



The Future of Europe: **Renewing the project**

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List of abbreviations

CAP	Common Agricultural Policy
CBI	Child basic income
CCM	Civilian Crisis Management
EADS	European Aeronautic Defence and Space Company
ECB	European Central Bank
ECJ	European Court of Justice
ECPC	European Civil Peace Corps
EDA	European Defence Agency
EES	European Employment Strategy
ENP	European Neighbourhood Policy
EMP	Euro-Med Partnership
EMU	European Monetary Union
EIT	European Institute of Technology
ESDP	European Security and Defence Policy
EU (12, 15, 25)	European Union (at different stages in its growth)
EVHAC	European Voluntary Humanitarian Aid Corps
FDI	Foreign direct investment
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GNV	Government net value
IMF	International Monetary Fund
LoI	Letter of intent
MEP	Member of the European Parliament
NATO	North Atlantic Treaty Organisation
NGO	Non-governmental organisation
OMC	Open Method of Coordination
OOCAR	Organisation for Joint Armaments Cooperations
R&D	Research and Development
OECD	Organisation for Economic Cooperation and Development

Introduction and summary

The future of the European Union (EU) has never been the subject of so much intense scrutiny, with academic analysts, media commentators and think-tank pundits all weighing in on the subject of its current misfortunes and malaise. It is hard to believe, when faced with the post-Constitution-rejection hand-wringing, that, over the last two decades, the EU has successfully completed two rounds of enlargement. The last of these, in 2004, marked the end of the post-war division of the continent, has broken down most of the barriers to commerce among its member states, and has undertaken the most ambitious experiment in economic and monetary union in history. All of this would have been unimaginable to even the most Euro-optimistic of observer, as recently as the early 1980s.

This report does not intend to contribute to either the fatalistic chorus of recent opinion, or proposals to relaunch the process of 'deepening and widening the EU' via new ambitious projects. Instead, it undertakes an analysis of the EU's progress and contemporary challenges, and proposes ways of renewing the project in four related domains: Europe's economy, its 'social dimension', its political system, and its relations with the world. Rather than a crisis, or even malaise, I argue that the EU and its member states are facing an entirely manageable process of adjustment, which requires pragmatic, rather than grandiose, solutions.

In putting those solutions in place, the limits to the EU's role set by its budgetary constraints, institutional weaknesses and multi-level, multi-member structure must be more fully recognised than in recent times, and its strategies – at least in the short term – resized and recalibrated accordingly. In the longer run, moving forward requires stepping back, and addressing a number of key contradictions in the EU's present set-up – especially its embedded spending priorities – rather than envisaging new and perilous scenarios of integration, based on notions of 'variable geometry' and 'deeper union' among core members. Renewing the project, and building greater support for it among multiple European populations, requires, in brief, refocusing the enterprise with feasibility, sustainability and credibility as its three operating principles.

The argument, in summary, is as follows:

1) Since the 1990s, the European project has been underpowered and overextended, as certain communities of political and policy elites have attempted to drive it forward without the requisite financial and institutional resources. In lieu of a hard-to-achieve intergovernmental bargain on establishing a hierarchy of priorities and finding the means to deliver them, the EU has seen the proliferation of objectives and ambitions under the Lisbon programme¹, and the arrival of a new phase of multi-level policymaking via horizontal and vertical 'coordination'.

Unfortunately, although predictably, the latter has delivered little by way of results. In both internal and external policies, the EU faces a recurrent 'conditionality' problem: influencing the domestic policies of member states outside areas of core European competency can be as hard as changing the politics of non-member states via the instruments of the European Neighbourhood Policy. The consequent 'capabilities gap' is potentially far more damaging for the credibility and legitimacy of the EU than the so-called 'democratic deficit', and there was little in the Constitutional Treaty to address this issue. The only way of closing the capabilities gap is to reprioritise, do less, and do it better – in part by re-orientating the EU's limited financial resources.

2) In the economy, if the EU is constrained by having much of its resources tied up by intergovernmental bargains of the past – especially in the Common Agricultural Policy and the Structural Funds – Economic and Monetary Union's (EMU) Stability and Growth Pact also places limits on the reform capabilities of its member states. 'Globalisation' is much less important here than the demands of successfully managing the transition in these economies from manufacturing to service-sector employment, under conditions of budgetary austerity.

