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What Have We Learned?[1]
Problem-Solving Capacity of the Multilevel European Polity

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Abstract
This Working Paper is an attempt, occasioned by the evaluation of the Max Planck Institute for the Study of Societies, to provide a conceptual framework within which institute research on multi-level European problem solving could be discussed in the context of a more comprehensive overview of the literature. The framework combines an institutional dimension (distinguishing between supranational, joint-decision and intergovernmental modes of EU policy making) and a policy dimension (distinguishing between market-creating, market-enabling, market-correcting and redistributive policies). As institutional modes differ in their capacity for conflict resolution, and as policy types differ in the likelihood of severe policy conflict, greater or lesser problem-solving capacity can be explained by the location of a particular policy area on both of these dimensions.

Zusammenfassung
Aus Anlass der Evaluierung des Max-Planck-Instituts für Gesellschaftsforschung entwickelt dieses Working Paper einen Bezugsrahmen, in dem die Ergebnisse der am Institut betriebenen Forschung zur europäischen Mehrebenenpolitik im Kontext der internationalen Literatur eingeordnet und diskutiert werden können. Der Bezugsrahmen verbindet eine institutionelle Dimension (in der zwischen supranationalen, verflochtenen und intergouvernementalen Interaktionsformen unterschieden wird) mit einer Policy-Dimension (in der zwischen marktschaffenden, marktfördernden, markt-korrigierenden und redistributiven Policy-Typen unterschieden wird). Da Interaktionsformen sich in ihrer Konfliktregelungskapazität, und da Policy-Typen sich in ihrer Konfliktwahrscheinlichkeit unterscheiden, kann die größere oder geringere Problemlösungsfähigkeit in einem bestimmten Politikfeld durch dessen Lage in beiden Dimensionen erklärt werden.

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1 Introduction: A European Problem-Solving Gap?

The question of whether the Europeanization of public policy was generating a problem-solving gap was early on our research agenda. Starting from the analysis of the "joint decision trap" (Scharpf 1988), we concluded that policy-making at the European level was impeded by conflicts of interest between member states. Similarly, neocorporatist national regimes could not be transferred to the European level, where they would at best be replaced by pluralist patterns of interest intermediation (Streeck/Schmitter 1991). At the same time, the completion of the Single Market program, and eventually European Monetary Union, would allow capital owners and firms to evade national taxes, regulations, and corporatist regimes - with the result that regulatory and tax competition would undermine the postwar achievements of European welfare states, while the "neovoluntarism" of European-level policy could not provide a substitute for the "beneficial constraints" that had characterized national regimes of regulated capitalism (Scharpf 1989, 1996; Streeck 1995).

It is fair to say, however, that this perspective - expecting substantial losses in national problem-solving capacity that could not be compensated for by policies adopted at the European level - did generate much debate (see, e.g., Grande/Jachtenfuchs 2000), but has remained fundamentally controversial. One reason may be theoretical or ideological disagreement over the self-sufficiency of free markets and the need for political intervention (Genschel 1998), but there are also empirically based objections. On the one hand, a growing number of case studies have shown that (some)[2] European regulations are quite effective in providing protection above the level of the "lowest common denominator" (Pollack 1997; Eichener 1997, 2000; Joerges/Neyer 1997; Héritier et al. 1996; Héritier 1999). On the other hand, there is a body of qualitative and quantitative research trying to show that the integration of product and capital markets need not generate forms of regulatory and tax competition that necessarily involve national social protection policies in a "race to the bottom" (Vogel 1995; Garrett 1998; Swank 1998; Soskice 1999).

Our initial response was to introduce a number of conceptual distinctions - negative vs. positive integration, product vs. process regulations, and market-making vs. market-

correcting policies - which would allow us to identify policy areas where national-level problem-solving capabilities would be either fully adequate or severely constrained by economic and institutional integration and/or where European-level problem-solving capabilities would be either fully adequate or severely constrained by conflicts of interest between member states (Scharpf 1997b, 1999a). It became clear, however, that these dichotomous classifications of policy types could only be one element among others in more complex explanations trying to account for the full range of contingencies encountered in empirical research on a wide variety of policies responding to different types of problems and shaped by an even greater variety of causal factors and situational conditions.

Yet from a research perspective, this recognition is difficult to deal with: The full range of potentially relevant contingencies is not captured in quantitative studies, which, even if theoretically valid and reliable data are available, can only deal with a few variables at a time; it is not covered by qualitative studies either, as these have to concentrate on a limited number of cases. In both types of research, the problems, policies, and explanatory factors that can be explored are limited by the scope of the project and by the observations that are possible within it. Yet if we are interested in the overall problem-solving capacity of the multilevel European polity, we need to go beyond the variety of constellations that can be examined in any single project - which should be possible in secondary analyses of existing studies covering a wider range of policy problems, policy types, and policy-making institutions (Falkner 2000; Genschel 2000; Jachtenfuchs 2000).

By itself, however, the overview of a wider variety of case constellations would only create more confusion unless the more comprehensive information can be organized in a relatively simple conceptual framework. Yet if its simplicity is a precondition for effective communication and orientation, the usefulness of the framework for explaining past observations and for guiding future research depends on categorical "distinctions which make a difference" (as common-law lawyers would say) - meaning that (to use metaphors from other trades) they "go with the grain" and "cut at the joints" of the underlying causal structure of reality. The construction of such a framework is of course anything but straightforward, depending as it does on an interaction between deductive theorizing and inductive reasoning that is informed by the cases to be covered.

Most research at the MPIfG combines problem and policy analyses with (actor-centered) institutional analysis (Mayntz/Scharpf 1995b; Scharpf 1997a: Chap. 1). The same two-dimensional conceptualization is appropriate for structuring discussion of the problem-solving capacity of the multilevel European polity. The basic assumption informing the conceptual framework presented here is that policy-making institutions differ in their capacity for effective action in the face of policy conflict and that the probability of policy conflict differs between policy areas. The intersection of the two dimensions should thus define greater or lesser problem-solving capacity.

Table 1: Problem-Solving Capacity

Policy Conflict	Low	High
Institutional Capacity		
High	++	+
Low	+	0

In the following sections, I will first present and discuss the categories structuring these two dimensions with reference to EU policy-making; I will then proceed to show how the more detailed conceptual framework can be used to organize the complexity of available empirical information about EU policies and their effectiveness and to explain a great deal of the puzzles and apparent contradictions that have been generated by the existing literature as well as by the research projects undertaken at our own institute.[3]

2 The Institutional Dimension of Problem-Solving Capacity

The capacity to generate political solutions to societal problems is constituted, shaped, and constrained by the institutionalized modes of interaction through which collectively binding policies can be adopted and implemented. At the same time, however, capacity is a relative concept: The same institutions that facilitate effective policy responses to one type of problem may impede other types of policy choices (Scharpf 2000). The reason is that policies differ in the intensity of conflict that they tend to generate between policy actors (the subject of the next section) and that policy-making institutions differ in their capacity to resolve [4] policy conflict.

2.1 Institutional Modes: Legitimacy Constraints and Veto Positions

Institutions serve a dual function in policy processes. On the one hand, they organize collective decisions by establishing arenas, allocating and limiting competencies and resources, and regulating access and modes of interaction. On the other hand, they also provide the legitimating arguments which support the effectiveness of public policies by asserting a moral duty to comply with them even if the policy in question is against one's interest or preferences. From a problem-solving perspective, what matters is therefore both the capacity for collective action and the capacity to convey legitimacy to that action in the face of divergent preferences among the groups affected. The former is most directly affected by institutional rules defining the modes of interaction within the constellations of actors that are authorized to participate in the adoption and implementation of policy choices. At a given level of policy conflict, the capacity to act is greatest if a single (corporate or collective) actor is able to adopt and enforce effective policy choices unilaterally, and it is reduced to the extent that effective action may be impeded by the requirement of negotiated agreement among the occupants of multiple veto positions.

Regardless of the agreement or disagreement between policy actors, however, the capacity of policy institutions to convey legitimacy needs to be defined in relation to the target population that is supposed to comply with, or suffer the consequences of, the policies thus chosen.[5] The need for such legitimation is lowest for policies that satisfy existing constituency preferences, and it rises with the intensity of the preferences that are being violated. At the same time, institutions also vary in their capacity to legitimate the violation of intense preferences. Under modern conditions and at the national level, this capacity is greatest for the institutions of *majoritarian democracy*. At the European level, however, majority votes would not be able to legitimate highly controversial and politically salient policy choices even if the role of the European Parliament were to be further strengthened. The reasons for this have been developed in the "no demos" and "no public discourses" debates (Scharpf 1999: Chap. 1). However, contrary to what is often assumed in discussions of the "European democratic deficit" (Greven/Pauly 2000), we are not compelled to either assert that the preconditions of majoritarian democracy exist in the EU

or to deny the legitimacy of all European policies. It merely means that EU policies have to rely on the more limited legitimating powers of other types of governing institutions that are available in the multilevel European polity.

In this context, I find it useful to distinguish between three institutionalized modes of EU policy-making: The *supranational/hierarchical* mode, in which policy choices can be unilaterally imposed by supranational actors (i.e., the European Court of Justice, ECJ; the Commission; and the European Central Bank, ECB); the *joint-decision* mode, in which supranational actors play a significant role, but cannot act without the acquiescence of at least a qualified majority in the Council of Ministers; and the *intergovernmental* mode, in which policy choices depend solely on the unanimous agreement of member state governments. In addition, I will briefly discuss the new methods of *open coordination* and will also mention the mode of *mutual adjustment* which characterizes national policy processes significantly affected by EU policies or by the pressures of regulatory and tax competition among EU member states (Scharpf 2001a).

2.2 Intergovernmental Mode

The intergovernmental mode characterizes negotiations over amendments to the Treaties, which, so far, have been the prerogative of Intergovernmental Conferences and the summit meetings of heads of state and government in the European Council. Moreover, given the strong role of the Commission, the Court, the European Parliament, and comitology in the joint-decision mode, member governments have also been shifting important policy initiatives that do not require treaty amendments to the intergovernmental mode. On the basis of the Maastricht Treaty, this applies to policies in the "second pillar" (Common Foreign and Security Policy) and the "third pillar" (Police and Judicial Cooperation). However, even within the first pillar defined by the European Community Treaty (TEC), the strictly intergovernmental European Council has increased the significance of policy initiatives promoted by the rotating Presidency rather than by the Commission in recent years, and certain policy areas (such as taxation) have in practice been reserved for intergovernmental negotiations.[6]

In the past, the intergovernmental mode has provided the foundational legitimacy of all EU policies and institutions. It is indirectly derived from the fact that treaties and treaty revisions were and are negotiated by democratically legitimated national governments and ratified by the democratically legitimated parliaments of all member states. In the history of the EU, this indirect legitimation was generally considered sufficient and was not called into question until debate began about the need for a "European Constitution." At the same time, however, there is no question that, at the national level, the expansion of "government by treaties" has weakened the role of parliaments, political parties, interest groups, and the public,[7) as important policy choices are formulated in intergovernmental negotiations and are, at best, presented for ratification as a take-it-or-leave-it proposition. As this reduces the autonomy of national governing institutions and processes,[8] it also affects the indirect legitimacy of European policy choices derived from them.

If nevertheless the legitimacy of policy choices adopted in the intergovernmental mode is relatively strong, its capacity for conflict resolution is tightly constrained by the fact that each government has a veto. Even though there may be strong pressures on all governments to negotiate with "cooperative" interaction orientations in order to reach agreement in the face of divergent preferences, uncompensated concessions are difficult to defend against opposition back home if European issues have political salience in national politics. Under such conditions, negotiations may either break down or deteriorate into

"bloody-minded" bargaining where outcomes can only be reached through cumbersome package deals or side payments.

