non-inflationary growth«.

Therefore, the BEPGs are a key EU policy instrument of co-ordination where such co-ordination is politically rather than legally binding. That is, it is based on peer pressure applied by such means as the issuing of a recommendation to non-compliant states which may be made public if deemed necessary.

The size and content of the BEPGs have evolved over time from a four-page long document dealing with general guidelines in 1993 to a two-volume report including an assessment report in 2002. In the intervening years a number of changes have been made: country-specific reports were added in 1999; a special section on capital markets was introduced for the first time in 1998; separate sections on Research & Development and Information and Communication Technology (the »knowledge-based society«) as well as on the environment were incorporated in 2000. Furthermore, since 2000 the BEPGs are accompanied by an Implementation Report assessing the extent to which member-states have followed the previous year's recommendations.

In 2002, the Barcelona European Council urged the Council and the Commission to streamline the present policy co-ordination processes, stating that the focus must be on action for implementation rather than on the annual elaboration of guidelines. The Commission, in its turn, proposed that the BEPGs and the Employment Guidelines constitute the Guidelines Package. As such, they are reviewed simultaneously and are presented together in the form of an Implementation Package complementing its Spring Report.

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to its revitalisation rather than its redesign, while the reform of the SGP has resulted in its relaxation rather than its reformulation, the Integrated Guidelines cannot be said to represent a point of departure in EU economic and social policy. Furthermore, the neo-liberal framework that became prevalent in the 1980s and the ensuing emphasis on stabilisation and market liberalisation remain central policy elements. At the same time, the social implications and aspects of economic policy are awarded limited attention and even less support in terms of funding and prioritisation.

*The Integrated Guidelines' Economic Governance Cycle*

The economic governance cycle of the BEPGs has been subject to criticism for its limited democratic representation and accountability (Frangakis 2003). The limited contribution of the European Parliament and the complete absence of the national parliaments from the process of policy formulation are at the centre of this criticism. Thus, the European

Parliament is called upon to offer its opinion at two points in the process:

- at the point where developments in the European economy are reviewed by the ECOFIN Council, in preparation for the Spring Council, and
- when the ECOFIN debates the guidelines for the following year, on the basis of the »political guidance« offered by the Spring Council, and in preparation of the next European Council which concludes on the BEPGs.

As we saw earlier, the Kok Report focused on the weak political ownership of the Lisbon Agenda concluding that member states need to be implicated directly in the process of the formulation. To this end, national parliaments have been drawn into the process after policy has been concluded by the European Council, and the ECOFIN Council has adopted the particular guidelines for the period in question following the recommendation of the European Commission on which the European Parliament has offered an opinion. At that point, member states are asked to draw up national programmes detailing the action to be taken at the national level in order to achieve the Lisbon objectives (CEE 2005d). This is the new element introduced by the Integrated Guidelines into the economic governance cycle whereby member states are expected to choose the »local responses that best address their reform challenges, thereby fostering national ownership«. In other words, within a set policy agenda member states are invited to select the implementation process that best fits their particular circumstances. For its part, the Commission prepares a Community Lisbon Programme detailing the actions to be taken at the Community level which is to be implemented in parallel with the national programmes.

Generally, the EU is executive-dominated insofar as the making, administration, and implementation of policy entails the existence of a large number of two-tiered or multi-level inter-governmental committees the democratic accountability of which is problematic. This is especially so to the extent that the European Parliament has very limited sanctions in terms of calling the Council to account, while few national parliaments have generated effective ways of calling ministers to account over their actions in the Council.

Under these conditions, policy is often seen to be formulated in a popular vacuum dominated by technocrats enjoying immunity from accountability. Such a conception of policy has led to a fragile legitimacy which is called into question especially at the time of »grand bargains«, such as the Maastricht referenda and, more recently, the European constitution referenda, marking watersheds in public attitudes towards the EU (Banchoff/Smith 1999). Although the new economic governance measures introduced by the Integrated Guidelines go some way towards enhancing the transparency of policy formulation in the EU, they fall short of strengthening the EU's weak democratic basis. As a result, the process of integration continues to be perceived as a process of economic liberalisation, divorced from the concerns of ordinary citizens, calling into question the already fragile popular support for the EU.<sup>5</sup>

5 For example, the development of social policy and especially employment policy since the 1990s has been a retreat from legislative measures and a move towards other policy instruments such as recommendations and social dialogue (Armstrong/Bulmer 1998).