Desirable short-term goals include establishing a closer link between EU monetary and fiscal policy and national reform agendas, and redefining the Lisbon programme, the latter including a more incisive use of 'the open method of coordination' (OMC), especially in education reform. Unproductive intervention in member state employment policies should be discontinued, and new means of promoting human capital growth, and research and development (R&D) put in place.

1. An action and development plan for the European Union, adopted for a ten-year period in 2000 in Lisbon, Portugal, by the European Council. It aims to make the EU the world's most dynamic and competitive economy by 2010.

3) Regarding the social dimension, I argue that a 'European social model', as such, does not exist, and the use of the term for rhetorical and ideological ends only obfuscates what Europe can and should do. Proponents of 'Social Europe' – a quasi-federal welfare state at the European level – have tried to implement their vision through legislation, 'social agreements' between European employers and trade unions, and, more recently, through OMC. It is time to accept that welfare reform and recalibration can only be carried out by member states, and that the influence of the EU within that process is necessarily limited.

A continued use of the post-Lisbon OMC for the purposes of information gathering and monitoring is recommended in some areas, while a more focused, targeted form should be deployed in others. But a more realistic understanding of its limited scope, especially in boosting job creation and promoting social cohesion, is required. Attention should be focused, instead, on building consensus on more concrete social policy advances, such as a European child income guarantee.

4) Regarding relations between Europe and the wider world, moving forward with a European foreign and defence policy is not only supported by European publics, but necessary due to the changing nature of external security threats and a failure to realise scale economies in EU defence budgets. There is much debate about whether Europe should exert 'hard' military power abroad or 'soft' civilian power via aid and trade promotion. This debate is misconceived to the extent that the EU already pursues both, but is unable to deploy either adequately.

It is recommended that the EU rationalise defence spending and the European military-industrial complex, and use the money saved for other purposes. At the same time, the 'soft power' of European aid and trade initiatives that now fall under the European Neighbourhood Policy needs to be redeployed, given the failure to anchor reform in partner states that will not become EU members. Two major 'soft' initiatives set out in the Constitutional Treaty should also be pursued: the creation of a European civilian expert reconstruction corps and a European humanitarian support corps.

5) As for the political dimension of the EU project, the increasing recourse of the EU to deliberation and referendums hit a dead end with the rejection of the draft Constitutional Treaty by France and the Netherlands, and the discrediting of these methods of 'popular democracy'. But careful consideration should be given to the reasons why the French and Dutch rejected the Constitutional Treaty, and to the more general views held by European publics of the EU and what it should be doing.

By focusing more closely on issues where the EU can truly make a difference to people's lives, one form of legitimacy – 'outcome legitimacy' linked to effective policy implementation – can be enhanced. 'Input legitimacy' – gained from democratising the EU – is more difficult, given the gulf that still exists between fragile and poorly coordinated Euro-parties and nationally embedded political ideologies and opinion. More limited reforms are required here, including enhancing the European Parliament's influence over the selection of the Commission President and Commissioners, and strengthening the links between national parliaments and the EU institutions.

1. Europe's policy dilemmas: why the EU should do less and do it better"

Europe suffers from an extremely unhealthy political dynamic, with too much energy focused in recent years on the constitutional debate and not enough on reform. Meanwhile, problems of real substance – such as the distorted EU budget – have been avoided. Emphasis has been given instead to extending the influence and mandate of the EU via 'new modes governance' that simply raise expectations, only to dash them when they fail to deliver the goods.

Problems of increased but unmet expectations are also created by a core paradox in EU policymaking – the source of much misunderstanding among European publics, and one that European officials and politicians do too little to correct: that, as the EU's declared policy goals become increasingly ambitious (most notably, but not only, in the Lisbon programme to make Europe the world's foremost knowledge-based economy), the resources and institutional capacity for meeting them remain wholly unequal to the task (Creel *et al* 2005; Majone 2005, 2006).

In both internal and external policies, the EU also faces a recurrent 'conditionality' problem: influencing the domestic policies of its own member states outside areas of core European competencies can be as hard as changing the politics of non-member states via the trade-and-aid instruments of the European Neighbourhood Policy. The consequent 'capabilities gap' is potentially far more damaging for the credibility and legitimacy of the EU than the so-called 'democratic deficit', but there was precious little in the draft Constitutional Treaty to address this critical issue.