The main function of the treaties, however, is not the formulation of substantive European policy, but the establishment of European institutions and procedures through which "secondary" EU policies are to be adopted. Even under favorable circumstances, policy-making by intergovernmental agreement is a slow and awkward process, and policies so adopted are very hard to change in response to new circumstances or preferences. Hence treaties are best employed to determine a limited range of relatively simple, presumably stable and politically salient "primary" policy choices. Given the original political commitment to create a "European Economic Community" and the obvious importance of removing tariffs and quantitative restrictions to trade and free movement, it is also no surprise that the substantive provisions of primary European law are mostly about negative integration. In order to become effective, however, even these needed to be interpreted and applied to changing circumstances by institutions created or authorized by the treaties. This is even more true in areas in which the treaties merely establish European legislative competencies without specifying the substance of policies to be pursued. If the legitimacy and effectiveness of European policies is considered problematic, the main concern is therefore about the policy-making functions of European institutions that were created by the treaties, particularly where these institutions are able to act in disregard of the preferences of national governments and parliaments.

2.3 Supranational/Hierarchical Mode

In the supranational/hierarchical mode, European institutions are able to impose binding policy choices without the agreement of national governments. This is true of monetary decisions by the ECB, policies defined by the ECJ in its interpretation of treaty provisions and secondary European law, and decisions by the Commission when it unilaterally adopts directives, when it issues regulations specifying the content of Council directives, and when it initiates treaty infringement procedures against individual member states. In this mode, the European capacity for conflict resolution is not constrained by the veto positions of national governments. It is therefore possible to adopt policy choices that violate the interests and preferences of national governments and their constituents even on politically salient issues. By the same token, however, the legitimate reach of supranational capacity is limited by relatively narrow normative constraints.

For the ECB, the substantive legitimacy of its "sound money" course of monetary policy has a clear intergovernmental base in its explicit mandate to maintain price stability (Art. 105 TEC), which was adopted in the Maastricht Treaty after extensive negotiations and much public debate (Verdun 2000). Similarly, when the Commission and the ECJ enforce explicit treaty commitments, they seem to be on safe grounds in light of Arts. 211 (ex 155) and 220 (ex 164) TEC. At the same time, however, the reach of these powers was dramatically extended and deepened by the judge-made doctrines of "supremacy" and "direct effect" (de Witte 1999). Nevertheless, policies defined by the ECJ continue to benefit from the cooperation of national judiciaries and hence from nationally rooted legitimacy beliefs and respect for the "rule of law" shared by national publics and policy elites as well (Burley/Mattli 1993). The caveat is, however, that these conventional legitimacy beliefs would not support the exercise of explicit *law-making* functions.[9] Admittedly, there is no clear dividing line between interpretation and legislation, and most national high courts probably operate on the other side of this hypothetical line much of the time. Nevertheless, the fact that judicial law-making has to masquerade as interpretation makes a difference, especially since the possibility of having judicial misinterpretations of

the "legislative intent" corrected by democratically legitimated political actors is much more remote at the European level than it is in the nation state.

It follows that the legitimacy of supranational policy choices by the Commission and the ECJ is strongest in areas where the original intent of the treaty-making governments is clearest - which are, by and large, the policies of market-making negative integration. It is true that the Court, protected by its self-created doctrines of supremacy and direct effect, has extended the reach of negative integration beyond the historical intentions of member governments, but in doing so it was still going forward in the direction that was originally agreed upon. That same basis of legitimacy would not have been available if Commission and Court were to have used their supranational powers to achieve purposes about which member governments were deeply divided.

2.4 Joint-Decision Mode

The joint-decision mode is the main institutional avenue of European legislation. It is characterized by a strong role of the Commission, whose initiatives are a formal precondition of European legislation (Peters 1996). These initiatives respond to a wide variety of inputs - from the Council, individual member governments, the European Parliament, subnational governments, European associations, national associations, large firms, and expert groups convened by the Commission - which are documented in the extensive literature on European interest intermediation and policy networks (Kohler-Koch/Eising 1999; Benz 2000). Nevertheless, the Commission (or more specifically its specialized Directorates General) is generally able to follow its own preferences in selectively translating inputs into legislative initiatives. At the same time, the role of the European Parliament in the legislative process has been considerably strengthened by the expansion of its co-decision powers to the point where its specialized committees are consulted well in advance of formal decisions by both the Commission and the Council (Shackleton 2000). Moreover, the veto positions of individual member governments have been greatly reduced as the decision rule in an increasing number of policy areas has been changed from unanimity to qualified majority. Nevertheless, at the end of the legislative process, European policies still depend on the support of a large majority of the weighted votes of member governments in the Council. In many areas, however, that is not yet the end of the policy-making process, as the Commission clearly dominates the comitology processes through which general Council directives are translated into specific directives and regulations with direct legal effect (Joerges/Vos 1999). Since the EU has no administrative infrastructure of its own, these need to be implemented by national and subnational governments. Yet again, the Commission is charged with monitoring national compliance and may, at its discretion, initiate infringement proceedings against member governments which it believes to be in violation of Treaty provisions or of Council and Commission directives, regulations, and decisions.

In the joint-decision mode, in short, national governments have considerable power to block European legislation, but the direction of legislative initiatives and the specification and enforcement of detailed rules are largely under the control of supranational actors. As a consequence, the institutional capacity for effective action in the face of policy conflict tends to be considerably greater than would be true of strictly intergovernmental negotiations. By the same token, however, the "intergovernmental" legitimacy arguments that originally supported European legislation in the joint-decision mode have lost much of their weight. What seems to have taken their place are arguments asserting the legitimacy of "network governance" (Kohler-Koch/Eising 1999), which presumably have their normative roots in the Roman maxim *volenti non fit iniuria* - meaning that policies that are

supported by a broad consensus, after serious deliberation and consultation of all affected interests, need no further legitimation (Benz 2000). However, if that argument is accepted, it also follows that EU legislation in the joint-decision mode will be unable to legitimate hard policy choices on controversial and politically salient issues.

Network governance creates a large number of de facto veto positions. The system is kept going by the existence of strong pressure on all parties to reach agreement - in COREPER, in the Council, and in "deliberative" comitology proceedings (Lewis 2000; Benz 2000). By itself, however, that consensus merely allows decisions to be reached, but it does not necessarily legitimate them. Exasperation over the extremely bureaucratic perfectionism of European regulations is ubiquitous, and national responses to the BSE scare have shown that deliberation and consensus behind the closed doors of European-level committees cannot create legitimacy for policies that have strongly negative political salience in national constituencies. However, such cases are probably exceptions rather than the rule. Where strongly negative responses can be anticipated, or where the policy preferences of national governments or of major interest groups strongly diverge, the more likely outcome is either deadlock or a compromise at the lowest common level. In other words, EU policy processes in the joint-decision mode tend to anticipate legitimacy deficits and to avoid them by resorting to "non-decision" - which also implies that in such cases existing EU policy will be very hard to change. Moreover, if a policy area is generally characterized by strongly divergent preferences, it is likely that governments will have maintained the intergovernmental mode by insisting on unanimous decisions in the Council.

2.5 Open Coordination

Starting with the introduction of an Employment Title in the Amsterdam Treaty and its implementation in the "Luxembourg Process," the EU has begun to institutionalize a mode of policy coordination among member states which is intended to avoid the self-blocking tendencies that limit the effectiveness of European policy processes in the joint-decision and intergovernmental modes in the presence of divergent national preferences. Under the label of "open coordination," the new mode was extended at the Lisbon Summit to a variety of policy areas concerning social protection and economic promotion. Even though "Luxembourg" and "Lisbon" differ in the degree and the detail of institutionalization, the basic approaches are similar. Both processes involve the Commission, national governments, a permanent committee of high-level national civil servants, the Council of Ministers, and the European Council in defining common policy objectives and in assessing national efforts to reach these objectives.

It is clear, however, that harmonization is not to be part of the process and that any European-level action will take the form of guidelines, benchmarking reports, and recommendations. Given that all effective policies have to be adopted and implemented at the national level, legitimacy is not a problem. The more interesting question is whether these very demanding procedures are effective in solving problems in the sense that national policy responses will be improved (or at least influenced) as a result of open coordination. The hope is that benchmarking and peer review will stimulate processes of policy learning and innovation in areas where European governments face common problems but could not agree on common policy responses (Ferrera et al. 2000).

2.6 Mutual Adjustment

In the absence of effective open coordination, "mutual adjustment" (Scharpf 1997a: Chap. 5, 2001) is the default mode in which member states must try to cope with those problems

for which European solutions are not available. Here, each country is on its own, but to the extent that governments find themselves affected by policies adopted in other member states and are themselves influenced by the incentives of regulatory and tax competition, their policy choices are in effect Europeanized, and it makes theoretical sense to conceptualize (some) national policy choices as moves in a Europe-wide (or even larger) non-cooperative game (Dehejia/Genschel 1999).

3 The Policy Dimension of Problem-Solving Capacity

Our assumption is that policies differ in the types and the intensity of conflict which they tend to generate and that the probability of conflict is a characteristic of the constellations of interest that are typically represented by policy actors [10] in a given policy area. Given the fact that our focus is on European economic integration, the primary interests involved are either pursuing the benefits of larger and more efficient markets or seeking protection against negative consequences of market competition. Before I proceed to discuss these interest constellations in greater detail, however, it seems useful to present a brief overview of the historical evolution of EU policy areas.

3.1 Market-Making and Social Protection Policies

At the national level, the governments of capitalist democracies have to respond simultaneously to both market-making and social protection interests, and while the relative emphasis on policies serving either type of interest varies between countries and over time, there is no question that both concerns have equal constitutional standing and should be pursued in the same institutionalized modes of policy-making. This was not originally the case in the processes of European integration, and it still is not the case now.

After the demise of plans for a European Defence Union in 1954, the ultimate goal may have remained political union, but the driving force behind European integration was a widely shared interest in realizing the economic advantages that were associated with the creation of larger European markets.[11] The ultimate beneficiaries were supposed to be consumers, but the main political support came from industrial and (after the establishment of the Common Agricultural Policy, CAP) agricultural producers, who expected to benefit from unimpeded access to the markets of all member states. This quest for economies of scale has not only driven the geographic enlargement from the Economic Community of the Six to the preset Union of the Fifteen and beyond; it also explains the progress from a free trade area to a customs union and to a common market eliminating national non-tariff barriers to trade in goods and services and to capital mobility.

Whether the theoretically predicted and politically anticipated economic benefits of larger and more perfectly competitive European markets have in fact been achieved is surprisingly unclear (Ziltener 2001). What matters here is that the process of market integration has continued even in the absence of demonstrably positive economic effects. One reason, surely, is that economic integration was repeatedly treated as a strategy (or as a substitute) for advancing the much more difficult goal of political integration. Moreover, with the worldwide ascendancy of neoliberal ideas in economic policy and with rising concerns over "Eurosclerosis" in the 1980s, market-making goals became progressively radicalized, moving far beyond the mere integration of the national markets that had existed in the "mixed economies" of member states. European competition policy was extended to eliminate public procurement practices and state aids that could distort free competition, and "liberalization" was extended to service branches and public utilities

which - as nationalized industries or highly regulated monopolies or cartels - had been exempted from market competition in all member states (MacGowan 2000). By the same logic, finally, it was thought that the transaction costs imposed by the existence of multiple currencies and variable exchange rates ought to be eliminated by the creation of monetary union and a common currency (Verdun 2000; Moravcsik 1998: Chap. 6; Dyson/Featherstone 1999).

For a large part of this history, social protection interests - concerned with the welfare state, employment protection, work safety, industrial relations, and environmental protection - played a very limited role in European integration. Admittedly, the original treaties did include rules on gender equality and against the discrimination of migrant workers which required existing rules to be modified in some countries. Furthermore, European policies on coal and steel and on agriculture were also designed to stabilize employment and incomes in these very tightly integrated economic sectors. In general, however, France was the only one of the original Six to propose the establishment of explicit social policy and welfare state competencies at the European level.

Initially, the asymmetry between market-creating and social protection competencies did not matter much, since the integration of product markets was a slow process as long as national non-tariff barriers could only be overcome through harmonization directives that depended on unanimous agreement in the Council of Ministers, while even greater obstacles impeded the integration of service, capital, and transport markets. However, these conditions changed in the 1980s. Resistance to the integration of product markets had been broken by the Court in the *Cassis* revolution, and the liberalization of services and public utilities was facilitated by a shift to neoliberal policies in key member states which, in combination with competitive pressures and the strategic employment of legal action by the Commission and the Court, ensured the realization of the Single Market program.

