

## Confronting Crisis in the European Union: A Fresh Start

### 1. Tackling the issues in the right order

The European Union is suffering a deep crisis: disdain, disillusionment and distrust top the list of prevailing sentiments towards the European institutions, as was brought home dramatically by the failed referenda on the Constitutional Treaty in France and the Netherlands.

The diagnosis of the problem, however, and its attendant cure are far from clear. Is declining popularity a transitory effect of persistent slow growth and unemployment or, more fundamentally, of mounting social strains blamed on globalisation and immigration? Is it the frustration from the apparent inability of the European Council to reach agreement on vital decisions affecting the security and well-being of its citizens? Is it the distance and complexity of common institutions, turning out an endless flow of cumbersome rules, seemingly undisturbed by objections raised from all quarters? And, finally, is it the perceived lack of democratic accountability of European institutions, the widespread perception that a creeping theft of sovereignty has expropriated citizens of their right to take fundamental decisions shaping their economic and social circumstances, changing their societies without consulting them?

While these proposed explanations are not necessarily well founded, they do point to policy issues that are constantly being raised in public policy discourse and therefore must be given an appropriate response. Grievances do not amount, per se, to the identification of the cures, but they reflect to an important extent the frustrations generated by weak policies. For instance, widespread fears of integration or immigration do not provide sound reasons for raising barriers against the free flow of people and capital: protectionism would dramatically damage the economy without helping a bit to resolve social strains in our societies. Other queries appear more solid, such as the longstanding critique on the functioning and accountability of European institutions, systematically ignored by Brussels

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policy circles, and the various rounds of institutional negotiations over the past decade, including the Convention that led to the Constitutional Treaty.

In some member countries, the relationship between domestic political opinion and policy-makers is as difficult as that which obtains at the EU level. It is not by coincidence that the distrust in the domestic policy-making élite is also greatest in France. The French electorate has been told for years that all successes are due to the actions of the French government and that all problems come either from Brussels or from globalisation. When the same political élite then tried to sell the draft Constitutional Treaty, it is not surprising that the outcome was a no to both Europe and to the domestic élite.

Up until recently, it did not matter greatly that public opinion was no longer enthusiastic about European integration, since the elaborate compromises reached at the EU level were usually pushed through national parliaments where the governments, which had signed the deal, dominated the agenda. With the failed referenda in France and Holland, however, it is no longer possible to continue to rely on what was once called the 'permissive consensus'. This implies that domestic political weakness in key countries is spilling over to the EU level.

There is thus a crisis of legitimacy both at the EU and, in many cases, at the national level. The EU's problems cannot be fully resolved until democracy is working satisfactorily at the national level as well. However, improving the functioning and democratic accountability of the EU as well as clarifying the distribution of competences between the member states and the Union will not only be beneficial by itself, it will also clarify in many cases the terms of the national debate.

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The European Council has addressed at its meetings the decline in popularity of the Union and the possibility that ratification of the Constitutional Treaty will fail, but so far has not managed to develop effective responses. In June 2005, the Heads of State and Government called for a period of reflection devoted to listening to “citizens, civil society, social partners, national parliaments and political parties”. The main conclusion was that “citizens remain committed to the European project ...[but] ... expect the Union to prove its added value”. In June 2006, the European Council decided a “twin track” approach whereby on the one hand it would try to improve the “delivery of concrete results” from Union policies, working within existing treaties; on the other hand it would “continue to reflect” on institutional reforms and ratification of the Constitutional Treaty.

The presidency conclusions of that meeting vividly illustrate policy sensitivities at this juncture. Internal security comes first, with efforts to accelerate implementation of the Schengen *acquis* and legislative measures under consideration on border control and police and judicial cooperation; a “global approach” to migration whose main purpose is to mitigate migrants’ pressure on EU borders; and measures against terrorism, international crime and trafficking in human beings. Environment, energy and the economy come second. Due tribute is paid to Kyoto and the Energy Charter, the Lisbon strategy and the European social model; the list of policy goals is long but lacks focus and a clear direction. The instruments available to implement agreed policies appear weak, little more than well-meaning exhortations. Precise specification of objectives and publicity on member states’ achievements are avoided, lest somebody gets embarrassed.

Tellingly, the chapter “Looking to the future” places institutions first and enlargement second: a reflection of the view that further enlargement must be subordinated to effective reforms of common institutions – but there is no agreement on what should be changed and how. Here too the proposed medication indicates where the pain is. It was agreed to improve transparency of Council deliberations; strengthen the role of national parliaments in the early stages of EU legislation, so as to better respect the principle of subsidiarity; and improve comitology procedures, long seen as the seat of opaque decision-making out of sight of Parliaments and the public opinion. As for the Constitutional Treaty, the Council had little to say, except noting that some countries are still continuing the ratification process: code-words signalling the divisions over the fate of the ponderous document.

Enlargement is last. At its forthcoming December meeting, the Council will debate “all aspects of further enlargement, including the Union’s capacity

to absorb new members” since “the pace of enlargement must take the Union’s absorption capacity into account”. Accordingly, the Commission was asked “to provide a special report on all aspects pertaining to the Union’s absorption capacity”, notably including “the perception of enlargement by citizens ... and the need to explain the enlargement process adequately to the public”. That report has now been published.<sup>1</sup> It neatly dissects the issue into operational questions on the functioning of institutions, the impact of enlargement on the EU budget and the ability of new member states to meet the obligations of membership. The ready conclusion is that serious impediments do not exist but better communication is called for to convince a reluctant public opinion. Unfortunately, the public opinion is not likely to be reassured by technical argument. Visible opposition to further enlargement in many European quarters is also generating growing opposition to domestic reforms in applicant countries.

Altogether, while there are useful policy initiatives, the European project is in the doldrums, seemingly unable to re-connect to European citizens. The crux of the difficulty lays in the ambiguity and opacity of policies and goals in the areas that matter most to public opinion: rather than confronting disagreements and sorting them out, increasingly over the past decade the member states have concealed them in convoluted language, acknowledging all views and following none. The Commission has followed suit by filling its papers with ever-longer lists of goals where everyone could delude themselves in believing they had won the day.

In order to rebuild consensus, three critical areas stand out in need of clarification and fresh initiative: the common framework for policy coordination, the budget and the democratic deficit in European institutions. The chances of success would be enhanced by tackling these issues in the right order. Policy coordination should be addressed first since it has a crucial role in re-establishing support for the goal of integration; the new budget would then be able to better reflect policy priorities; and, finally, the debate on institutions would rest on more solid foundations with credible policy and budgetary frameworks in place.