The EU is also afflicted by a cacophony of voices declaring crisis, stagnation and disorientation, and proposing grandiose schemes for dealing with a supposed collapse of purpose, vision and will.

Policy pundit Charles Grant (2006) argues that the 'EU's malaise means that two of its defining characteristics over the past twenty years – continual "deepening" through treaty-based integration, and continual "widening" through the accession of new members – can no longer be taken for granted', and proposes a solution of 'concentric circles', or parallel 'convergence clubs'. Meanwhile Belgian prime minister Guy Verhofstadt (2006) believes that 'the creation of a political union makes it possible to continue enlarging the union without any major problems...'. Both are wrong – in their diagnosis of Europe's ills as well as in their suggested remedies. This kind of policy quackery can only worsen the disease.

The EU has made major advances in recent years, and the momentum achieved with the Single Market, EMU and the most recent enlargement has been considerable. But the bicycle metaphor – that, unless the integration process keeps moving forward to greater and grander union, it will falter and collapse – has never been less appropriate for understanding the development and future of the EU (see, for example, Gomes de Andrade 2005). Europe badly needs a pause in the integration process – in both its deepening and widening dimensions. It is important to fully digest those changes now and adjust to their multiple ramifications across many policy domains. It is also high time to resolve the numerous contradictions that have bedevilled the European project in the past, and that still threaten its future.

The mania for deepening in some quarters is a major threat to achieving that critical objective: proposals to push forward with political union even among the core Eurozone members (for example, Kalff 2006) fly in the face of political and economic logic (those countries remain highly diverse in their social systems, labour market arrangements and distributive preferences, not to mention their own aspirations for 'ever closer union'), as does the looser notion of a Europe of 'variable geometry', of groups of countries, that is, moving ahead at different speeds in different areas.

Although some forms of 'enhanced co-operation' may be appropriate, as mentioned with regard to defence and security policy below, the basis for building core 'convergence clubs', or a proliferation of 'concentric circles' in the policy preferences and affinities of different member states, is weak (Ahrens *et al* 2006).

Such developments also risk making the Eurozone less, not more, attractive to new members, while also threatening serious political, organisational and regulatory divisions within the existing Union. There is, after all, a big difference between aligning non-member countries, such as Georgia, more closely with the EU's common foreign and security policy concerns, and moving towards a 'fuzzy and flexible' Union based on an 'issue-based' system of 'co-operation' (Barysch 2006) with little in the way of underpinning structure or hierarchy.

Such talk amounts to a massive distraction from the real issue at stake in the contemporary EU: the trend since the early 1990s, initiated by the signing of the Maastricht Treaty, to attempt the construction of a

‘virtual government’, ostensibly to accompany advances in the Single Market and EMU, but with none of the intergovernmental consensus and commitments that underpinned those innovations, and with no redeployment of the EU’s limited resources. This trend was formalised at the Lisbon Summit in 2000 and has subsequently produced a succession of ‘coordination processes’, institutionalised to varying degrees in employment, social inclusion, pensions, research and innovation policy, and education.

Although the intentions were commendable – after all, the plans of the Lisbon Agenda to make Europe the world’s foremost ‘knowledge society’ by 2010 were not misplaced, given the problems afflicting Europe’s ‘innovation systems’ – the means for achieving them have been feeble. The prime instrument – the ‘open method of coordination’, based on the peer-review and benchmarking of national policy development – has revealed, more than anything else, the extent of the EU’s capabilities gap. For, not only were there no new resources or incentives attached to this new instrument, but it was advanced in precisely those areas where the EU cannot act at all, or, at least, not without the explicit consent of its member states. The aim was, therefore, to do *more* with *less*.

The bigger problem is one of making and implementing future-orientated policy in a multi-level system. Only certain policies are conducive to pan-European action, for the EU’s supranational resources are largely constrained – via the Common Agricultural Policy and Structural Funds, which together dominate the EU’s budget – by past constitutional settlements.