With this, the neoliberal program for European integration was completed in principle, even though the process of its further perfection is still ongoing. However, unions and left-of-center political parties, who had by and large been content with the exclusion of social protection policies from the European agenda, were now faced with a serious challenge. National markets could no longer be closed to goods and services produced under different national production regimes, and at the same time the exit costs of mobile capital and firms were greatly reduced. Thus, if high levels of regulation and taxation were maintained, national producers, complaining of reverse discrimination and suffering competitive disadvantages, would threaten to exit. Yet if regulations concerning production processes were relaxed and taxes on mobile factors of production reduced, interest groups and voters who had come to rely on existing systems of social protection would rise in protest against the dismantling of the welfare state and against social injustice.

As a result, demands for "European solutions" are now being made in many non-economic policy areas - just as had been predicted by neofunctional theorists (Wessels 1997). Moreover, confronted with these demands, left-of center parties and unions have generally come to support the Europeanization of public policy in the hope of recreating the social protection capabilities that are eroding at the national level under the legal constraints of negative integration and the economic pressures of regulatory and tax competition. That was also the promise of the "Social Dimension" which Jacques Delors had associated with the drive to complete the Internal Market and Economic and Monetary Union (Ross 1995). As we shall see, however, this promise is not being fulfilled. In order to discuss the reasons, it will be useful to refer to a more detailed version of the conceptual frame introduced above.

3.2 The Conceptual Frame Elaborated

In Table 2, I present an elaborated conceptualization which, on the vertical axis, lists the institutional modes discussed above. They are arranged in an order that suggests that the capacity to adopt effective policy choices in the face of policy conflict decreases from top to bottom, being highest in the supranational/hierarchical mode and lowest in the intergovernmental and open-coordination modes.

In the horizontal dimension, I have listed four generic EU policy areas that are directly or indirectly related to economic integration in an order that reflects the probability of policy conflict (to be discussed below). The first area includes *market-creating policies*, which merely remove national obstacles to the free movement of goods, services, capital, and labor ("negative integration"). The second describes *market-enabling policies*, which, in order to remove remaining non-tariff barriers to trade, have to harmonize national product standards and turnover taxes. The third category of *process regulations* describes efforts to harmonize production-related national regulations and factor taxes that do not constitute barriers to trade, but where national solutions are directly affected by international regulatory and tax competition. *Welfare state policies* which are not production-related, finally, have no effect on trade and only indirect effects on competitiveness, but they are affected by revenue constraints caused by the integration of capital markets (Scharpf 2000: 68-85).

In order to complete the overview of "first-pillar" policies, Table 2 also includes two policy areas that will not be discussed in detail below, namely *economic promotion and protection* and *fiscal equalization.*

Table 2: Institutional modes of EU policy-making, policy-related preferences, and policy areas

Policy-related preferences	**Larger competitive markets** → **Protection against negative integration, regulatory and tax competition** →				**Fiscal redistribution** →	
Policy areas / **Institutional modes**	Market-creating policies	Market-enabling regulations	Process regulations	Welfare state policies	Economic promotion & protection	Fiscal equalization policies
Supranational	Negative integration, mutual recognition, competition law, liberalization	Migrant workers, monetary policy	Gender equality			
Joint decision	Liberalization	Health, safety, & environmental product standards, service markets	Work safety, environment, labor law, gender equality		CAP, R&D policy, industrial policy, regional funds	Implementation of cohesion funds
Intergovernmental	Negative integration	VAT, harmonization, Monetary Union	Capital taxation		CAP reform	Medium-term budget, cohesion funds
Open coordination		Fiscal coordination		Employment, social exclusion		
Mutual adjustment		Mutual recognition	Environment, labor law, factor taxes	Social security, health, education, etc.	Industrial policy	

In the inside cells of Table 2, I have listed examples of specific European policies that were either adopted or seriously promoted. Empty cells suggest either a lack of European competencies or the absence of serious policy initiatives. It is useful to point out here, however, that there is not necessarily a one-to-one relationship between institutional modes and specific policies. Policy choices adopted in the supranational mode by the Court may become the object of treaty negotiations or of Council directives, and the Commission may

waver between imposing a directive on its own or initiating a Council directive (Schmidt 1998a: 211-217, 1998b). Conversely, the Europeanization of monetary policy could only be achieved in the intergovernmental mode through the adoption and ratification of the Maastricht Treaty, but now that the amendment is in force, monetary policy choices are imposed by the ECB in the supranational/hierarchical mode (Dyson 2000). Similarly, once a general Council directive is adopted, policy shifts toward the "supranational" end of the continuum as it becomes subject to the authoritative interpretation of the Court or is made more specific through regulations and decisions adopted by the Commission after consulting comitology committees that cannot be effectively controlled by national governments or by the Council (Joerges/Vos 1999).

In a more fundamental sense, it could be said that, once adopted, all European policies are shifted into the supranational mode by the combined effect of the supremacy doctrine and the "joint-decision trap" (Scharpf 1988): Given the high consensus requirements of Council directives and even more so of Treaty revisions, it is inevitable that many existing policies will stay in place and will remain supranationally binding, even though they could not be adopted by current majorities in the Council of Ministers. If the issues involved have high political salience, such as the BSE and foot and mouth disease (FMD) crises, this fundamental asymmetry could also become a problem for democratic legitimacy. As mobilized national publics become aware of how tightly policy choices are constrained by European regulations (adopted, perhaps even unanimously, under conditions when they had either broad support or low political salience), it will be difficult to explain why these constraints cannot now be relaxed in response to severe problems and massive political demands because of minority opposition in the Council of Ministers (or in one of the hundreds of comitology committees).

3.3 Policy-Related Preferences [12]

The horizontal location of policy areas, from left to right in Table 2, is meant to suggest differences in the probability of policy conflict. The assumption is that these differences are determined by policy-related constellations of preferences among policy actors. The salient types of preferences involved are represented by arrows in the top row of the table. Here I distinguish between preferences for the creation of larger and more competitive markets, preferences for protection against the effects of market competition, and preferences for and against fiscal redistribution among member states. However, before I discuss these, it is necessary to point out what this conceptualization does not include.

3.3.1 Policy Preferences and System Preferences

Given the fact that (for all member states most of the time) economic integration was the driving force, but not the ultimate goal of European integration, all explanations and predictions predicated on an analysis of the preference constellations involved in particular policy processes are plagued by a two-level problem. On the first level, it is plausible to focus on the balance of economic and countervailing social protection interests of a member state that are immediately at stake in a particular EU policy choice, and it may also make sense to rely on stylized and quasi-objective representations of the interests (defined in rational, egoistic terms) of the governments involved (Moravcsik 1998). At this level, agreement can only be expected for outcomes that leave each party better off than they would have been in the event of non-agreement. In addition, some governments and Commission directorates were (sometimes) influenced by policy-related normative or ideological orientations, mainly of the neoliberal or ordoliberal variety.

On the second level, however, both for governments and for the supranational actors in the Commission, the Court, and the European Parliament, the success or failure of European integration as such is not only at stake in Intergovernmental Conferences and European Summits, but is also a background condition in processes of "everyday" European policy-making. For supranational actors, that may be a constant concern (associated with their institutional self-interest), whereas for member governments it may be more realistic to think of a latent "system interest" in preventing the erosion of present achievements and in facilitating the further deepening of European integration which, if activated, may facilitate agreements that could not be explained by analyses of the proximate policy interests at stake. But when would such latent interests be activated? For national civil servants with longer terms of duty in COREPER, in the Council Secretariat, and in comitology committees, the threshold may in fact be quite low. Socialized into a European frame of reference, and under the influence of in-group pressures, they may indeed develop action orientations which value the success of negotiations for its own sake even if it might require substantial concessions in terms of predefined national interests - or even in terms that would be politically acceptable "at home" if proposed agreements were seriously reviewed (Hayes-Renshaw/Wallace 1997; Joerges/Neyer 1997; Lewis 1998, 2000).[13]

In practice, therefore, European policy-making by "stealth" and by "subterfuge" may have considerable potential (Héritier 1999) which is constrained only by the limits of "permissive consensus" - and by the absence of attention and possible mobilization of domestic interest groups, the media, and parliamentary parties. However, even if national publics are mobilized on issues with high political salience, ministers, and even more so heads of government, may shy away from defending national positions to the point where this might signal a readiness to secede from the Union or where it might push another government to the brink of secession (DeGaulle's France in the 1960s or Thatcher's Britain in the 1980s). Since European integration is considered a highly valuable, but still fragile achievement, its protection and promotion is a concern - primarily, but not only, of the government that has the rotating Presidency - that may indeed override the calculus of national self-interest. Unfortunately, however, for theory-based predictions, the intensity of these concerns tends to vary strongly from one policy area to another, from one country to another, and from one period to another. In the following overview, I will only look at the constellations of explicitly policy-related preferences, but we should bear in mind that, at least on issues that have low political salience in member states, the "negotiation space" within which agreement can be reached may exceed the limits defined by theories of interest-based bargaining.[14]

3.3.2 Preferences For the Creation of Larger Competitive Markets

The Europeanization of public policy was primarily driven by the shared interests of member governments in gaining free access to the larger European market for their producers and in obtaining for their consumers the benefits associated with economies of scale in terms of production and more intense market competition. These interests supported market-creating policies that removed national barriers to trade and free movement and that ensured the proper functioning of competitive markets, and they also had to support those market-enabling policies that were necessary to harmonize national regulations and taxes which would otherwise have constituted non-tariff barriers to trade.

Even if all countries expected to benefit from access to larger markets, however, national producers would also suffer from becoming exposed to international competition in their formerly protected domestic markets. This suggests that the resulting interest constellations

have the characteristics of a Prisoner's Dilemma. Under that assumption, the creation of free markets would still be in the common interest of all member states, but conflicts could be expected at the implementation stage when countries would be tempted to maintain protectionist practices while free-riding on the opening of other markets. This, at any rate, is the accepted justification of the strong hierarchical role of the Commission and the Court in enforcing negative integration and in controlling national measures that may distort competition through state aids and public procurement. By the same token, the proper functioning of European markets must be ensured by a European competition law that is also largely formulated and enforced by the Commission and the Court.

3.3.3 Preferences For Protection Against Market Competition

If the interest constellations associated with European economic integration had in fact resembled a symmetrical Prisoner's Dilemma, the adoption of the free market regime itself ought to have been a conflict-free process, and governments would also have had reason to agree *ex ante* on institutional provisions protecting themselves against temptations to free-ride. The fact is, however, that policy conflicts have been endemic throughout the history of European economic integration. The reason for this is that free trade initiatives and the realization of free trade regimes have also activated social protection interests in the member states which, however, were much more cross-nationally divergent in their policy goals than the free trade initiatives to which they responded.

Even if free trade is thought to be in the common interest, national economies or particular industries in these economies differ greatly in their vulnerability to competition. Thus even the original commitment to create a Common Market could only be achieved through the resolution of severe (primarily Franco-German) conflicts of interest. For France, the opening of its industrial markets to German competition was only acceptable if agricultural markets were also integrated- which would then create massive problems for less efficient German farmers. Tough intergovernmental bargaining led to complex package deals in which industrial markets were only gradually liberalized, while the integration of agricultural markets was to occur within the tightly regulated, subsidized, and protectionist regime of CAP. The integration of service and capital markets, though also envisaged in the EEC Treaty, was not actively pursued before the late 1980s. By that time, the salient conflict was again asymmetric, between early liberalizing countries pushing for rapid liberalization and protectionist countries defending their highly regulated or monopolist *service public* functions against foreign competition (Lyon-Caen/Champeil-Despats 2001).