Decisions in the three areas should be tackled separately, each one on its own merits, but the direction should be clear on all three in good time for the European elections in 2009 – although decisions on institutions might have to be postponed until later. It is not an impossible task if the European leaders really want to restore the Union’s credibility.

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<sup>1</sup> Enlargement Strategy and Main Challenges 2006-07, COM(2006)649 of 8 November 2006.

## 2. Soft policy coordination that matters

Policy coordination within the Union rests on ‘hard’ rules for free movement, competition policy and state aid, and monetary and fiscal policies; ‘soft’ coordination prevails everywhere else (Micossi, 2003). The hard rules are straightforward. Free movement and competition policies must be respected, under the threat of legal sanctions; exceptions are allowed for well-circumscribed public interests. Monetary policy is centralised in the hands of an independent European System of Central Banks; fiscal policy belongs to the member states but must respect the constraints on yearly deficits and the total debt of the public sector.

Soft coordination has its legal foundation in Articles 98-99 (for broad economic policies) and 125-129 (for employment policies) of the EC Treaty. Under these articles, the member states shall consider economic and employment policies “as a matter of common concern” and shall coordinate them within the European Council. The Council adopts yearly common orientations and guidelines for broad economic policies (Broad Economic Policy Guidelines or BEPG) and for employment; its members are called to report periodically on national implementing measures but there are no sanctions for failing to comply. Peer pressure is brought to bear by compiling ‘league’ tables that compare results and foster the adoption of best practices. The Commission provides the secretariat but has no power of initiative in policy design or Council decisions. The European Parliament is kept informed. This approach is known as the Open Method of Coordination (OCM).

In 2000 in Lisbon the European Council adopted an ambitious programme of structural reform to raise productivity growth and accelerate the transition to a knowledge-based economy – the Lisbon Agenda – also to be pursued through the OCM. All the main economic and social policies were included, including reform of education, employment and welfare systems, in many areas with specified quantitative policy goals – even if under the treaties the Union has little competence in these domains. These broad demands for (soft) policy coordination placed by the member states on the European Council and the Council of ministers need to be explained.

Two separate questions must be addressed. First, why do the member states want to coordinate their policies at Union level, beyond what is required by hard Treaty rules? And, second: if a demand for coordination is justified, how should the exercise be construed so as to make it useful and effective?

### Why coordinate policies at Union level?

Most economists believe that there isn’t much to be gained from policy coordination at the Union level,

since measured policy spillovers – say on growth, employment or inflation – across Union members appear small, notably for supply-side policies in the Lisbon agenda (perhaps with the exception of research policies). Furthermore, increased heterogeneity in member states’ economic and social structures entails rising costs of uniform policies (Tabellini & Wyplosz, 2004). The unavoidable conclusion is that national governments and politicians don’t know enough economics and their attempts at coordination are misguided.

However, a fundamental premise of the social sciences is that observed behaviour reveals something not only about individual preferences, but also about the efficiency of existing institutional settings. In this vein, Nobel laureate Gary Becker famously argued that any observed amount of redistribution is socially optimal; and Andrew Moravcsik (1998) contended that Union institutional arrangements reflect a viable compromise between their policy preferences. If the same line of reasoning applied here, the economists have not searched for the right evidence.

The EC Treaty’s paramount goal is economic integration through the four freedoms of movement – for goods, services, capital and people – and the creation of a Single Market (Articles 3 and 14). In order to sustain the free flow of trade and payments during the past five decades, the members of the European Community, later the Union, have accepted increasing constraints over their policy autonomy. Thus, after the collapse of the Bretton Woods System, at the end of the 1970s the European Monetary System (EMS) was created to stabilise exchange rates within the European Community (EC); in the early 1990s, crisis in the EMS – when the lira and pound sterling were forced out of the EMS by irresistible capital flows – convinced its members (except the UK) to surrender monetary policy and adopt the euro to preserve the internal market. The need to avoid trade disruptions motivated the other members of the EC to bring a reluctant and financially unstable Italy into the EMS in 1979 and into monetary union in 1998.

This revealed preference for exchange rate stability calls our attention to another feature of the EC economic structure: the rigidity of its labour, capital and services markets, effectively protected from market forces by regulation and corporatist arrangements. Exchange rate adjustments were especially disliked because they challenged established equilibria between capital and labour, the public and private sector and the different economic activities. However, by enhancing integration and competition, over time monetary union has created even-stronger pressure to repudiate rigidity and market barriers. If prices and wages cannot adjust in response to market forces, then the burden of

adjustment inevitably falls onto the labour market, leading to higher unemployment.

The rigidities and protections in our economies are incompatible with full realisation of the internal market: which explains why certain parts of public opinion view the Union policies and the euro as a threat to their ‘societal model’, why the services directive became so controversial. In the long run the inability to tackle domestic rigidities, notably in the largest continental economies, poses a mortal threat to the internal market. Should Italy, or France, fail to accept flexibility and open markets, eventually they would be tempted to renege on free movement and abandon the euro, with destructive consequences for all. Policy coordination may help avert this danger.

Therefore, there is a ‘common good’ made up by ‘sound’ domestic policies – i.e. policies that are consistent with integration in the internal market in all the member states; this public good is likely to be under-produced since the external repercussions of domestic policies will be underplayed in national deliberations. This externality may well explain why the member states of the Union have decided to “regard their economic policies as a matter of common concern” and, accordingly, have set up procedures to coordinate them. They have decided to do it “within the European Council” and with *ad hoc* procedures because the matter does not belong to Community competences and the member states are keen to retain full control of national policies.

As argued in IMF (2004b) and Debrun & Pisani-Ferry (2006), the benefits of coordination are likely to be reinforced by ‘learning’ spillovers in reform policies. Among other things, structural reforms are resisted by public opinion, owing to their uncertainty about adjustment costs and their distribution; the exchange of information between policy-makers can help improve policy design and allay fears on the effects of reforms, thus facilitating decisions. Empirical evidence lends support to this view: reforms tend to spread in waves and follow similar patterns within similar countries and regions, indicating the relevance of imitation in national policy processes (IMF, 2004a).

The existence of learning spillovers and policy imitation greatly enhances the importance of the policy message sent to the public by the European Council. If the policy message is clear and the member states can show that they mean business, a virtuous circle of improved expectations and economic performance can be set in motion. This would not only reduce the cost of reform; it would also strengthen the image of the Union to the extent that its citizens could again regard it as the source of effective solutions to their predicaments.

## What policy goals?

It follows from the above that the main goal of policy coordination at Union level is to build consensus on market-oriented structural reform, to convince a scared public opinion that economic integration and free movement are likely to improve their economic conditions rather than imperil them. Hard policy rules are not sufficient to this end; indeed, in recent years they have often been viewed as an unbearable limitation to domestic policy autonomy.