The problems of multi-level policymaking in a quasi-federal system are many. In some policy areas, there are obvious economies of scale, cross-border spillovers, functional interdependence and externalities for greater coordination and integration; and, when policy innovations occur there, they typically mobilise sufficient political support and ‘work’. Where those factors are not present, and where normative, administrative and financial resources are also limited, the policy outcomes are inevitably sub-optimal (Majone 2006).

As Alesina *et al* (2005) argue, there has been an overexpansion of EU policymaking in areas such as social protection, and sectoral policies such as agriculture, where economies of scale are low and the heterogeneity of preferences high. Meanwhile, there has been underinvolvement in areas such as defence, foreign relations, environmental protection, and international crime and migration-related policies, where potential economies are high and the heterogeneity of preferences low.

In Europe’s Employment Strategy (EES), for example, there is significant public and national political support as well as Commission sponsorship for its aims, but there are no obvious externalities compelling cross-national coordination, and a host of policy design and implementation problems impeding success.

The Lisbon-linked OMC attempts to bridge this problem. The fact that it has largely failed is due to, first, erroneous assumptions (for example, that deliberation can enhance transnational policy influence), and second, the difficulties of creating channels for effective policy communication and transfer, both horizontally across member states and vertically between Brussels and member state capitals. The worst-case scenario and outcome are referred to by Sapir (2006: 384), who suggests that the attempt to coordinate labour markets through the EES ‘is probably an obstacle rather than catalyst for reform because it tends to blur the responsibility between national and EU authorities ... and is a sure recipe for voters’ dissatisfaction with the European Union’.

Pelkmans and Casey (2004) refer to the dilemma thus: ‘With “open coordination” failing, the EU seems caught between too little centralization and the costly and unattractive alternative of too much centralization, with its problems of legitimacy and the challenge of responding to local diversity and consensual problem-solving.’ But it is not just a question of limited resources and inadequate institutional structures.

As discussed in the next section on the European economy, the idea that European policies can successfully target and stimulate the roots of growth assumes, first, that policymakers know what underpins economic growth, and, second, that they can then pull the relevant policy levers. Neither is assured. Although economists understand much about the impediments to growth in the EU in general terms, the specifics (regarding, for example, the organisation of labour markets, the nature of Europe’s ‘productivity problem’, and the role of research and development in firm growth) are the subject of much controversy (see, for example, Daveri 2004).

And, even if those specifics can be identified, the idea that more growth, higher levels of employment, improved productivity, higher rates of equality, increased labour market flexibility and security can all be

stimulated by EU coordination processes hits two obvious problems: first, from a practical viewpoint, there are few functioning links between policy formulation at the supranational level and policy implementation in the member states in any of these areas; and, second, even if there were, the combination of all of these goals in the EU's post-Lisbon policy discourse attests to a powerful strain of 'technocratic utopianism' (the idea that an expert elite can impose without representation a beneficial change in society) in trying to square too many economic circles, and paper over serious political and ideological divisions.

Short-term political benefits may be delivered by obfuscation – that is, ignoring the fact that more employment may mean *lower* average productivity and perhaps *higher* levels of wage inequality (as lower wage workers enter the work force), and playing down the reality that faster growth may *widen* rather than *narrow* the gap between the skilled and the unskilled, and between European countries and their regions. But this 'have-cake-and-eat-it' strategy will prove to be a longer-term folly.

In this context, doing more with less and failing to achieve much by way of results has only compounded the EU's credibility problems: announcing lofty but unachievable targets for the European economy across too many policy domains, and over a relatively short 10-year period, has inevitably created a widespread sentiment that 'Lisbon has failed', and simply added to the present gloom and doom.

Europe's key problem is, therefore, less its 'democratic deficit' than its *capabilities gap* – arguably the major source of disenchantment among its citizens (Majone 2006). Efficacy can make a major contribution to democratic legitimacy. Renewing the European project – as set out in the next four sections of this paper – thus requires that less is attempted, that the EU's limited resources are redeployed for those tasks, and that more concrete results are achieved.

2. Economic Europe: real and imagined challenges

The Single Market Programme set out to remove barriers to the intra-European mobility of capital, goods, services, labour and capital, with the aim of boosting productivity and accelerating growth. The goal of EMU was to complete that process by providing a single European currency that would reduce the costs of cross-border transactions. Its Stability and Growth Pact was designed to ensure the achievement of lower inflation and budget deficits. All provide an important framework and scope for greater economic dynamism and growth (Jones and Rhodes 2006).