Once market integration and liberalization are accepted in principle, the existence of nationally differing product standards, service regulations, and turnover taxes must appear as a barrier to free trade if the country of destination is allowed to apply its own rules to imported goods and services. From a strictly neoliberal perspective, the proper responses would be "mutual recognition" and the "country-of-origin" principle. From the perspective of social protection interests, however, these national rules serve important purposes of consumer and environmental protection, and turnover taxes have become important sources of revenue - all of which would be undermined if goods and services offering less protection or taxed at lower levels could be freely imported. Recognizing the validity of these apprehensions, the Treaty allows national service regulations and product standards to be maintained if they serve valid protection purposes (Art. 30, ex 36 TEC), and it maintains the country-of-destination principle for turnover taxes. To the extent that this remains true even after the *Cassis* decision, the advocates of free trade find themselves compelled to support the harmonization of product standards, service regulations, and turnover tax systems.

Attempts at harmonization, however, must then cope with the fact that national regulations may differ significantly from one another. Hence, even if they generally support harmonization, producers and consumers in each country would also prefer to have European standards conforming to their own existing rules. By itself, of course, this form of "regulatory competition" amounts to a "battle of the sexes" constellation which generally should not be a major obstacle to agreement (Héritier et al. 1996). Nevertheless, harmonization may still be blocked in cases where differing national rules have a significant impact on the price of products or where a change of product standards would affect a large installed base.

By contrast, the harmonization of process regulations, which do not affect the quality of products and hence cannot be used to justify the exclusion of imports, cannot rely on the free trade interests of producers and consumers. Its support has to come exclusively from social protection interests that are at risk of being undermined at the national level by the pressures of regulatory and tax competition. However, these are primarily the concerns of producers and workers in highly regulated and highly taxed countries, and they are directly opposed by the interests of producers in less productive countries who could not afford these demanding regulations. Welfare state policies are affected by the same conflicts of interest if they have a direct effect on the costs of production - with the implication that demands for harmonization would mainly come from member states that rely heavily on payroll taxes for the financing of benefits. Moreover, even if social transfers and social services are primarily financed from income and consumption taxes, harmonization will be greatly impeded by politically salient differences in institutional structures of European welfare states.

3.3.4 Preferences For and Against Fiscal Redistribution

As the financial weight of European policies increases, conflicts of interest among member states over the incidence of fiscal contributions and program benefits have also gained in importance. They affect the creation and implementation of European programs of economic promotion - including CAP, industrial policy, and R&D policy - which are meant to protect jobs and incomes in backward regions and declining sectors and to promote industrial competitiveness in global markets. They are also particularly virulent in negotiations over the medium-term budget, structural and cohesion funds, and CAP reform and of course in the negotiations over Eastern enlargement. Analytically, these are zero-sum conflicts in which compromise solutions greatly depend on the applicable decision rules - which explains why net contributor countries continue to defend the unanimity rule. Even then, however, a considerable degree of fiscal redistribution was achieved through package deals that obtained the agreement of economically less advanced member states to the liberalizing initiatives of the Single European Act and the Maastricht Treaty.

* * *

After this explication of the two-dimensional conceptual framework, I will now turn to a discussion of specific insights gained from empirical research, paying particular but not exclusive attention to research at the MPIfG. Since the focus is on problem-solving capacity, I will use the policy dimension as the primary organizing principle of the following sections, except for the final one, in which I will discuss what we have learned

about the adjustment of welfare states at the national level.

4 Market-Creating Policies

The market-creating policies of the EU have their origin in intergovernmental agreements. This was true of the Treaty of Rome committing the original Six to the creation of a Common Market and to the removal of tariffs and quantitative restrictions to trade; it was true of the Single Market program of 1986; and it was also true of the creation of European Monetary Union (Moravcsik 1998). It should be noted, however, that in the original Treaty further progress toward the integration of agricultural, transport, service, and capital markets was also to be left either to intergovernmental negotiations or to the joint-decision mode (which, under the unanimity rule, was not very different). Nevertheless, it is in the field of market-creating policies that the supranational/hierarchical mode has achieved its greatest substantive importance.

4.1 Negative Integration and Mutual Recognition

Even though intergovernmental commitment had laid the political and legal foundations for market integration, it was by no means clear how far governments would be willing to go in this direction. In fact, after the abolition of tariffs and the difficult compromises on CAP, the political support for economic integration appeared to have faltered in the economic crises of the 1970s. The renewed and ever more ambitious initiatives of the 1980s were therefore critically dependent on the constitutional revolution of the *Cassis* doctrine that was announced by the Court in 1979.[15] Its importance can hardly be exaggerated. Before that decision, governments simply invoked Art. 30 (ex 36) TEC to exclude imports that did not conform to national health, safety, or other product regulations. Thus the effective expansion of goods and service markets depended on the (unanimous) adoption of harmonization directives by the Council - which had become an extremely slow and cumbersome process.

Cassis removed that impasse by imposing a rule of "mutual recognition" in all cases where national product regulations did not meet Court-defined and very strict criteria of "proportionality." By the same token, the Commission was now empowered to initiate Treaty infringement procedures to remove non-tariff barriers to trade even in the absence of prior harmonization. In other words, the proper scope of market integration was no longer under the control of national governments relying on their veto powers in the Council of Ministers. From then on, "negative integration" through mutual recognition imposed by supranational legal action was a background condition in intergovernmental and joint-decision negotiations about the integration of European markets. This explains why even governments that, at the time, were not under the influence of neoliberal and free-trade beliefs agreed to the Single Market program of 1985 and to the move from unanimity to qualified majority for harmonization decisions in the Single European Act of 1996.

4.2 Competition Law, State Aids, and Liberalization

Similarly, there is a clear intergovernmental foundation for the active roles of the Commission and the Court in defining and enforcing a body of European *competition law* and of European rules controlling *state aids* (MacGowan 2000). These were understood as a necessary implication of the political commitment to create competitive European markets - which otherwise could have been frustrated by economic concentration and the

protectionist practices of national governments. It is also true, however, that the Court, and even more so the Commission in its neoliberal zeal, interpreted the Treaty mandates very broadly and with little sympathy for the numerous exemptions governments had written into Art. 87 (ex 92) TEC.

The impact of supranational activism was particularly important for the liberalization of *service public* or *Daseinsvorsorge* sectors - telecommunications, financial services, energy, air, rail and road transport, and financial services. In all member states, these had been *staatsnahe Sektoren* (sectors close to the state; Mayntz/Scharpf 1995a) which in one form or another - as public monopolies or highly regulated private monopolies or cartels - were exempted from (the full force of) market competition. Except for the field of transport - where Arts. 70-80 (ex 74-84) TEC had envisaged a "Common Transport Policy" that never came about, but which presumably was meant to be as *dirigiste* as CAP - it was not obvious that the Treaty was supposed to change this state of affairs, and in fact for the first three decades nothing much happened. Moreover, the textual justifications for liberalizing initiatives that could be found in the Treaty were all worded to suggest that they should only prevent discrimination against *foreign* suppliers and providers. Thus the basic free trade commitment requires the "abolition, *as between Member States*, of obstacles to the free movement of goods, persons, services and capital" in Article 3 [c] TEC. Similarly, Art. 12 (ex 6) rules out "discrimination *on grounds of nationality*," and all Treaty provisions establishing a European competition law - Arts. 81-89 (ex 85-94) TEC - are explicitly aimed at restrictive practices or at competition-distorting regulations or state aids which "*affect trade between Member States*." It is remarkable, therefore, that the major impact of liberalization policies was on the *internal* transformation of national economies, rather than on *transnational* trade.

Economists and lawyers with a strong preference for liberalization could of course argue that a national sector that was exempted from market competition was *eo ipso* closed to foreign suppliers and providers, even if these were treated no worse than potential national competitors. In some branches (air transport or road haulage, for instance), service providers in early liberalizing countries and their governments were indeed pushing for protected markets in other member states to be opened. Moreover, as the promise of lower prices and more efficient services spread from the United States and Britain, liberalization also came to be supported by big industrial consumers and their associations in laggard countries. National service providers, however, were generally[16] opposed, and their political influence in "sectors close to the state" was generally sufficient to defend the status quo against reform efforts in most member states. In spite of the lure of new technical opportunities and competitive pressures, therefore, the majority of national governments were initially unenthusiastic or even hostile to European initiatives for service and infrastructure liberalization.

It therefore seems puzzling that the liberalization and deregulation of a wide range of heavily protected sectors was ultimately achieved through directives that were adopted in the joint-decision mode by qualified majorities in the Council. A partial explanation may be the ideological ascendancy of market liberalism in the 1980s, under the influence of which some governments may indeed have welcomed the opportunity to evade domestic political constraints through reforms imposed by the European level (Moravcsik 1998). But that alone would not have been sufficient under the applicable voting rules. As *Susanne Schmidt* has shown in her dissertation project, the initial push again came from the Court, which, in response to a complaint made by the European Parliament, had declared the Council's inaction in the transport field to be in violation of the Treaty. Encouraged by this decision, the Commission then used its competence to issue general directives without Council agreement (Art. 86 III (ex 90 III) TEC) for the first time in order to liberalize the

market for terminal equipment in telecommunications. When this bold move was upheld by the Court, it defined a new fallback option which increased the bargaining power of the Commission, even though it generally preferred to promote liberalization through Council directives. In addition, the Commission developed a most effective "dual-track" strategy to undermine the resistance of protectionist governments and to build political support for a liberalizing Council agenda (Schmidt 1998a, 1998b). Through selective legal action against national monopolies, it forced individual member states to open their own markets - and persuaded their governments to support Council directives that would liberalize the markets of all member states. Nevertheless, as the eventual compromises in the energy or insurance sectors show, countries with a strong political commitment to their existing public service structures were at least able to proceed quite slowly toward full market competition.

By and large, however, if market creation is defined as the problem, the problem-solving capacity of European policies adopted in the supranational/hierarchical and in the joint-decision modes must be rated exceptionally highly. Once the foundations had been laid by intergovernmental agreement on Treaty provisions which, however cautiously, established a commitment to market integration, supranational action by the Court and the Commission was able to build on this foundation, and on the supremacy of European law, in order to establish and expand free market regimes that effectively neutralized the protectionist preferences of member governments. It is a credit to the strategic skills of the Commission that this free market program, even where it went far beyond the initial preferences of most member governments, was generally realized with the acquiescence of these governments in the Council of Ministers.

4.3 Monetary Policy and Fiscal Coordination

The centralization of *monetary policy* and its assignment to an independent European Central Bank was, of course, again the outcome of tough intergovernmental bargaining. The same is true of the ECB's mandate to treat price stability as its "primary objective" (Art. 105 I TEC). However, since macroeconomic performance is determined by the interactive effects of monetary and fiscal policy (and by wage increases), and since the size of the EU budget is insignificant in comparison to the aggregate budgets of EMU member states, it was also thought necessary to achieve central control over national fiscal policy. In part, this requirement was made more specific in the Stability Pact which, at German insistence, was added as a condition of Monetary Union. It represents only a partial solution, however, since it merely defines upper limits for public-sector deficits; and even in this regard it falls short of the demands of its promoters since, according to Art. 104 XI (ex 104c) TEC, the application of sanctions is not automatic or left to supranational/hierarchical enforcement procedures, but depends on political decisions in the Council. Beyond that, fiscal coordination is left to procedures resembling the mode of "open coordination," in so far as recommendations proposed by the Commission and adopted by the Council are not binding on member governments.

Moreover, it is now being realized that the centralization of fiscal policies would not be conducive to effective macroeconomic coordination at the level of national economies. As *Henrik Enderlein's* dissertation project will show, the eurozone is not, at present, an "optimal currency area" since growth rates, inflation rates, and the phases of the business cycle continue to differ significantly among its member economies. As a result, member governments can no longer count on a monetary policy that fits the conditions of the *national* economy. For high-growth and high-inflation countries, this implies that real interest rates will be too low, adding fuel to inflation; and for low-growth and low-inflation countries, ECB interest rates will be too high, pushing the economy into recession and

adding to already high rates of unemployment (Enderlein 2001). Under these conditions, the coordination of European fiscal policies - meaning that national budgets should expand or contract at the same time in response to the average state of eurozone economies - could only make matters worse. If monetary instruments are chosen without regard to the current condition of the national economy, national governments depend all the more on the autonomous use of their fiscal instruments and, if available, of their influence on national wage increases.