The message sent out by the European Council on the direction of economic policies has been muddled: we must change at the same time that our ‘social model’ must be preserved; we need market-opening measures in services but want to preserve many special protections – e.g. for public services employees, regulated professions, small shop-keepers and university professors – well beyond what is justified by public interests; and, finally, more flexibility and adaptability of labour are desirable but greater spending in education and research might improve productivity without reducing employment protection.

The message is muddled because the European Council is divided on the appropriate medicine for Europe’s low growth: some countries advocate expansionary budgetary policies as an alternative to market-opening measures; they would also like to mute the effects of tax competition on private capital flows by imposing minimum tax rates on corporate income. Other countries place the emphasis on supply-side measures; they argue that capital will shun high-taxation countries and that the Union should aim at creating an economic, social and institutional environment favourable to entrepreneurship and risk-taking. They have on their side massive empirical evidence showing that public spending cannot create sustained growth; that market-opening reforms always lead to higher growth and lower unemployment; that the efficacy of research and infrastructure investment is predicated on a favourable economic environment.

Unless this disagreement is resolved, there can be no clear policy message and public opinion will continue to regard the European Council as an ineffective, even irrelevant sounding board. A strong message can only be founded on a credible policy framework centred on renewed commitment to the goals of integration and flexible economic structures. Otherwise, the entire European project cannot advance and will remain vulnerable to the sirens of protectionism.

At the same time, citizens must be reassured that they will be helped in meeting the challenge of integration and globalisation; that appropriate policies can increase the number of those who will gain from integration and effectively protect those who might

initially stand to lose. There are plenty of success stories in the Union that may be shown to allay public fears and may be replicated. Compromise and ambiguity in policy goals have diverted attention from the real question to be tackled, which is to manage adjustment properly, rather than resist it, and convince citizens that they will not be left alone. In this regard, two critical policy areas stand out: employment protection and immigration.

### *From employment to income protection*

Outdated labour market rules are main reason why the full benefits of the internal market and monetary union have failed to materialise, and productivity and innovation stagnate (Sapir, 2005). They are a main source of insecurity for ‘insiders’, i.e. protected workers, who see their corporatist shields crumbling under the thrust of globalisation and technological change and oppose change only to gain time; their protection prevents ‘outsiders’ from getting stable jobs and confines them to a precarious life of exclusion. The insecurity of both groups provides fertile ground for fomenting anti-Union sentiments.

The experiences of successful reform in Anglo-Saxon and Nordic European countries show that we are not condemned to stagnation and decline, provided we are ready to adapt our economic and social institutions. Rigid employment protection should be replaced by temporary income protection and active support to accompany affected workers to a new job; thus, resources could flow more easily to new sectors and innovative activities. The gradual elimination of dual labour-market arrangements would boost equity in our societies together with economic efficiency: a recent study shows that in the long run dual labour markets damage human capital, with permanent adverse effects on productivity and the growth potential (cf. Allard & Lindert, 2006).

The European Council has a crucial role to play in building support for the right policies in this domain – but so far has shirked from taking a clear stand. Its message would be heard more distinctly if it was simple and direct, indicating the desirability of precise policy measures: for instance, it could recommend that the required relaxation of employment protection be accompanied by a Union-wide minimum wage and an unemployment subsidy equal to the minimum wage – to be set somewhere between 50 and 70% of the statutory wage for regular long-term employment of low-skilled workers. Active labour market policies, as already applied with success in a number of EU countries, would ensure training and reemployment to those displaced by restructuring. The endorsement by the European Council of such a comprehensive and coherent policy package would help reduce the public’s resistance to reform and encourage irresolute governments to act.

### *Welfare policies and migration permits*

Immigration poses even more difficult challenges for free movement, since it is broadly perceived as a main source of economic insecurity; immigrants are also seen as posing a threat to the availability of social services for poor natives. These fears breed opposition to enlargement. In a 2006 survey by Eurobarometer on “The future of Europe”, 63% of respondents in the EU-15 believed that enlargement would increase unemployment, up from 43% in 2003; this percentage was above 70% in Austria and France (Grant, 2006).

The Union dimension of the issue is enhanced by substantial policy spillovers. There is evidence that restrictions and selection systems in one country divert migrants’ flows to other countries in the Union (Brücker, 2006); migration is attracted by generous welfare entitlements and their redistribution component (Boeri, 2006), which in some member states has already led to a selective lowering of welfare entitlements. Moreover, immigration is absorbed more smoothly in well-functioning labour markets, which attract migrants with higher qualifications; while countries with rigid employment protection tend to attract low-skilled migrants, with direct impact on the wages and jobs of low-paid native workers. Labour migration also presents a number of challenges for source countries, which may see their pool of young and educated substantially diminished.

Thus, the task of policy coordination in the European Council is well identified: it must contribute effective remedies to the negative spillovers that may result from uncoordinated national policies.

First of all, immigration from new member states since 2004 has been considerably larger than expected, notably into countries that opened the door without transitional measures. However, available evidence would not indicate any strong job displacement in receiving countries; in many cases, labour inflows from enlargement countries alleviated labour market shortages and supported an increased activity rate of the native populations (Heinz & Ward-Warmedinger, 2006). The adverse impact on low wages in receiving countries is likely to have been more significant, given existing wage differentials between the EU-15 and enlargement countries, but conclusive evidence is yet lacking. On welfare services, migrants are over-represented among recipients of non-contributory social transfers, such as social assistance and housing benefits (Boeri, 2006); on the other hand, they are in general net contributors to pension systems and public budgets. It should also be noted that migrants from within the Union countries often intend to return to their country of origin as soon as conditions permit; the evidence from previous enlargements confirms that initial flows are partially reversed after some years (OECD,

2006). This fact and the substantial flows of remittances to relatives left behind also mitigate fears of large adverse effects of migration on source countries. Of course, for all these various effects it is not easy to disentangle the general impact of migration from the specific effects of intra-EU migration flows, which represent a lesser share of the total (cf. OECD, 2006).

However, better communication of economic data is not likely to change deeply-held beliefs. Appropriate policies to manage immigration flows and access to welfare policies are also required, while avoiding the danger of creating different classes of citizens and preserving uniform treatment of workers in similar conditions.

The adoption of a minimum wage and unemployment subsidy would go a long way towards counteracting the perception of migrants inducing lower wages for low-skilled native workers; a common Union framework would act as a sort of ‘welfare floor’ and generalised safety net against poverty, thus mitigating the diversionary effects of different labour market rules in the member states (Atkinson, 1998). The Union social funds – which aren’t very well spent at present – could be utilised to support these welfare payments in poorer regions, as suggested by Boeri (2006), giving also the Union some monitoring powers. The image of the Union could benefit enormously from such a scheme, which would directly address societal fears and project a message of fairness over the entire European society.