This makes for a weak European identity which in turn strengthens the territorial politics of the EU member states as the root of democratic governance.

### *Conclusions*

It has been argued that the Integrated Guidelines have introduced certain new elements into the process of policy formulation in the EU. These are largely of a procedural nature: for example, the merging of the BEPGs and the Employment Guidelines into one set of guidelines; the reporting by member states and by the Commission on a broad spectrum of policy areas within one document instead of the proliferation of reports that has become common in recent years; the clarification of the area of responsibility of the Commission vis-a-vis that of the member states.

Such procedural innovations, however, do not resolve the problem of the democratic deficit that is endemic in the institutional structure of the EU. The role of the European Parliament, as well as that of the national parliaments, remains a secondary one in relation to that of governments. The fact that more information is to flow both to the European and to the national parliaments is to be welcomed. This, however, goes only part of the way towards dealing with the fragile legitimacy of EU policy formulation. In particular, the democratic content of economic policy formulation would be greatly enhanced were the European Parliament to participate on a par with the Council. In addition, national parliaments would need to provide an opinion. Such an opinion would be of a consultative nature and it would need to be taken into account both by the European Parliament and by the Council. In this way, national parliaments would be actively involved throughout the process of policy formulation rather than at its end point, while public awareness would be greatly raised.

In terms of content, the Integrated Guidelines reflect the changes that have been made to the Lisbon Agenda and to the Stability and Growth Pact. As discussed earlier, such changes do not redress the basic asymmetry of EU policy whereby the economic aspects of policy prevail over the social ones. On the contrary, this asymmetry is exacerbated by the following two factors:

- The low level of the Community budget. For example, in 2006 the agreed expenditure ceiling stands at 1.11 percent of gross national income in commitments.<sup>6</sup>
- The dichotomy between monetary and economic policy whereby the former is conducted in isolation from the latter by an independent body, the European Central Bank.

Overall, economic and social policy making in the EU is evolving under the pressure of global developments and of its internal political and social contradictions. The outcome

6 The failure of the June 2005 European Council to agree on the financial perspectives for 2007 to 2013 is indicative of the crisis the EU finds itself in. The then President of the European Council, Luxembourg Prime Minister Jean-Claude Juncker, noted that »Europe finds itself in a deep crisis« (European Council 2005).



of the 2005 referenda in France and the Netherlands, rejecting the proposed constitutional treaty, is indicative of the growing unrest in Europe due to its inability to deal with the mounting social and economic problems in many areas.

The European Council, assessing the situation at its June 2005 meeting, concluded that

»these results do not call into question citizens' attachment to the construction of Europe. Citizens have nevertheless expressed concerns and worries which need to be taken into account.« (European Council 2005)

Our analysis of the Integrated Guidelines leads us to the conclusion that such »concerns and worries« have not been taken into account in a clear and adequate way.

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## Democracy and Europe's Crisis of Legitimacy

*Stefan Collignon*\*

The European Union is in a state of profound crisis. The way it responds to its current situation will determine whether the European dream can survive. The failed ratification of the Constitutional Treaty first revealed the crisis. The European Council meeting in June 2005 then aggravated it, when the heads of state and government failed to agree on a financial framework for the EU budget over the next seven years. Although a compromise was stitched up in December, the European Parliament has rejected it as insufficient. Without the financial means to implement policies, the efficiency of European policy-making is seriously hampered, and without a constitution there is little hope that this will improve.

Yet, the idea of European integration is not dead. When the citizens of France and the Netherlands rejected Europe's Constitutional Treaty in their referenda, they only brought into the open the crisis of EU legitimacy that has developed for years in the shadow of the high diplomacy of European intergovernmental cooperation. However, they did not create this crisis; nor did they reject »Europe«. Opinion polls in France reveal that only one quarter of the »No«-voters were sensitive to »sovereignist« arguments about maintaining French identity (see for example Ipsos 2005). Given that the »No« won with 54 percent, the »sovereignist« share reflects approximately the electoral weight of Jean-Marie Le Pen, the extreme right wing candidate in the 2002 presidential elections. Three quarters of those who voted against the Constitution did so, not because they rejected Europe, but because they wanted a different Europe.

But what Europe do they want? The problem is that European integration has created such a wide range of common public goods, which are administered by cooperation between governments, that citizens feel political control is escaping them. Hence, they want more democracy. The sustainability of the EU is in question, with far-reaching geostrategic consequences, unless the issue of democracy is handled. I will first trace the main challenges to the European integration model and then discuss possible responses.

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