5 Market-Enabling Regulations

The intergovernmental commitment to market integration had initially removed national competencies to impose tariffs and quantitative restrictions on trade, but left intact the power of member states to regulate and to tax internal economic activities. If these powers were exercised in a way that discriminated against imported goods, foreign providers of services, or migrant workers, the original law of the Treaty gave the Court and the Commission ample supranational/hierarchical authority to intervene.

5.1 Migrant Workers

There is now a large body of case law ensuring that migrant workers are protected by the same rights as domestic workers under labor law and social security. As a consequence, there is also a large number of Council directives dealing with the coordination problems among national social security systems that have arisen as a result of these judicial interventions (Leibfried/Pierson 2000). From a theoretical perspective, these policies are interesting since it is hard to explain them as a response to the economic interests that otherwise support the opening of product, service, and capital markets. Instead, countries of origin may have cared for the welfare of their citizens working abroad, and unions in the host country would have an interest in preventing competition at substandard wages and employment conditions. Yet neither would have been able to determine the outcome of ECJ judgments. It seems more plausible, therefore, to see the expansion of European law protecting migrant workers as an instance of the logic-driven, rather than interest-driven, evolution of legal rules: If the Treaty guarantees "an internal market characterized by ... the free movement of persons" (Art. 3, c TEC) and prohibits "any discrimination on grounds of nationality" (Art. 12 TEC), then it would logically follow that the employment of foreign workers must be governed by the same rules that apply to domestic workers. The same may be true in other areas of anti-discrimination case law.

5.2 Product Standards

However, national policies need not be discriminatory to have the effect of non-tariff barriers to trade (Armstrong/Bulmer 1998). If product standards and service regulations differ from one country to another, producers and providers cannot sell identical products in all member states, and hence the expected economies of scale of the larger European market cannot be realized. Even under the *Cassis* rule, however, mutual recognition could not be imposed by the Court if such regulations were appropriate means for protecting consumer, health, safety, or environmental interests. In other words, the removal of these non-tariff barriers could not always be achieved through supranational action, but often depended on harmonization directives adopted in the joint-decision mode.

From the perspective of free trade interests, then, the harmonization of product standards generally appears to be desirable. In practice, however, harmonization efforts had to cope

with the fact that national regulations may differ significantly from one another. In discussing these difficulties, it is useful to distinguish between "coordinative" and "regulatory" standards (Werle 1993; Scharpf 1994). The former serve the immediate interests of producers and consumers by ensuring the technical compatibility of hardware and software products. In their absence, firms would not be able to sell identical products in all European member states. Hence harmonization can generally rely on the shared interests of the industries represented in European standardization committees (e.g., CEN, CENELEC). While producers and consumers in each country would presumably prefer to have European standards conforming to their own existing rules, the resulting Battle-of-Sexes constellations will generally have low levels of conflict.

By contrast, product standards of the regulatory variety and most service regulations are supposed to serve the interests of consumers and workers, or they may serve to protect the environment or other politically specified values, rather than the immediate interest of producers. Nevertheless, producers would prefer common product standards to nationally differing regulations. For consumers, workers, and other protected interests, however, differences may be more salient since national rules are likely to reflect differing national sensitivities to certain types of risks and differing abilities to pay for the higher-priced products required by more demanding rules. As a consequence, harmonization through intergovernmental negotiations under the unanimity rule was cumbersome and often ended in deadlock.

The breakthrough came in the 1980s with the shift to qualified majority voting in the Council and with new harmonization procedures that used Council directives only for formulating very basic requirements, leaving the further specification of product norms to Commission directives, regulations, and decisions that are developed in hundreds of highly specialized advisory, regulatory, and management committees composed of experts delegated by national governments or nominated by interest associations and the affected industries (Joerges/Vos 1999). The harmonization of product norms in comitology procedures has been found to approximate "deliberative" problem-solving, rather than interest-based strategic bargaining (Joerges/Neyer 1997) and, given the veto positions of high-regulation countries under Arts. 30 (ex 36) and 95 (ex 100a) TEC, it is also plausible that many of the European standards do in fact provide high levels of protection (Eichener 1997, 2000). Moreover, the professional orientations of participants in comitology procedures seem to bias the output not only toward the much-lamented perfectionism and excessive detail of European product regulations,[17] but also toward a progressive expansion of the domains that are being regulated.[18]

Nevertheless, even in the field of product standards, free trade interests will not always prevail. Impediments to harmonization may arise from the costs of changing a large "installed base" (which has so far prevented the European standardization of electrical and telephone plugs and sockets). Of similar importance may be culturally ingrained preferences for certain types of products with high political salience (e.g., homeopathic medicine) and the institutional interest of national regulatory agencies, both of which may combine to defend divergent national regulatory regimes. These difficulties are well illustrated and analyzed in *Jürgen Feick's* project studying the arduous history of attempts to harmonize the licensing of pharmaceuticals despite the strong support of major industrial producers. Here, paradoxically, the move toward a mutual recognition of national licenses, based on the harmonization of national testing procedures, proved so difficult that the large producers of innovative pharmaceuticals were able to mobilize political support for the creation of a centralized European licensing facility, which now exists alongside diverse national licensing systems (Feick 2000).

5.3 Service Regulations

In general, we find that the harmonization of product standards (which constitute barriers to trade) is less difficult than the harmonization of regulations of production processes. In service branches, however, this distinction is less clear and has less explanatory power than is true for material goods. In the case of *uno actu* services, which are consumed as they are performed, *the process is the product*. Hence if the underlying justification of the distinction in the case of goods is the fact that consumers and users are affected by the qualities of the product, but not by the conditions under which it is produced, then regulations of service provision should be considered to be product regulations.

Since most services are locally provided and locally consumed rather than imported, free trade issues and hence the need for harmonization used to play only a minor role.[19] However, as formerly protected service branches have become liberalized, international trade in transport, communications, financial, and business services is gaining in importance, and nationally differing regulations of service provision and consumption may indeed become economically significant barriers to trade. If the protective purpose of national regulations is considered valid (e.g., in markets characterized by significant information asymmetries between providers and consumers), mutual recognition may not be an acceptable outcome, while the diversity of national regulations may still create serious obstacles to harmonization. In the insurance sector, *Susanne Schmidt's* current project shows that the problem was ultimately resolved by the adoption of a divided regime: In the markets for mass insurance, where consumer protection concerns are highly salient, business depends to a large extent on local information, and transnational trade was not an economically attractive option for service providers. As a result, national rules governing insurance contracts were allowed to stand. In the markets for insuring large industrial risks, by contrast, consumer protection seems less important since buyers and providers meet on a more equal footing. Again, therefore, harmonization could be avoided - but this time under rules requiring the mutual recognition of national regulations.

Yet another explanatory constellation is illustrated in *Susanne Lütz'* project on recent transformations of banking and capital market regulations in Europe. Again, national regulations differed, but the parties whose interests were protected by them - holders of savings accounts, creditors, and investors - could not benefit from their defense. As capital transfer controls were abolished in the 1980s, the integration of financial markets achieved a global, rather than a merely European dimension, and mobile capital would flow to the most attractive locations. Here, however, attractiveness was not defined by the absence of regulations. Creditors had reason to care about the solvency of banks, and investors were interested in safeguards against deception and insider trading. Moreover, U.S. regulations governing the access of European firms to the large American capital market and the investment practices of large American pension funds created massive incentives for European countries to approximate the - relatively demanding - regulatory regimes of the United States. As a consequence, regulatory competition did not result in the "race to the bottom" that is usually expected (Lütz 2000).

Even though the institutional arrangements for regulating financial markets and for controlling insider trading and other practices in stock exchanges differed greatly among EU member states, European companies and national regulators shared an interest in attracting large institutional investors, including American pension funds operating under strict U.S. regulations of permissible forms of investment abroad. National reforms of stock market regulation therefore began to converge on the pattern of state regulation that had been established by the U.S. Securities and Exchange Commission, and European

harmonization merely ratified the result. In short, international competition for the business of potent and demanding "consumers" did in fact strengthen the regulatory capacities of the state. Similarly, in the field of banking regulations, the "upward harmonization" (Luhmann 2001) of capital adequacy regulations was driven by the interest of the industry and of national regulatory agencies. For the former, the quality of national regulations of credit risks is a "certification" factor that influences a bank's rating in interbank borrowing, whereas national regulators have an interest in coordination at high levels of security in order to avoid the international repercussions of bank failures. In both fields, the interest constellations among national industries and national governments therefore favored coordination and would have ensured a high degree of convergence even in the absence of European harmonization.Thus, taken as a whole, the problem-solving capacity of the multilevel policy process is now probably higher than it was when national regulatory systems were still operating autonomously.[20]

5.4 Harmonization of Turnover Taxes

Tax policy at the European level is not (yet) about European taxes; it is about the harmonization of national taxes. Attempts at harmonization may be driven by either free trade or social protection interests. On the one hand, diverse systems of taxation and diverse tax rates are considered an obstacle to the integration of product, service, and capital markets; on the other hand, tax competition in the integrated European market is seen to constrain public revenue and welfare state finances. Hence European tax harmonization may, in principle, serve both market-making and market-correcting purposes. In fact, however, the partly successful European harmonization of turnover taxes served market-making purposes, whereas the mostly unsuccessful attempts at capital tax harmonization were driven by social protection interests.

Turnover taxes would constitute serious barriers to trade if exports were taxed by both the country of origin and the country of destination or if the methods of taxation differed between countries. As *Philipp Genschel* showed in his project on European tax harmonization (Genschel 2001), the second problem was eliminated at an early stage when member state governments agreed on a standardized systems of value-added taxation in the late 1960s. At the same time, double taxation was avoided since exports were exempted from VAT in the country of origin and taxed at the domestic rate in the country of destination. While the "country-of-destination" principle eliminated tax competition among member states, cross-border trade is still burdened by the bureaucratic procedures required by the move from one VAT regime to another. In the interest of more perfect market integration, the Commission has time and again proposed a move to the "country-of-origin" principle - which would entail either massive tax competition or the full harmonization of VAT rates. So far, however, member governments have been unwilling to sacrifice their autonomy in setting VAT rates in order to achieve comparatively minor gains in market perfection.

From the social protection perspective, the present state of VAT does not constitute a problem. Since national taxes are refunded on exports and imposed on imports, differing national tax rates created tax competition only as a consequence of private cross-border shopping when customs controls were removed. In the absence of harmonized tax rates, however, a shift to the country-of-origin principle would create heavy downward pressures on countries such as Denmark which rely on high VAT rates to finance the welfare state - and for the same reason these same countries also have to resist attempts at further harmonization. From their perspective, even the present degree of harmonization may have gone too far in constraining national policy options that would either increase VAT rates on

energy and other exhaustible resources or that would reduce rates on certain types of services.[21]

6 Regulations of Production Processes

The category of process regulations was originally introduced to characterize production-related environmental regulations in contrast to regulations of product standards (Rehbinder/Stewart 1984), but has been extended to cover all regulations and taxes that increase the cost of production without affecting the attractiveness of the product itself in the eyes of the consumer. These include not only environmental and work safety rules, but also rules limiting working time or ensuring paid maternal leave and minimum wage, employment protection, and industrial-relations legislation or factor taxes - all of which may have a significant impact on the costs of production but will not generally affect the qualities of the goods and services that are produced. Since the free trade regime of the EU (which is stricter than the WTO in this regard) does not allow the exclusion of products which are in themselves harmless on grounds of "social dumping" or "environmental dumping," free trade interests and consumers have no reason to mobilize support for the harmonization of process regulations. Initiatives therefore have to rely exclusively on the support of those interests that expect to suffer from free trade and the pressures of regulatory and tax competition. However, these interests are likely to be divided.

Where process regulations have a significant impact on production costs, producers in countries with very expensive regulations have an interest in achieving "a level playing field" through European harmonization at their own level. However, this interest is directly opposed to the interest of producers in less productive countries with low levels of regulation, who would lose their competitive advantage through harmonization. At the same time, workers and environmental interests in high-regulation countries would strongly oppose common European rules that would require existing national standards to be lowered.