On the other hand, the Union should try to discourage selective exclusion of immigrants from welfare benefits. The US experience shows that a decentralised system discriminating against immigrants is not likely to be politically sustainable; in all likelihood it will eventually be challenged before EU courts (Boeri, 2006).

The second measure that should be rapidly pushed forward by the European Council is a common scheme for admission of immigrant workers from third countries to the Union, as the European Commission has already suggested with its Policy Plan on Legal Migration (European Commission, 2005b), so as to provide a framework of rights to all third-country nationals in legal employment in the Union but not yet entitled to long-term residence. Specific measures are envisaged to deal with highly skilled workers, temporary and seasonal workers and trainees.

The general criteria for admission should include the existence of a work contract and an ‘economic need’ test, as suggested by the Commission, but could go further. As proposed, amongst others, by Boeri (2006) and von Weizsäcker (2006), it should also include a ‘point system’ for the selection of applicants for residence and work permits. A point

system allocates each application a score based on objective criteria, typically including language abilities, education and experience; successful experiments have been tried in Australia, New Zealand and Switzerland; the UK and Germany are moving in that direction.

By combining a common legal framework with a point-based admission system and a ‘welfare floor’ as described, the Union would achieve several important results: it would create a level playing field in the labour markets; it would raise the growth impact of immigration, owing to its higher skill content; and the unskilled and those with criminal records would find it more difficult to come. As a result, there is ground to hope that native workers would be less fearful of immigration and would reduce their opposition to the free flow of labour within the Union and further enlargement.

### *Making soft coordination bite*

We have established that the European Council has legitimately tried to develop a common framework for the coordination of the economic policies of the member states. The OCM was chosen as the implementing method because ‘hard’ rules and the Community method cannot apply: economic policies remain a central prerogative of national governments and parliaments and, in addition, efficient uniform policies across the member states would be impossible to design, given the wide differences in economic structures and policy preferences.

Soft coordination via the OCM provides an appropriately flexible framework whereby the European Council identifies the common goals and the member states decide the appropriate measures to get there. However, results in the implementation of the Lisbon agenda have been disappointing. A report commissioned by the European Council in 2004 accurately described the reasons of failure (Kok, 2004): too many and incoherent policy goals, confusion of responsibility between the Union institutions and the member states and weak implementation at national level. Moreover, public opinion was led to believe that all policies were in the hands of the Union, leading to disillusionment and frustration when it became apparent that the Union, left alone, was powerless. The report suggested that the member states should take explicit primary responsibility for implementing well-identified reform policies; that procedures for peer review should be strengthened by stronger publicity on national results and ‘naming and shaming’ the laggards; and that Union policies, including the budget, should better reflect Lisbon priorities.

Accordingly, in 2005 the Commission published its policy recommendations to the spring meeting of the European Council (European Commission, 2005a); however, while accepting the thrust of the Kok

Report, it was unable to present a simplified and meaningful list of goals. The Council, for its part, decided not to follow the Commission's recommendations on the strengthening of peer review procedures; as a result, the benchmarking and publication of policy results has de facto been abandoned. Finally, as documented by Pisani-Ferry & Sapir (2006), the national 'integrated' economic programmes for the implementation of the Lisbon agenda have in the main remained pious intentions. Therefore, soft policy coordination in the European Council remains ineffective and without teeth.

There is no magic formula to resolve the problem; the Kok recommendations appear fully valid and should be taken seriously. The European Council must concentrate its policy goals on the protection of the internal market and integration; and must effectively allocate the responsibilities for their implementation and obtain serious commitment by the member states to do their share. Peer pressure must be strengthened, benchmarking should be resumed. The spring meeting of the Council offers the opportunity to review the state of affairs and bring new life to soft policy coordination.

### 3. Priorities and decision-making for the EU budget<sup>2</sup>

At present the European Union's budget contributes to the disillusionment and distrust of the population. The problem is that it does not reflect the priorities of EU citizens. Over 40% of spending supports agriculture, a declining sector which employs less than 5% of the labour force. Outlays for research and innovation, the main drivers of productivity growth, are too small to be effective and this obvious contradiction with the priorities loudly proclaimed by the Council affects the credibility of the EU's entire growth strategy. Moreover, there is very little money for the new public goods of domestic and external security that public opinion demands.

However, reform is impossible as long as the budget is determined in an intergovernmental European Council negotiation in which no one defends the over-arching European interest, since all member countries care only about their 'net balance' of contributions to or from the EU. Radical changes are thus needed both in the content of the budget – its revenues and spending programmes – and decision-making procedures to endow the Union with an effective instrument to foster its policy goals. Only with a new procedure, one in which European interests dominate, could the Union design a better budget. The European Parliament, which represents European citizens directly, must be given the main say in the budget's structure, while the European

Council of the member states' national leaders should provide appropriate safeguards against excessive spending. Movement in this direction can start immediately, even within the present legislative framework.

The impasse after voters' rejection of the draft EU Constitutional Treaty in France and the Netherlands only increases the need for reform along these lines. We now know that the electorate rejects the outcome of intergovernmental negotiations that often reflect more the positions of special interest groups than those of the EU population.

That the EU budget no longer reflects the Union's main missions and policy goals is now clear. How did this come about? Decades ago the rationale for farm and regional aid, the items that now dominate the allocations, was the perception that Europe had to ensure its own food supplies and that poorer member countries had to be bribed to accept the internal market and monetary union. But the main legacy today of the 'founding' compromises on agricultural and structural funds is that the budget is basically seen as a tool for redistributing money between member states rather than fostering common goals.

This implies that in the intergovernmental negotiations that determine the budget no voice promotes overall EU interests. For any individual member country, the return from defending an all-encompassing EU-wide interest is negligible against the return from changing the budget in a way that might lead to lower overall efficiency, but still gives more money to its own country.

Moreover, the increasing detachment of the budget from the Union's own objectives is reinforced by decision-making procedures that ensure rigidity in budgetary allocations. Decisions on the overall resource ceiling and the allocation of spending among the main budget headings are laid out in the multi-year financial perspective (MYFP) for seven years. Besides, decisions on agriculture and other multi-year programmes like research are often taken outside the regular budgetary procedures and within a different time frame.

The current MYFP (valid 2007-13) does not contain meaningful movement in the right direction. Reform continues to be prejudged by the Franco-German deal of 2002 to block further reform of agricultural policies until 2013. Only if this obstacle can be removed can there be hope that the review of the budget scheduled for 2007-08 will lead to reform.