But, though launched in the mid-1980s, Europe is still coming to terms with the consequences of implementing the single market in goods and services. Indeed, the single market in services is still not complete, although a major step towards that goal was recently made with the approval of the Services Directive, which promises to give a major boost to the European economy over coming years (Miscossi 2006). The EU is also still in a period of experimentation with EMU which, like the single market programme, has provided important benefits to its member economies, but has also introduced new constraints for national policymakers and uncertainties for workers, consumers and savers.

Enlargement – although an extraordinary success – has added to perceptions that Europe has entered a new period of rapid economic adjustment, turbulence and instability.

‘Globalisation’ is the term frequently employed – often lazily and inaccurately – to explain the forces at work. Yet there is little evidence that opening European economies to larger flows of trade and capital (and now also people) is responsible for its ills. Despite much hand-wringing, especially on the left, regarding the prospects for the European ‘social model’ in the age of globalisation, there is no evidence of a ‘race to the bottom’ in social spending, or that increased trade and capital flows are undermining European welfare states.

Nor is there any evidence that financial market actors ‘reward’ countries that retrench their welfare states (Moseley 2000). And despite some evidence of declines in top rates of income tax and corporation tax, providing some support for the tax competition thesis, corporation tax has never been a significant source of taxation: as tax rates have fallen, loopholes have typically been closed, and aggregate tax yields have remained largely unchanged (Garrett and Mitchell 2001; Glyn 2006). Within the EU, as Majone (2005: 185-187) argues, the member states have engaged in a ‘race to the top’ in taxation, rather than a ‘race to the bottom’.

Indeed, except for those countries where spending had risen to excessive levels in the 1980s, and left them dangerously exposed in a period of much greater uncertainty than today, there has been little sign of retrenchment, and social outlays have continued to grow (Castles 2004). In Europe, there has also been a ‘race to the top’ in social outlays, as southern member states have gradually converged on their northern neighbours. It is true that some European jobs are going abroad, as companies seek to diversify their markets and benefit, in some cases, from lower labour costs. But there is little hard evidence that domestic jobs in high-wage European countries are being relocated on a significant scale to the low-wage regions of the East and South (Konings and Murphy 2004).

The best evidence against the ‘race-to-the-bottom’ thesis is found in Scandinavia, where Europe’s largest and most effective welfare states, and highest levels of employment, are also found in its most open economies. The secret lies in the latter’s combination of competitiveness and welfare, and there is growing evidence that globalisation can feed productively into that mix. In the words of De Grauwe and Polan (2005: 120):

‘Globalization puts pressure on nations to be competitive [...] It forces government to be efficient, even if they do not like to be. Those who succeed improve the competitiveness of their country and are rewarded by more welfare for their citizens; those who fail reduce productivity and competitiveness, and are punished by less welfare for their citizens. In this sense, globalization can force governments to be more responsible to the needs of their citizens.’

Of course, this is of little consolation to the governments and citizens of those countries whose welfare states, labour markets and innovation systems are ill-adjusted to changing patterns of competition, and face a difficult period of transition and reform. But those problems need to be put in perspective. Contrary to the impression given by the publicity surrounding the Lisbon programme, Europe ‘as a whole’ does not face especially severe problems of employment, economic growth or even innovation.

It is certainly true that all countries face issues of ongoing adjustment, especially in upgrading skills and compensating the losers from the process of increased competition and technological change: if there is a consensus on the impact of globalisation, it is that it rewards the flexible and well-educated and punishes those with low or no skills.

As the Sapir Report on the European economy (Sapir *et al* 2004) argues, it is also true that the EU has strongly diverged from the United States (the traditional yardstick) in terms of employment and productivity, both absolutely and relatively, over the last 30 years. EU-15 living standards (GDP per capita) are roughly 70 per cent of US levels, approximately one-third of which analysts attribute to labour productivity differences, and the rest to differences in the utilisation of labour, including differences in employment rates and hours worked.

But the most important economic problems facing 'Europe' are not EU-wide at all. Ireland, the UK and the Scandinavian economies perform well on most if not all indicators – and reveal that there are multiple paths to strong growth and high rates of employment. The new Central and Eastern European member states are also experiencing high rates of growth that will gradually help them come to terms with the legacy of state socialism.