At the European level, most (but not all) of these policies would need to be negotiated in the joint-decision mode, and some would require unanimous agreement in the Council of Ministers. Hence our theoretical expectation was that the outcome of negotiations would, at best, be common European minimal standards that are still acceptable to countries with low levels of protection, but that will not eliminate the pressures of regulatory competition, if they exist, on countries with high levels of protection.[22]

6.1 Gender Equality

These expectations do not apply to the European law on gender equality - which is the one area where process regulations could be advanced and extended in the supranational/hierarchical mode by the Commission and the Court. Unlike the protection of migrant workers against discrimination, these rules are not even logically related to a market-enabling function; they have a clear social protection origin. They owe their place in the primary law of the Treaty (Art. 141 (ex 119) TEC) to French concerns over competitive disadvantages that might follow from its legislation on equal pay for men and women. Other governments acquiesced - perhaps because each country was only expected to apply its own standards for men to women as well. Moreover, the injunction of the original Art. 119 was only addressed to member states, and it probably was not foreseen that the Court and the Commission would take the matter in their supranational hands (Falkner 1994). Once they were in charge of defining the requirements of gender equality,

however, the outcome was in part paradoxical: The Court's legal syllogisms had a strong deregulatory touch, allowing employers to avoid national regulations intended to protect women against unfavorable working conditions, and men to challenge positive discrimination laws intended to improve the career opportunities of women (Tesoka 1999). This is not meant to deny that in some countries the case law on gender equality did in fact improve the status of women in the labor market. Moreover, in response to protests and the spirit of the times, Council directives and even intergovernmental Treaty revisions (e.g., Art. 141 IV TEC) have corrected some of the excessively formalistic definitions of equality in the case law.

6.2 Process Regulations with Fuzzy Edges

In general, however, the harmonization of process regulations has to be achieved in the joint-decision mode rather than in the supranational/hierarchical mode. Here, our theory-based expectations would apply - and by and large, we found them confirmed by the empirical record. We had to recognize however, that there are instances where the distinction between product and process regulations does not provide a theoretically valid dividing line. Work safety regulations, for instance, may indeed affect the costs of industrial production processes. Under modern conditions, however, safety is largely incorporated in the hardware and software of machine tools and office equipment - which are themselves traded products whose manufacturers would be unable to realize the economies of scale of the larger European market if they had to comply with different safety rules in each country. In other words, in these cases process regulations are in effect product regulations, the adoption of which depends on the factors discussed above. Once that is understood, it seems less surprising that some of the harmonization directives on work safety and ergonomic qualities of work places are indeed providing high levels of protection (Eichener 2000).

In other cases, the distinction loses its explanatory value because, in the eyes of the consumer, the process of production does indeed affect the quality of the product. That was shown to be true in *Susanne Lütz'* project for capital market regulations protecting the interest of investors; in the aftermath of the BSE scare, this has also become true of the rules defining the permissible feeding and medication practices for cattle and other livestock, and it may become true for other foodstuffs. Under such circumstances, regulatory competition may indeed generate a race to the top if consumers are informed and care about the qualities in question. By the same token, harmonized regulations at high levels of protection may also find the support of producers in low-regulation countries, who would otherwise be vulnerable to consumer boycotts.

6.3 Environmental and Employment Regulations

It should be understood, however, that these qualifications do not detract from the basic theoretical proposition: European regulations of production processes which would significantly raise the costs of production without affecting the quality of the product in the eyes of the consumer are likely to differ in their impacts on the competitiveness of national economies operating at different levels of average productivity. Hence the harmonization demands of countries with high levels of protection are met by the opposition of member states with less productive economies. As a consequence, European process regulations (which are not, at the same time, product regulations) tend to have the character of minimum standards that do not place excessive demands on producers' ability to pay in economies with less than average productivity. This has been shown to be true for EU

environmental policy (Golub 1996a, 1996b). Moreover, the current projects by *Gerda Falkner* and her collaborators on the implementation of EU directives concerning the "social" conditions of employment in all fifteen member states, shows that all of the seven directives that were adopted in the 1990s take the form of minimum standards. Again, there are caveats, however. Given the diversity of national policy legacies, some aspects of European minimum standards are likely to require adjustments even in countries that are generally seen to be in the avant-garde of social protection (Bercusson 1999; Falkner 2000). Moreover, the *Falkner* projects also show that the assumed equation of high-regulation and high-productivity countries does not always apply: Certain social employment regulations that are on the books in some Southern countries are more stringent than those in the Northern welfare states, with the result that more demanding Europe-wide minimum standards will not necessarily be blocked by the resistance of Southern governments.

6.4 Industrial Relations

Even though legislation on industrial relations also constitutes a regulation of production processes, the economic pressures for harmonization are mitigated by the historical co-evolution of systems of industrial relations, production regimes, and product market strategies. Hence national configurations may differ greatly in the extent, form, and effectiveness of worker representation in collective bargaining and management decisions, but as long as production regimes and product strategies are part of the same matrix, economies with highly institutionalized systems of industrial relations may be as competitive as economies with deregulated labor markets and decentralized wage negotiations (Soskice 1999; Hall/Soskice 2001). Nevertheless, even in "corporatist" systems, the distributive conflict between capital and labor will at best be moderated by the "antagonistic cooperation" between management and organized labor. It is therefore no surprise that international competition should induce employers' associations to ask for the reduction of specific cost elements even at the risk of unbundling the "beneficial constraints" (Streeck 1997a) of a complex constellation.

By the same token, unions in highly regulated systems have tried to protect their positions through European harmonization. These efforts have failed almost completely - almost, because the European Works Councils directive does provide a minimum of information rights for workers in multinational European companies (Streeck 1997b). The reason, however, is not merely the resistance of employers' associations and governments in less regulated economies, but also the fact that there is no agreement among European unions on a common model of industrial relations that could be protected by European harmonization initiatives (Ebbinghaus/Visser 2000). In other words, institutional diversity would have constrained agreement on common European rules even if class conflict and competitive concerns had not stood in the way.

6.5 Harmonization of Factor Taxes

As with turnover taxes, the harmonization of factor taxes on capital and labor might occur under decision rules corresponding to the joint-decision mode. In fact, however, finance ministers in ECOFIN continue to dominate tax decisions, and national governments continue to defend their vetoes by insisting on unanimous decisions. As a consequence, interactions continue to approximate the intergovernmental mode, and the focus of interaction seems to be more in the nature of "bloody minded" bargaining than of cooperative, let alone "deliberative" problem-solving.

In his project, *Philipp Genschel* showed that free trade interests are primarily concerned about double taxation and the additional bureaucratic burdens that nationally divergent tax systems might impose on the cross-border movements of goods, services, and capital. In the field of *capital taxation*, however, the main issue of double taxation was already eliminated through bilateral tax treaties and national legislation before European tax policy became an issue. While differing national tax systems continue to impose bureaucratic burdens on multinational firms and cross-border investments, the pressure they exerted was not strong enough to overcome the resistance to harmonized rules that arises from differences between existing national tax systems. By comparison, advocates of free trade cared even less about the harmonization of *social security contributions* since these, like other process regulations, were no impediment to free trade or capital movements.

Thus, if the harmonization of factor taxes is presently a serious European concern, it is generally driven by social protection interests in high-tax countries, whereas free trade interests are now more attracted by the downward pressures on tax rates that could be expected from international tax competition. However, the nature of competitive pressures differs between different types of capital taxes. The taxation of *income from interest* is primarily vulnerable to tax evasion if assets are transferred to countries with low or zero source taxes and if income is not reported to the country of residence. Here, it is often assumed that tax competition resembles a symmetrical Prisoner's Dilemma and that harmonization ought to serve the revenue-maximizing interest of all countries. In fact, however, small countries will gain more revenue by attracting foreign assets than they lose through low tax rates on domestic capital incomes (Dehejia/Genschel 1999). Moreover, revenue from taxes on capital interest may not be the major concern of countries defending their comparative advantages in the market for financial services. In any case, the mobility of financial assets is not limited to EU member states, and EU-wide harmonization would therefore not provide a perfect solution to the problems of tax competition. As a result, harmonization has been an extremely conflictual and slow process, and even the compromise that was finally reached in 2000 is marred not only by very long transition periods, but also by its dependence on the cooperation of tax havens outside of the EU (Genschel 2001).

In the case of taxes on *company profits*, downward pressures are the consequence of a complex combination of competitive incentives (Ganghof 2000). On the one hand, low source taxes on local operations may influence the choice of investment and production locations. On the other hand, low taxes on company profits may induce multinational corporations to relocate their legal domiciles and headquarters functions. Even if there is no discrimination in favor of foreign companies, this is a form of competition that may be won by small countries, whereas large countries would lose large amounts of revenue if they tried to match the lowest rates of profit taxation. These conflicts of interest have so far prevented the harmonization of profit taxes, and even the efforts to define a "code of conduct" governing tax benefits that discriminate in favor of non-resident companies have not yet succeeded. It remains to be seen whether announcements by the Commission that discriminatory tax benefits will now be examined under the rules governing state aids will be able to stop the most blatant practices.

Finally, *social security contributions* have a direct impact on the costs of production and hence on international competitiveness in European product markets. It may therefore appear remarkable that attempts at their harmonization have never been on the European agenda. Nevertheless, on the basis of what was said before, the explanation is straightforward: In terms of the free trade interests that shaped the European agenda for the first three decades, there was no reason to consider the harmonization of a form of

taxation that did not interfere with the free movement of goods, services, and capital. To the extent that it might constitute an impediment to the free movement of persons, it could be assumed that any problems were dealt with by the legal rules ensuring non-discrimination of migrant workers and the portability of accrued entitlements and benefits. By contrast, social protection interests, which might have had reasons for avoiding the pressures of tax competition, saw no chance for effective harmonization, given the immense differences in the degree to which member states did and still do rely on social security contributions to finance their welfare expenditures (Scharpf 2000).

7 Welfare State Policies

Since the "social" regulations of employment conditions were among the process regulations discussed in the previous section, the present concern is with European policies affecting the core functions of national welfare states. These include the provision and financing of means-tested social assistance, of earnings-related social insurance covering income losses in cases of unemployment, sickness and disability, and in old age, of health care, and of social services for families with small children, for the handicapped, the sick, and the aged. All these policy areas are affected by tax competition and, at least to some extent, by regulatory competition as well, and considerable pressure for harmonization might therefore be expected to come from social protection interests. With the exception of means-tested social assistance, however, which is tax financed everywhere, the financing, the form of provision, and the availability of these functions varies considerably among member states. At the same time, under Art. 137 III (ex 188) TEC, European harmonization continues to depend on unanimous agreement in the Council.

As a consequence, the Europeanization of public policy has affected the core functions of the welfare state only in marginal ways - and almost exclusively as a consequence of market-making European law. Thus EU rules against the discrimination of migrant workers have ensured their access to contribution-financed social insurance systems and the portability of accrued benefits. Moreover, there are elaborate coordination rules under Art. 42 TEC (ex 51) to ensure that workers with employment histories in more than one member state pay contributions and receive benefits according to the law of a single designated state. However, since these coordination rules were first formulated for the original Six, all of which had Bismarckian social security systems, the fact that there are no similar coordination rules for the taxes paid by migrant workers is generating increasing difficulties as countries with tax-financed social security systems have joined the Community and as even the original Six are changing the financing structures of their systems (Pieters 2001). To the extent that EU rules also ensure access to tax-financed benefits for the families of migrant workers, or for workers who are no longer employed, they have been considered a problem for countries with a tax-financed basic pension and with tax-financed national health systems. Moreover, EU rules ensuring free trade in goods and services have been interpreted to allow cross-border purchases of medical services, pharmaceuticals, and medical appliances at the expense of national health insurance systems, and there seems to be a serious concern that EU competition law might allow private insurers to enter the "markets" of national social insurance systems - at least in areas where these are seen to provide defined-contribution benefits for individual risks (Leibfried/Pierson 2000). Beyond that, however, the EU has treated the core welfare state functions as being off limits for positive European regulation.