As long as the exorbitant farm subsidies remain, the intention to limit appropriation commitments to 1% of GDP has shifted most of the adjustment burden onto structural funds – with all the bitter rows and standoffs between old recipients and new entrants that this has implied. There has been insufficient room for the desirable shift of resources in favour of

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<sup>2</sup> This section is based on Gros & Micossi (2005).

research, education, and institution-building that is badly needed to reignite growth, or the new requirements in foreign policy, defence and internal security.

Rejection of the draft EU Constitutional Treaty in the referenda in France and the Netherlands should trigger a fundamental rethink of the Union budget. Radical changes are needed both in the content of the budget – its revenues and spending programmes – and decision-making procedures to endow the Union with an effective instrument to foster its policy goals. Only with a new procedure, one in which European interests rather than national special interests dominate, could the EU come up with a better budget. The combination of the scheduled review of the budget and the ongoing re-thinking of the role of the institutions provides an opportunity for reform.

The fate of the referenda shows that citizens must be made fully aware of what the EU is doing, so they can decide intelligently on the money they are willing to devote to the Union. The European Parliament, which is the citizens' direct representative in European institutions, must be given the main say in budgetary decisions (with appropriate safeguards against excessive spending). The debate on these changes should be opened immediately. The nature of the budgetary process could be changed radically if a political agreement can be reached on what is needed.

### **What priorities?**

Does the Union now require a much bigger budget to fulfil its mission? Historically, the first aim of the EU was to open markets and integrate national economies. By now market integration has been largely achieved for manufactured products, although not yet for services – but the latter function is mainly regulatory and does not require substantial spending at the EU level. Greater resources would essentially be needed only to strengthen market surveillance and enforcement at national level.

The adoption of a common currency is also not an argument for more spending at the Union level. EMU too can be run without a large central budget, since fiscal policy has clearly been left in the hands of the member states. Even if anti-cyclical stabilisation were entrusted to the Union, this would not seem to require a large budget. It could be undertaken simply by coordinating national budgets; and asymmetric shocks could be handled by establishing a common insurance fund to provide appropriate (temporary) financial assistance to affected countries.

As for the common agricultural policy (CAP), there is broad agreement that all subsidies and price supports should be phased out, and that their place should be taken by direct payments to farmers and rural development programmes. Furthermore, it is

clear that member states are in a better position than the EU to execute such a 'new' agricultural policy, which basically entails inter-personal redistribution and local development.

Farm spending is a major distorting factor in the EU economy and a distinct obstacle to implementation of the Lisbon agenda of liberalising European economies. The new members of the Union have relative large agricultural sectors and are thus keen to keep expenditures high. But in fact they are likely to suffer most if present levels continue, since the CAP pushes relative prices and incomes to favour agriculture and thus discourages investment in industry and services, where the potential for technical progress and productivity increase is much larger. Moreover, EU external development aid is made ineffective and crippled politically by the barriers to farm imports that are maintained because of the CAP.

Historically, farm subsidies have been a major source of tension between the member states, because of the skewed distribution of payments and their impact on countries' net balances vis-à-vis the EU. There is a strong positive relation between agricultural spending and the size of countries' net balances with the Union. Phasing out the CAP would help restore a climate of solidarity and shared interest in future negotiations on the budget and new budgetary rules.

When the EU's internal market programme was launched and plans for EMU began to take form, it was argued that the EU needed to compensate poorer member countries for taking a risk by exposing their weak economies to full competition and by agreeing to plans for a common currency that would require budgetary discipline on their part. Structural funds have thus represented the concrete expression of solidarity between the member states and their people, as the Maastricht Treaty explicitly recognises. This arrangement is necessary for an effective functioning of the Union's political institutions.

Financing under this heading should therefore continue to exist – but it should also be clear that such support cannot last forever and should be phased out as the newcomers' standards of living rise as a result of integration. To this end, eligibility should be based on objective and transparent criteria and include incentives to reward the best performers, enhancing the perception of structural funds policy as a European public good.

Indeed, public policies can play an important role in raising productivity, growth and employment. Yet more generous public spending will not work unless there is an economic and social environment open to competition, risk-taking, and change. Without this, higher public investment would not succeed and would only feed inefficiency and waste. The best role



for the European Union to play is that of a catalyst for better policies, with success dependent on national policies.

The one exception might be research and development, which constitutes a typical public good whose benefits extend far beyond national boundaries. Recent research suggests that R&D is a key growth factor. Here a substantial increase would be justified in EU funding of public and private research centres and networks of excellence in all sciences, and in enhancing the mobility of researchers.

More resources cannot be justified, however, unless EU funds are spent more productively. The present system, in which priorities in the Framework Programmes are the result of political negotiations in the Council and funds are disbursed by the European Commission, leads to a wasteful multiplication of priorities and fragmentation of grants. It should be dismantled.

Increased EU funding alone, of course, cannot bring European R&D to the level required to realise the EU's proclaimed goals of building a 'knowledge society'. More than 90% of all R&D spending in Europe remains at the national level. And R&D spending in Europe in any case yields a much lower return than its US counterpart in terms of commercially exploitable ideas. The objective should be not just to increase the quantity, but also to improve the efficacy of European research spending. The best way to do this is to open the market. National R&D funding – including all national science support programmes – should be open to Union-wide competition.

It is useful to consider as well other new functions ('public goods') that the Union usefully can and should take up on a much larger scale, such as internal and external security and foreign policy. With the free movement of people within the EU, the need for a common approach to guarding external borders and combating international crime has become evident; over time, common institutions will be required in this field. In a Union that is soon to have 27 members, a matrix of bilateral liaison officers among national policy agencies has over 700 different points of contact. The sheer force of complexity of an intergovernmental approach strongly suggests that this area must be run under the Community approach. A European FBI, a European Border Guard and a European prosecutor might well be operating by the time the next MYFP is discussed in the 2010s. The economies of scale present in the field of external security have been forcefully illustrated in recent conflicts, from Kosovo to Iraq and Lebanon. When member states do not coordinate their policies and pool their means, Europe does not count.

This brief discussion suggests one guiding principle for the EU budget: expenditure at the EU level is appropriate only if needed to safeguard a European public good. Over time, this simple principle should become fully internalised in the structure of the EU budget. There is no justification for spending, over decades, a major part of the EU's scarce resources on a declining industry such as agriculture. Substantial resources must still be devoted to promoting income convergence, which is needed to preserve the political cohesion that allows the EU to work efficiently. And the role of the Union in fostering productivity, growth and employment should increase, with a strong focus on human capital and research.

Altogether, this does not seem to require a major increase in EU resources. One percent of aggregate GDP/GNI would provide adequate margins for the Union to perform effectively the tasks that have been described – if we are able to put money where it is needed, rather than continuing to yield to the demands of organised lobbies.

### *How to get a better budget?*

The distorted allocation in the current budget is no accident of history. As argued above, it is the outcome one would expect from current decision-making procedures. They need to be changed. At present they only reinforce the anachronistic structure of EU budgets. The system of own resources is decided by the Council by unanimous vote, based on a proposal by the Commission, after consultation with the European Parliament. The decision thus taken is then recommended for adoption by the member states "in accordance with their respective constitutional requirements" (Article 269 of the EC Treaty).

Decisions on the yearly budget are taken by the Council (by qualified majority) and Parliament (by absolute majority) together (Article 272); the Council has the last say over "compulsory" expenditures, including, notably, the CAP, and Parliament has the last say over the rest of the budget. The Commission prepares the preliminary draft budget but subsequently has no formal role in the decision. It is, however, responsible for executing the budget.

The system of the MYFP was agreed to at the end of the 1980s, after years of bitter confrontation between Council and Parliament. Under this new system, the Council prescribes by unanimity the MYFP, including annual ceilings for total resources and the main headings of spending, for a period of between five and seven years. The initial proposal is prepared by the Commission, but the Council may modify it. The European Parliament negotiates with the Council and then votes on a resolution to accept the Council decision by absolute majority of its members. In practice, Parliament has had little influence on the

main figures – for the CAP and structural spending – but has used the opportunity to exact concessions on its own programmes and exert influence on yearly budgets. The MYFP projections are then enshrined in an inter-institutional agreement that binds Council, Commission, and Parliament to “loyal cooperation” in yearly budgetary decisions, and, notably, to respect annual expenditure ceilings.

This system has three main drawbacks.

1. First, the yearly budget – which is the instrument with legal value under the treaty – is not the real seat of budgetary decisions, which are taken elsewhere.
2. Second, all significant decisions are taken by the Council, outside the Community method and based on intergovernmental negotiations in which every member state has veto power.
3. Third, the MYFP figures are adopted for time periods that are completely disconnected from the incumbencies of legislatures and Commission tenure.

Clearly, the Union will not have a proper budget until both the MYFP and the yearly budget will be truly co-decided by Council and Parliament, based on a (non-binding) Commission proposal. However, this decision-making power should not be extended so far as to override the decision on the total resources ceiling, since the latter impinges on national parliaments’ taxation powers. This constraint is essential, since the European Parliament is likely to have a bias in favour of more spending at the European level.

Here it should be kept in mind there are a number of areas where the greater European interest might best be served not by more spending at the EU level, but by other measures, such as increasing competition or coordinating national policies. One solution might be to leave the last word on total resources to the Council, but let the European Parliament determine their allocation across categories of spending. Such a distribution of competences would probably lead to a useful negotiation in which the allocation of spending proposed by the European Parliament would be accepted by the Council to the extent that it was seen as reflecting European interests and ‘value for money’. Were this not the case, the Council would reject the demands for a higher resource ceiling and cut it down to size.

Another beneficial change that does not require any change to the treaty would be synchronisation of the reference period for the MYFP with the terms of office of the Parliament, so as to strengthen the interrelation between budgetary decisions and the results of the European elections. The MYFP should run for five years, and enter into force one year after

the election of a new Parliament, to allow it sufficient time to deliberate after election.

In this game of self-restraint, the Parliament, by accepting the ceiling on total expenditures, would gain credibility with governments and the electorate. In exchange, it would be allowed to assert its competence in deciding what European public goods should come from the Union budget.

#### 4. Serious debate on institutions

The debate about the future of EU institutions and the Constitutional Treaty appears deadlocked; the need to wait for the outcome of presidential elections in France is one reason, but not the only one.

Although a majority of the population continues to favour a stronger Union in such areas as internal and external security and foreign policy, European institutions are unpopular. They are seen in public opinion as ineffective, remote and arrogant. The unabated flow of internal market legislation is blamed on ‘Brussels’ as something coming from outside, even if decisions are actually taken by a Council of national ministers and an elected Parliament. Obviously, public opinion is not well informed about the functioning of the European institutions; nevertheless, these criticisms should be taken seriously since they are very widely and deeply held.

#### Listening to public complaints

There is little doubt that European decision-making is cumbersome and slow; experience shows, however, that important decisions are taken rapidly when there is broad consensus – not necessarily unanimity – among the member states. The problem is that consensus has become more difficult to reach amongst the old members of the Union (Emerson et al., 2006). A greater variety of political preferences provides only part of the explanation; the main reason is that the original equilibrium between constituent interests in the European construction – between big and small member states, between Union institutions, between Union and national institutions and regional governments, between public institutions and private interests – has been irrevocably altered and a consensus must be found on what constitutes the correct new balance.

The feeling of remoteness mainly reflects weak political accountability. The flow of competences to the European Commission and Council executive committees has weakened the control exercised over them by national parliaments. Agenda-setting has been firmly placed in the hands of the Commission, which is an unelected body, and the Council, whose members are always happy to see issues moving to ‘Brussels’ where deliberations often escape not only public scrutiny, but also the need to balance

competing interests within the government. The European Parliament has been a poor substitute in providing political accountability since the public is largely unaware of its activities and does not see it as a forum for public discourse, as shown by declining participation in European elections.

Moravcsik (2005) has argued that lack of political accountability in the domains of activity of the Community is not very important, due to their narrow scope – mainly technical matters relating to internal market, consumer protection and the environment – and the existence of adequate institutional checks and balances in decision-making that sufficiently empower veto groups representing meaningful subsets of national polities. Similarly, Cassese (2002) has argued that the Union is a “composite public authority that embraces the member states”, which therefore represent an indirect legitimating force. Moreover, he maintains that decision-making is subject to continuous scrutiny by national bureaucracies, networked executive agencies, the judicial system, and private interests groups – the lobbying community – all of which are involved daily in law-making. In sum, both authors consider that these ‘intergovernmental’ and ‘cooperative’ channels provide an adequate source of legitimacy and accountability.

These considerations are relevant but they do not eliminate the problem. The outward shift of executive powers over several decades has reflected the decreasing ability of national government to handle the issues effectively at national level in an increasingly integrated economic and social environment; each step was supported by powerful forces within the member states. However, the mechanisms and arrangements forged by the main stakeholders involved in the process to protect their interests have rendered decision-making opaque and have blurred responsibilities. Moreover, the process has often escaped explicit approval by national parliaments; the public may have supported, or not opposed, each increment in Union powers, but evidently they are increasingly unhappy with the overall result, which entails substantial limitations in national policy autonomy, and want to regain some direct political control (Micossi, 2002).