This was in part due to neoliberal opposition against any extension or reinforcement of welfare state policies. The more important reason is that the policy legacies and institutional structures of existing social protection systems in European welfare states are

extremely diverse. These differences are extensively documented in the comparative project directed by *Fritz W. Scharpf* and *Vivien A. Schmidt* (2000a, 2000b): "Scandinavian," "Anglo-Saxon," and "Continental" welfare states have defined differing dividing lines between the welfare functions that individuals and families are expected to provide on their own and those functions which are assumed by the state. As a consequence, European countries differ greatly in their levels of welfare spending and taxation, and they also differ greatly in the levels and structures of employment in sheltered-sector services. The same is true of differences in European systems of industrial relations (Ebbinghaus/Visser 2000). In other words, there is no common "European social model."[23] On theoretical grounds, we expect these differences between European welfare states to largely resist harmonization, and the empirical record seems to support this expectation.

Since both the beneficiaries and the providers of welfare state services and transfers have based their life plans on the continuation of existing systems, their replacement by different common European solutions would face massive political obstacles at the national level. British voters, who have had to make their own private arrangements for most life risks, could never accept Scandinavian levels of taxation; Swedish women, who have come to rely on the availability of high-quality public services, would never accept a return to Continental patterns of family work and gender relations; and German patients and doctors would be united in protest against the establishment of a British-type National Health Service. Similar differences prevent the harmonization of national systems of industrial relations and of employment regulations.

As a consequence of these anticipated electoral responses, and of the veto positions that organized labor tends to enjoy in left-of-center governments, European directives in the field of the welfare state and industrial relations need to avoid direct challenges to the policy legacies and institutional structures of the different types of national welfare states; indeed, in order to maintain their own continuing control, member states insisted on the unanimity rule even at the Nice Summit, when they were most clearly confronted with the need to avoid immobilism in anticipation of Eastern enlargement. In short, in the field of welfare state policies, the problem-solving capacity of European policy processes in the joint-decision or intergovernmental modes is extremely low. Instead, there is now a "Lisbon process," which is designed to achieve progress in the open-coordination mode. However, it is too early to judge its effectiveness.

8 Adjustment at the National Level

Any assessment of the problem-solving capacity of the multilevel European polity must, of course, also take account of changes at the national level, where the policy space is legally constrained by the rules of negative integration on the one hand and economically constrained by the pressures of regulatory and tax competition on the other. As a consequence, many domestic policy choices are no longer determined by nationally available policy resources and national policy preferences alone; they have assumed some of the characteristics of foreign policy - just as international relations between EU member states have assumed characteristics of European domestic politics. It is thus meaningful to speak of the "mutual adjustment" among EU member states as a mode of Europeanized policy-making.

Successful adjustment would serve both competitive and protective purposes: Since negative integration increases the intensity of international competition, countries must seek to maintain and increase the competitiveness of their economies; and since negative

integration combined with the pressures of regulatory and tax competition challenges existing social protection policies, countries seeking to maintain protection levels must find solutions that are legally and economically viable in the open economy.

8.1 Competitive Adjustment: Deregulation and Tax Reform

Competitive adjustments may, in turn, primarily increase productivity or reduce costs. These distinctions are analytically useful even though the empirical dividing lines are sometimes less clear, as actual policies will often be designed to serve multiple purposes. This is true of regional and sectoral industrial policies which may at the same time reduce costs through subsidies and attempt to increase the productivity of employment in declining regions and branches, whereas R&D and innovation policies are more clearly at the competitive and productivity-increasing end of the spectrum. Comparative studies of European regions and the policies affecting their competitiveness have been carried out in an internationally cooperative project designed and carried out by *Colin Crouch* and *Helmut Voelzkow*. They show that policies adopted at the regional level make a difference. More generally, they support the proposition that - at least in the large member states of the EU - nationally uniform industrial policies are becoming less effective, whereas the capacity of subnational governments to respond autonomously to the specialized needs of regionally concentrated industries has gained in importance. In international comparison, this also suggests that the comparative advantages of "small states in world markets" (Katzenstein 1985) will continue to increase, unless larger states learn to make full use of decentralizing options (Scharpf 2001b). It also appears to us that nationally distinct systems of innovation (Casper 1997; Soskice 1999) are presently being transformed in unexpected ways as governments and large firms respond to new global challenges. In this regard, however, we have no answers as yet and are still in the process of designing a research project that will explore recent changes.

In the comparative literature on political economy, the more generally expected outcomes of competitive adjustment are cost-cutting strategies involving deregulation and tax reductions. If goods and services produced under foreign regulatory and tax regimes are allowed to compete on domestic markets, and if constraints on the mobility of factors of production are removed, regime competition is expected to exert downward pressure on burdensome regulations and high rates of taxation on factors of production or factor incomes (Sinn 1993). It should be clear, however, that tax cuts and deregulation will not follow directly from economic competition, but instead will be mediated by domestic political institutions and processes providing varying incentives and opportunities for governments, opposition parties, and intermediary organizations to promote or oppose them.

Thus *Susanne Schmidt's* current post-doctoral project will show that there is indeed reason to be skeptical of hypotheses that try to explain observed deregulation as a direct effect of international regime competition. Comparing German and French responses to the European liberalization of the road haulage and insurance markets, it appears that the effective deregulation of previously cartelized and highly regulated sectors went much further in Germany than was legally required by EU directives and that it also went further than it did in France. Moreover, the more radical German response does not seem to be a consequence of economic pressures: Liberalization did not in fact generate much competition from foreign providers; hence deregulation was not needed to prevent the reverse discrimination of German providers. Instead, it seems that in the multiple-veto political system of the Federal Republic, European liberalization directives unfroze a stalemate between domestic political forces challenging and defending high-regulation

regimes that had outlived their economic rationale. In France, by contrast, a less constrained political system had been able to continuously adjust and modernize existing regulations and continued to do so after the adoption of European directives. In other words, radical deregulation in Germany owes more to the pressures of pent-up reforms in the "semi-sovereign" German state (Katzenstein 1987) than to the legal constraints of mutual recognition and the pressures of regulatory competition.

Given the importance of intervening political variables, there is now a body of literature which, on the basis of multivariate statistical analyses of cross-national time-series data on exposure to trade, capital controls, levels of taxation, and public expenditures or deficits, claims that regime competition has no causal influence at all on national policy choices (e.g., Garrett 1998; Swank 1998). In our view, such sweeping conclusions are not justified. In the tax field, the challenge of this literature is taken up by the dissertation project of *Steffen Ganghof*, which, through a combination of quantitative analyses and comparative case studies, will show precisely how international competition is creating specific constraints and tradeoffs for countries with different policy legacies and how the responses of individual countries are shaped by differences in their policy-making institutions and their political preferences (Ganghof 2000).

The empirical sequence began with politically motivated cuts of the nominal rates of personal and corporate income taxes in the United States and in the UK, the impact of which on public revenue was limited by simultaneous "base broadening." Under the pressure of tax competition, Scandinavian countries then moved toward "dual income tax" solutions, where taxes on corporate profits, or on all income from capital, are reduced to the low Anglo-Saxon rates, while progressive and very high rates of taxation are maintained on income from labor. The social asymmetry of this solution became a political problem in Sweden, where it contributed to the defeat of the Social Democrats in 1990, and in Denmark, where the explicitness of this dualism had to be softened by subsequent reforms. Nevertheless, the dual-tax strategy has allowed Scandinavian countries to maintain very high levels of revenue without endangering their competitive position in international capital and investment markets.

Finally, in Continental countries, high nominal rates were riddled with exemptions for a wide variety of purposes and groups. Nevertheless, nominal rates also came under pressure. In most countries, however, political resistance and economic concerns about investment disincentives were strong enough to prevent an Anglo-Saxon strategy of radical base broadening - with the consequence that revenue losses could not be compensated for. At the same time, a move toward the Scandinavian dual income tax was not only highly unpopular but would, at least in Germany, violate constitutional norms of equal taxation. In the past, Continental countries generally responded by raising VAT rates and social security contributions (Manow/Seils 2000a, 2000b). As the damaging effects of payroll taxes on employment came to be realized, however, this trend was halted and even reversed in some countries - beginning in the mid-1980s in the Netherlands and later taking place in France, Belgium, and Germany as well. The pressure is now on cutting social expenditure and perhaps on an expansion of green taxes. As the dissertation project of *Eric Seils* is showing, the change of policy has only had a significant effect on labor costs in the Netherlands so far. In the meantime, however, Belgium and France are following the Dutch example in targeting tax cuts or subsidies to reduce the tax wedge specifically for low-wage employment.

In the tax field, then, our projects show that domestic resistance to competitive adjustment may be strong enough to prevent the most economically efficient policy responses to the pressures of international regime competition. As a consequence, we also find few

examples where changes in national policies have the manifest characteristics of a "race to the bottom." However, as *Steffen Ganghof's* project will show in detail, this does not justify sanguine interpretations: International tax competition has created severe financial strains for advanced welfare states, and the resulting pressures to adjust have created difficult dilemmas and "trilemmas" for national policy-makers. It is true that countries still have choices, and that politics still makes a difference. But it is not true that countries could avoid paying a high price if they fail to come up with economically effective responses.

8.2 Protective Adjustment: Employment and the Welfare State

Protective adjustment in the fields of employment and the welfare state was the subject of an internationally cooperative project directed by *Fritz W. Scharpf* and *Vivien A. Schmidt* (Scharpf/Schmidt 2000a, 2000b). Covering the policy responses to changes in the international economic environment of twelve advanced welfare states (including three that are not members of the EU)[24] in the period from the early 1970s to the late 1990s in the employment and social-policy sectors, the project did not specifically focus on the EU. It is nevertheless worth noting that European policies, while very much part of the problems that nine of the twelve countries had to cope with, did not appear to be part of the solution in any of these countries.[25]

The project shows that the integration of product and capital markets created major challenges for all national employment and welfare systems. As a consequence of more intense international competition in product markets, employment in the exposed sectors of the economy declined everywhere, increasing welfare state expenditure and reducing revenue from work-based contributions, while international tax competition created additional strain on welfare state revenue. At the same time, capital mobility constrained national options for Keynesian demand management, and for EU countries aspiring to join European Monetary Union, the Maastricht criteria and the subsequent Stability Pact also had the effect of reducing the options of deficit financing.

However, the project also shows that countries differ greatly in their vulnerability to common external challenges. Remarkably, these differences did not matter so much in the internationally exposed sectors of the economy, where all countries tried to reduce costs and increase productivity without being able to stabilize, let alone increase, employment rates.[26) Where there were overall employment increases, they were due to jobs created in the sheltered sectors, where services are locally provided and locally consumed. The big difference here is between countries that were able to expand (private or public) services in the sheltered sector sufficiently to maintain high levels of total employment and those that had to accept high and persistent rates of unemployment. This is directly related to differences in the policy legacies of specific types of welfare states.

Scandinavian countries have very high rates of employment in the public sector, because their welfare states provide universal and high-quality social services for families with children, the sick, the handicapped, and the elderly. Anglo-Saxon countries, by contrast, have very lean public sectors but achieve high levels of private-sector employment in the sheltered sector as a consequence of deregulated labor markets, low levels of taxation, and high income inequality. Finally, Continental welfare states have on average as little public-sector employment as the Anglo-Saxon countries and as little employment in private services as the Scandinavian countries. Hence their total employment rates are low and unemployment is high and persistent.

The problem of the Scandinavian welfare states is the very high tax burden - on average

about 20 percent of GDP above the level of the Anglo-Saxon countries. These are not a problem for private investments or for export-oriented production, since capital taxes have been reduced to very low levels. However, taxes on income from labor (and in Denmark VAT too) are very high. The problem is thus not primarily economic but political in character: Scandinavian welfare states are secure as long as middle-class voters find the benefits which they receive sufficiently valuable to accept high taxes as a fair price to pay.

In Anglo-Saxon countries, the main problem is the existence of a poverty trap for the "working poor" with low occupational qualifications and - since social assistance benefits for families with children are comparatively generous - the existence of an unemployment trap for "workless families". The solutions adopted by "Third-Way" governments in the UK and earlier in Australia tend to combine "in-work benefits" with improvements in education and training systems and with fairly rigorous "activation" measures. Again, the main problem is political: Middle-class voters, who receive few benefits (apart from free health care) from the welfare state, need to be persuaded that it is appropriate to pay (somewhat) higher taxes in order to improve the situation of the least well-off. Since such arguments cannot be based on appeals to self-interest, the tone of policy discourses is more moralistic, and there is a greater emphasis on the reciprocal obligations of beneficiaries than there is in other countries.