Besides weak accountability, the perception of arrogance in the exercise of Union powers also has causes of its own: they notably concern the manners of operation of the European Commission. While the Commission must respond to the Parliament for the execution of the budget, in the minute exercise of its powers, it basically behaves as an unaccountable bureaucracy, responding to organised interests groups and national influences as it sees fit. It is this feature that makes it so important to appoint own nationals to sensitive jobs.

The main countervailing force supposedly lies in the coordinating role of the college of Commissioners; however, with the increase in competences and the number of member states, coordination only affects the broad political direction; the rest is left in the hands of the bureaucracy, under weak control by Commissioners.

Significant implementing powers in the application of law and the administration of financial programmes are in fact exercised at directorate or even division level. The internal machinery is cumbersome and the obligation to consult all services before proceeding with decisions has increasingly turned inwards the focus of officials’ efforts: since their overriding preoccupation is to achieve internal approval, once they obtain it they have little room to accommodate the sensible objections of those that will bear the consequences of their decisions.

The Financial Regulation – enacted by Council in the wake of the scandals under the Santer Commission – has added an element of madness to the process. Anybody receiving financial support by the Commission has to satisfy abstruse conditions mainly designed to protect the staff from all responsibility. Applications for financial support and programme management have become incredibly burdensome; selection criteria are difficult to read for the outsider; money is disbursed every year with larger delays, but few complain for fear of being excluded from the next call. As a result, even the natural constituency of the Commission – the thousands of researchers and NGOs receiving financial support for initiatives of European scope – are increasingly disaffected and widely voicing their discontent.

### *Clear choices on fundamental issues*

In Amsterdam and Nice, the member states tried to speed up the machinery with minimal corrections by changing voting rules in the Council and reducing the number of Commissioners. After twice failing to agree, they turned to comprehensive design. They did manage to find an agreement between the member states on a new Constitutional Treaty, but that text lacks popular support, and not only in France and the Netherlands where voters overwhelmingly rejected it. Its main flaw is that, rather than resolving institutional tensions, it has papered them over: by pretending simplification while retaining all the old procedures under new names; by somewhat strengthening subsidiarity provisions but fixing in iron all existing policies in Part III of the Treaty; by promising an end to the creeping expansion of Union competences while including the Charter of Rights in Part II, which the Commission and Court of Justice would have surely built up into new powers in such domains as individual rights and social policies (Baldwin, 2006).

The Constitutional Treaty is not likely ever to enter into force, even if eventually 18 countries are expected to ratify. However, we should not delude ourselves into believing that evolutionary adaptation of existing institutions and decision-making procedures will suffice; something will be needed to take its place.

True, the Council and the Commission have not been paralysed following enlargement, and the newcomers have used sparingly their veto powers (although Cyprus is doing it in matters relating to Turkey's accession, with potentially explosive consequences for enlargement negotiations). Nevertheless, decision-making in the Council has become painfully slow, e.g. in areas of acute public concern in Pillar Three (Grant, 2006 and Emerson et al., 2006). Furthermore, as has been argued, the demands for simplification, decentralisation and improved democratic accountability seem well-founded. The main issue is the increasing distance between European decision-making and the seats of political representation where public choices are discussed and adopted under public scrutiny.

Part I of the Constitutional Treaty text already includes many of the elements required to re-establish efficacy and legitimacy in Union institutions. Part II and most of Part III are likely to face continuing opposition, as French presidential candidate Nikolas Sarkozy has explicitly acknowledged in his widely publicised September 2006 speech for Friends of Europe – but Germany insists that there is no Plan B and the text should be retained in its entirety. What seems clear is that muddled compromise this time will not do and clear choices will be needed on a number of fundamental issues. Discussion should start immediately.

### *The nature of the Treaty and subsidiarity*

A first issue that must be clarified concerns the nature of the Treaty. The use of the word 'constitution' with reference to what remains an international treaty raised a clamour of opposition and was imprudent, because it sent the wrong message: that the main purpose was not only to give constitutional status to certain paramount principles established by the European Court of Justice, such as the primacy of European law, but also to provide fresh legal foundations to all of the *acquis*. In contrast, some member states, many regional governments and large swathes of the public were asking precisely the opposite: a constitution in the meaning of constitutional federalism (Siedentop, 2000), i.e. to establish clear limits to the exercise of public powers at Union level vis-à-vis other levels of government as well as the private sector, and have the Union concentrate where its action could bring clear benefits to citizens.

There are two sides to the issue, one of merit and one of procedures. On the merit of competences, there is a well established demand for stronger Union powers in matters of foreign policy and external and internal security; these are indeed the domains where some member states are already advancing their cooperation within small groups, as with the Prüm Treaty and various diplomatic initiatives in troubled areas of the world (Grant, 2006). But there is also a demand for the Union to scale back its activity, e.g. in agriculture and social policy, the environment and consumer protection, as well to reduce administrative interference in the management of programmes, as with structural funds and research, where the member states and the scientific community have distinct comparative advantages.

A serious effort is also required to simplify and coordinate existing internal market legislation, as President Barroso and President Santer, before him, have tried to do, alas with meagre results. The problem here is that cumbersome legislation is not due to the whims of Commission officials, as too many observers prefer to believe; rather, it reflects the compromises necessary to balance the competing interests when legislation was negotiated. Thus, simplification is impossible without determined political support by the heads of state and governments in the European Council, which has been sorely lacking so far.

Treaty procedures are even more important to reassure citizens and competing political bodies that the Union is serious about subsidiarity. In its Protocol on the Application of Subsidiarity and Proportionality, the Constitutional Treaty empowers national parliaments to send EU bodies a reasoned opinion raising issues of subsidiarity. When objections are raised by at least one third of national parliaments, the Union is obliged to review its draft; this share is reduced to one fourth in matters of freedoms, security and justice (Articles 6 and 7). Moreover, after legislation has been approved, the member states may challenge it on grounds of subsidiarity before the European Court of Justice, also on behalf of their national parliaments; the same prerogative is attributed to the Committee of Regions in matters where consultation of the Committee is compulsory (Article 8).

The Convention also considered the possibility of scrapping Article 308 of the EC Treaty, which allows the Council to decide, by unanimity, to act in areas where there is no Community competence when they consider such an action necessary to "attain, in the course of operation of the common market, one of the objectives of the Community"; unfortunately, they retreated in the face of determined opposition by the Commission and traditional 'Brussels' policy circles. In fact, in recent years this article has rarely been used; not much would be lost in scrapping it, while

the message would be very well received by all those who fear that the creeping expansion of Union powers will not abate.

Finally, in the domains of consumer protection and the environment, the Community's powers to initiate legislation are 'open-ended'; instead, they should be limited by reference to well-defined Community interests, as already is the case with internal market legislation under Article 95. According to Article 153, the Community "shall contribute to protecting the health, safety and economic interests of consumers as well as to promoting their rights to information, education and to organise themselves in order to safeguard their interests". Similarly, under Article 174, "Community policies on the environment shall contribute to pursuit" of a long list of environmental objectives. In neither case is Community action justified with reference to a Community dimension. On the contrary, under Article 95, legislation may be initiated only when free movement is threatened by national restrictive measures that pass the test of necessity and proportionality for the protection of legitimate interests under Community law. The introduction in the Treaty of criteria of Community value-added for initiating legislation in consumer protection and the environment would greatly help in inhibiting unjustified European initiatives.

### *Decision-making*

The Constitutional Treaty provides a number of effective solutions to improve decision-making within the Union that should be retained, e.g. the double majority for voting in the Council, the passerelles for moving from unanimity to majority voting and the simplified procedures for Treaty revision in certain policy areas, the inclusion of the European Council into the Treaty framework and the end to the rotating presidencies in the Council.

On the other hand, the unification of the CFSP special representative and the Commissioner for external relations is widely supported but raises issues that have not been satisfactorily addressed. The main objection is that this figure, at the same time vice-president of the Commission and executive agent of the Council, with own powers of policy initiatives, would irreparably weaken the president and upset checks and balances within the Commission; especially if, as envisaged, he or she were given coordinating powers for all external actions of the Community – from trade, to development assistance, to regulatory negotiations with third countries.

Underneath this issue is another, even more important one, which has yet to be recognised by 'europhile' policy circles. As convincingly argued by Giandomenico Majone (2005 and 2007), decision-making by the Community method – whereby the

Commission has exclusive powers to initiate legislation – cannot be applied to the 'political' tasks of the Union, from policy coordination to foreign policy and internal security, because the method is not democratic since the Commission is an unelected body. Revealed policy preferences confirm this contention: in practice the Community method is only applied to internal market matters – i.e. the original 'functional' tasks of the Community; in no case outside this domain has the Commission been given powers of initiatives and agenda-setting (cf. also Moravcsik, 2005).

Therefore, the combination in the new figure of the 'foreign minister' of tasks of a very different nature, and accountability mechanisms, as revealed by different decision-making, would no doubt create unmanageable conflicts – among other things, due to the temptation for the 'foreign minister' to choose the decision-making procedure promising the easiest approval of his proposals.

The undemocratic nature of the Community method has broader implications. While greater resort to majority voting in the Council is essential for improving decision-making in the Council, the Community method does not provide a general model of decision-making for the Union. Different decision-making procedures reflect different balances of national and Community interests that cannot be arbitrarily altered.

Symmetrically, the Commission cannot take up broadly political functions without compromising its tasks of impartial 'guardian of the Treaty'. Loose talk of the Commission as an embryo of a future European government should be avoided: it can either be a 'government', elected by Parliament or voters, and leave its tasks of arbiter in the initiation and enforcement of internal market legislation to an independent agency, or remain the executive agency to foster the internal market laws. It cannot be both.

### *Resuming progress*

There can be no progress on the institutional debate unless the issues of subsidiarity and decision-making are placed in their proper perspective. The public demands more centralisation in certain areas but less in others; more important, it wants to be reassured that the transfer 'by stealth' of sovereign functions is halted and may only happen following explicit debate in representative national bodies. In matters pertaining to the national political sphere, the public is not ready to consign to the Union the powers of setting the agenda and initiating legislation without its consent.

While waiting for the French elections, the Council would be advised to start discussing initiatives that would send the right message to public opinion even before modifying the treaties. An immediately

feasible action would be to start applying by agreement the Constitutional Treaty's provisions on subsidiarity that give national parliaments the power to demand that pending legislation be re-examined. The initiative for legislative simplification launched by President Barroso should receive stronger support by the European Council, since the resistance mainly comes from the specialised councils of ministers and their committees. It should be extended to include a reduction in the Commission's administrative tasks in programme management. Finally, reform of budgetary procedures could be advanced by inter-institutional agreement. The European Parliament's powers over the allocation of spending in the EU budget could be extended to multi-year spending programmes before the start of the negotiations on the new financial perspective. Parliamentary debates on the subject would then be far more meaningful to the public.

## 5. Conclusions

The European Union is in deep crisis for two main reasons: First, the original balancing of interests between member states has been fundamentally altered by successive enlargements leading to near paralysis in decision-making on major issues. Second, public support for policy-makers and institutions has been dwindling due to weak policies in addressing the twin challenges of integration and globalisation. Rather than squarely confronting the issues, national leaders have tried to avoid hard choices at home and have papered over the differences of opinion in the European Council, thus sending muddled messages to the public opinion, fuelling a sense of impotence. One could thus argue that the present problems of the EU reflect a generalised crisis of democratic institutions in Europe (see recent interview in *La Repubblica* with Giuliano Amato – Giannini, 2006). It will thus be difficult to make the Union work properly if its member countries continue to wrestle with unresolved problems of legitimacy of their own institutions. But improving the working of the Union will be a first important step to address the wider problem of representative democracy in Europe. It is time that the European Council gets its acts together and starts leading the Union again.

A fresh start is required in three critical areas: a coordinated policy initiative to re-establish support for integration and internal market policies; an agreement to reform the EU budget; an open discussion of institutional issues to confront demands for simplification, decentralisation and subsidiarity in the management of Union affairs.

A clear time horizon should be set for decisions to be taken in good time before the European election of 2009. The overhaul of policy coordination can be fully decided already at the spring meeting of the

European Council. Decisions on the new budgetary procedures should be completed by December 2008, so as to let voters judge competing political forces also based on their proposals for the future budget of the Union – which the Council and the Parliament would then approve with the new procedures during the new legislature.

Taking the 2009 elections for the European Parliament as a target date for action and decisions is important not only in order to give the Union's citizens a meaningful choice, but also because this date should then be used as an EU election day in those countries where a referendum is still needed to approve any agreement on the institutions.

On institutions, rapid decisions will only be possible if the member states can agree on a minimal Treaty reform based on the key provisions of Part I of the failed Constitutional Treaty. Were this option not practicable, the European Council should at least agree to implement immediately those provisions that can be adopted without Treaty reform so as to give more voice to national parliaments in Union affairs and show convincingly that the public's demands for simplification, decentralisation and subsidiarity have been heard.

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