In Continental countries, finally, the problem is exclusion: Women, older workers, and low-skilled workers find fewer employment opportunities than they do in either the Scandinavian or the Anglo-Saxon countries. On the one hand, social services are underdeveloped and create relatively few employment opportunities in the public sector. On the other hand, the Continental welfare state is relatively expensive since it has to support a large share of the population depending on unemployment, disability, early retirement, or social assistance transfers. As a consequence, demand for private-sector services is constrained not only by highly regulated labor markets but also by relatively high tax burdens and by the fact that work-based social security contributions are still the main source of welfare state finance.

Compared to Scandinavian and Anglo-Saxon countries, Continental welfare states therefore have the worst of both worlds, and it is not clear how they can escape from this position in either the Scandinavian or the Anglo-Saxon direction. Tax increases to allow considerable expansion of publicly financed social services are as unpopular as labor market deregulation to allow the expansion of private-sector services, and even a shift in the revenue mix of the welfare state from social security contributions to income taxes or green taxes may run into severe political opposition. As a result, we consider the study of reform options and reform strategies in Continental welfare states to be among the most interesting and potentially policy-relevant research areas in our program. Thus *Eric Seils*' dissertation project is comparing the relative success of the Netherlands and the failure of Germany in containing and ultimately reversing the rise of the tax wedge affecting low-wage employment. Similarly, *Martin Schludi*'s dissertation will compare the role which unions in several countries have played in opposing or facilitating pension reforms that would contain the rise of wage-based contributions (Schludi 2001).

9 Conclusion

One conclusion from this overview is that the Europeanization of public policy was mainly successful in furthering free trade interests through market-creating and market-enabling policies. Institutionally, these processes were driven by the competencies of negative integration and competition policy exercised by the Commission and the Court in the

supranational mode on the one hand and by the inherent perfectionism of comitology procedures harmonizing product and certain process regulations in the joint-decision mode on the other. Social protection interests have been able to shape market-enabling policies in areas where European harmonization was required to overcome non-tariff barriers to trade or in areas where neither economic conflicts of interest nor major and politically salient differences between national policy legacies stood in the way of harmonized process regulations. Beyond that, however, the creation of "Social Europe" is blocked by conflicts arising from the diversity of welfare state aspirations and solutions at the national level. Since these conflicts cannot be resolved within the given institutional framework of the EU, social protection interests continue to depend on the problem-solving capacities of member states. These are constrained by the legal gridlock of negative integration and competition rules on the one hand and by the economic pressures of regulatory and tax competition on the other. Nevertheless, the constraints created by economic integration are not so tight as to rule out national policy choices realizing widely differing patterns of work and welfare. We can say this much with some assurance on the basis of our current empirical research and our knowledge of the relevant literature. In a more speculative mode, we add the following observations:

It seems that European integration has more or less reached its economic goals with legal requirements of negative integration, liberalization, and competition rules, the stringency of which exceeds those of long-established federal nation states such as the United States or Switzerland. At the same time, it is becoming clear that economic integration has exhausted its potential as the driving force behind European political integration. Instead, the tightness of economic regulations is becoming politically counterproductive and will become more so after Eastern enlargement. One symptom is the increasing tendency of EU heads of government to strengthen the Presidency at the expense of the Commission in the preparation of policy initiatives and in the negotiation of policy compromises to be reached at Summit meetings rather than in regular procedures involving the Commission, the Parliament, and the Council. Another one is the turn that the *finalité* debate started by Joschka Fischer has taken since the Nice Summit: While proposals for reforms strengthening the democratic legitimacy of European institutions have provoked massive opposition among member governments, the emphasis is now on the constitutional limitation of European policy choices - through a catalogue of individual rights and, more significantly, the search for legal instruments that would be more effective than "subsidiarity" in constraining the exercise of EU competencies.

At the same time, in response to the BSE scare and FMD, member governments not only reasserted national controls but are also in the process of designing national versions of agricultural reforms of which it is as yet uncertain how they could be integrated into a future version of CAP - which, in any case, will have to renationalize some of the present CAP functions in order to contain the budget escalation of Eastern enlargement. Moreover, it is becoming clear that the Europeanization of monetary policy will not, and cannot, be followed by the Europeanization of fiscal policy among eurozone governments. Instead, the present divergence of growth rates, employment, and inflation among member economies shows that the "one size fits all" interest rates set by the ECB need to be complemented by nationally diverging fiscal and wage policies.

Under such conditions, it should be expected that the legal constraints of negative integration, competition policy, and the Stability Pact will have to be somewhat relaxed and that the *acquis* that has to be accepted by newly acceding countries will eventually be defined more selectively and with longer transition periods than is presently envisaged. At the same time, in its recent decisions, including the latest one upholding a German law requiring power networks to purchase electricity from renewable sources at preferential

prices, the Court has shown some willingness to moderate the unconditional supremacy of competition rules over strongly held national policy preferences.

In any case, it seems unlikely that any major new initiatives for economic integration - comparable to the Single Market and Monetary Union - will provide major new impulses for political integration. It would also be surprising if the essentially normative arguments promoted by the German government in the post-Nice "constitutional" debate were to induce institutional changes which - in the face of dramatically increasing diversity after Eastern enlargement - would improve both the legitimacy and the problem-solving capacity of EU policy processes. In a longer historical perspective, we might instead speculate about the possibility that now, after the EEC strategy of 1956 has run its course, the European Defence Community (EDC) strategy of 1954 might be given another chance. In that case, impulses for more effective political integration might arise from crises and conflicts forcing member states into more effective and better legitimated cooperation in the areas of Foreign and Security Policy. These fields, however, are beyond the scope of our past and present research programs.

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Endnotes

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2 Since case studies tend to focus on processes that did in fact result in an EU policy, rather than on initiatives that failed or that were not even introduced in anticipation of failure, they may be perfectly true individually and yet produce a selection bias in the aggregate. The resulting distortion is similar to the "non-decision problem" discussed in American "community-power" research more than three decades ago (Bachrach/Barratz 1962, 1963, 1970).

3 It should be noted, however, that MPIfG research, and hence my framework, does not cover the full range of EU policies. It is essentially limited to regulatory policies that are either intended to bring about economic integration or that are designed to protect national societies against the negative consequences of economic integration. This excludes policies in the "second" and "third pillar," and it also excludes a range of promotional and redistributive policies within the first pillar (e.g., CAP, industrial policy, R&D policy, or the structural and cohesion funds) that do not fit this specification. If the conceptual scheme presented here is sound, it ought to be possible to extend and adapt it to other policy areas, but I am not trying to do that in the present paper.

4 Conflict may be resolved through procedures that allow some actors to override the opposition of others, or through procedures that facilitate consensus-building.

5 The refusal to change existing policies in the face of new problems or changed constituency preferences should be treated in analogy to the adoption of a new policy.

6 From the perspective of national parliaments, however, there is a critical difference between these two forms of "intergovernmental" policy-making: At least in principle, treaties can be rejected by a national legislature, whereas it is legally bound to transpose

European directives into national law, even if these directives have to be adopted by unanimous agreement in the Council.

7 This appears to be a more appropriate description than the claim by Moravcsik (1994) that the Europeanization of policy choices "strengthens the state" (i.e., the national executive), which ignores the fact that national governments are also losing the capacity to realize their most preferred policy choices.

8 The same problem plays a large role for parliaments at both levels in German federalism (Lehmbruch 1998).

9 I will not discuss the procedural legitimation of US-style independent regulatory agencies here, but note that this form of delegated legislation is circumscribed by stringent rules of publicity and adversary procedure and that its outcomes are easily reversed by the democratically legitimated Congress. Neither of these conditions would apply to autonomous rule-making by the European Commission.

10 It needs to be understood that constellations involve the actors authorized to participate in European policy choices - government ministries, Commission directorates, etc. - but the interests they represent are likely to be a combination of the socioeconomic interests of their constituents, of their role-specific understanding of the public interest, and of their institutional self-interest.

11 This is not meant to deny the crucial role that European integration has played in creating conditions in which, for the first time in history, war between European countries has become unthinkable. As economic boundaries were being removed, moving political boundaries between member states has ceased to be a salient national goal.

12 In the present text, I often use "interests" and "preferences" interchangeably. In earlier work, Renate Mayntz and I (1995b) defined "preferences" as the more inclusive category that contains interests (in the sense of material and institutional self-interest) as well as normative (or ideological) orientations and identity concepts.

13 In German ministerial bureaucracy, the Ausschuss der ständigen Vertreter (COREPER) was nicknamed the Ausschuss der ständigen Verräter (traitors).

14 "Neorealist" International Relations theorists might describe these second-level interests as "geopolitical" (Moravcsik 1998, 27-35). Alternative conceptualizations could be derived from models of iterated games and generalized reciprocity (Keohane 1984, 110-132). Constructivist notions of preference modification and learning may facilitate useful descriptions of the shift from one definition of interests to the other (and back?). By contrast, the systems theoretic emphasis on the extreme complexity and fluidity of "interdependent, reflexive, destabilized and competing" institutional orientations (Sand 1998) is likely to overwhelm all attempts at conceptual ordering, let alone systematic explanation.

15 Case 120/78, 1979.

16 In electricity, the French monopolist EdF was among the original supporters of liberalization, but remained of course opposed to any opening of the French market (Schmidt 1998: 192, 235-236). Similarly, since it has been privatized, Deutsche Post is pushing the German government to support the liberalization of all postal markets in Europe.

17 A rational-choice explanation could be stated in a simple model: Let us assume that national delegates are simultaneously accountable to two national constituencies, i.e., export industries interested in common standards and social protection groups interested in maintaining their national requirements. Under these assumptions, it will be easier to cumulate national requirements than to persuade a delegate that an idiosyncratic national requirement ought to be dropped.

18 For example, a very general Council directive on product safety was (plausibly) specified in safety regulations for children's toys and then extended to safety regulations for the design of children's playgrounds reflecting cumulative national requirements - allegedly with the consequence that half of the playgrounds in France had to be closed (communication by Laurent Thévenot, EHSS, Paris).

19 If service providers choose to make use of the freedom of establishment, Art 43 II (ex 52) TEC allows each member state to apply "the conditions laid down for its own nationals." What does create difficulties is then the mutual recognition of diplomas and certificates of qualifications - which, under Art. 47 (ex 57) TEC, depends on the adoption of Council directives, rather than on the Cassis rule.

20 In theoretical terms, we have here a combination of the "certification effect," where regulations serve as a signal to consumers (Scharpf 1999, 92-95), and of the "California effect" described by David Vogel (1995), which depended on California being allowed by U.S. law to exclude automobiles that did not conform to its high emission standards.

21 As an experiment, the EU does presently allow lower VAT rates on some local services.

22 By the same logic, regulations that have no significant impact on production costs and international competitiveness (such as the Drinking-Water or the Flora-Fauna-Habitat directives) might well be harmonized at higher levels of protection.

23 The one exception is social assistance which, with some exceptions in Southern member states, is ubiquitously available for people without other means of support and is financed from general revenues in all countries. Here, agreement on common European minimum standards (preferably set at levels that are proportionate to average incomes in different countries) ought to be feasible in theory (Atkinson 1998). It remains to be seen whether the Lisbon process focusing on "social exclusion" will be able to achieve a similar outcome through the mode of open coordination.

24 Australia, Austria, Belgium, Denmark, France, Germany, Italy, the Netherlands, New Zealand, Sweden, Switzerland, and the United Kingdom.

25 A partial exception is Italy, where pension reforms in the 1990s were facilitated by the need to meet the Maastricht criteria to join European Monetary Union (Ferrera and Gualmini 2000). Our conclusion might have been different if the project had also included Ireland, Portugal, and Spain, where employment and reform efforts seems to have benefited greatly from membership in the EU.

26 Countries do differ in the extent to which service functions were externalized from industry to service branches, but if employment in industry and in production-related services is considered in the aggregate, the statement made in the text remains true (Scharpf 2000).

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