The economic malaise is concentrated, instead, in certain core Eurozone countries – notably France, Germany and Italy – that are experiencing low levels of employment, relatively low levels of growth and, in some instances – Italy and Greece – very high levels of public debt. The latter countries, in particular, are caught in a vicious circle of reduced productivity and competitiveness, and downward pressure on the welfare of their citizens.

The Lisbon agenda and its 'coordination processes' – put in place to provide a joint, pan-European response to Europe's multiple challenges (slow growth, high unemployment, inadequate training and education systems, and insufficient investment in research and development and the assets required by the 'knowledge society') – is now widely regarded to have failed. As argued above, this is partly because it has few teeth and even fewer resources, but also because it aimed too high, tried to do too much, and sought to include too many policies and countries within its ambit.

As argued below, this is especially true of the 'European Employment Strategy', the most ambitious and institutionally well-grounded of Europe's 'open methods of coordination' (OMCs), but, evidently, also of its less well-developed equivalents in the critical areas of research, innovation and education. There is also considerable uncertainty among economists as to where the 'real' problem lies, especially in debates over why Europe's productivity levels and living standards lag behind those of the United States – the standard benchmark of unfavourable comparisons (for example, Daveri 2004). And there is also a gradual recognition that, if 'Europe' might, under certain circumstances, provide the solution, some of its recent innovations are also part of the problem.

The macro-economic regime of EMU is important here, for, as revealed by recent research (for example, Soskice 2006), by reducing the scope for national reflation and focusing competition on unit labour costs, EMU has helped subdue the performance of economies with high non-wage labour costs and highly skilled workers.

If public spending is restricted by the Stability and Growth Pact, private consumption is constrained by the pressures of competition. In the coordinated market economies of France, Germany and Italy, given high and difficult-to-reduce non-wage costs, firms have been holding down wages to compete, and workers with the highly specific, firm-related skills have increased their savings to insure against the risk of unemployment. These countries' growth dynamics are quite different from those of Europe's liberal market economies (the UK and Ireland), where generic skills are more easily transferable, non-wage labour costs are lower, and private consumption higher.

Reform capacity is also, thereby, restricted in the continental economies. Budgetary constraints combine with worker hostility to change in precisely those countries where further reform to product and labour markets is required – especially in reducing levels of employment protection in favour of 'person protection; that is, assisting workers' transitions from one job to the next and cushioning that process with unemployment insurance.

Many economists (for example, Boeri 2005) argue that competition – especially in product markets – will gradually force these systems and their workers to adjust. But market-induced reforms take time and cost money. The danger in the meantime is that political conflict will increase, and that the consensus on the role

of 'Europe' in promoting reform will be an early casualty.

This analysis points to two obvious conclusions. First, the Lisbon agenda, as others have argued, needs to be refocused and given more clout, especially by restructuring the EU budget and through a reassessment and redeployment of the OMCs. Second, Eurozone fiscal policy needs to be made more flexible, and used to reward and facilitate reform in countries where resistance to change is the greatest. Regenerating growth and raising tax revenues from that growth will also help accomplish structural reform (Hughes *et al* 2004). Although the challenges are considerable, these two reforms can be linked to give the EU both more effectiveness and credibility – and thereby also enhancing the legitimacy of the project.

Regarding the EU budget, agricultural spending through the Common Agricultural Policy (CAP) – amounting to just under 50 per cent of the budget – is the single biggest obstacle to progressing the Lisbon agenda. The figures are astonishing, and just one fact explains why the EU is so ineffective as a policy actor outside its core regulatory functions, rendering all other arguments superfluous by comparison: support for French, German and Italian farmers alone accounts for half of CAP spending and a quarter of the entire EU budget.

That budget (in 1998 figures) amounts to just Eur 250 per inhabitant, or around one per cent of GDP; it lies somewhere between the national budgets of Finland and Denmark in size (Bartolini 2005: 191). Forget the debate on the 'democratic deficit': this is where the real root of Europe's legitimacy problems lies. For the EU spends little, most of it goes to farming, and it spends least in those areas where public support for greater EU involvement has been strongest (Gros and Miscossi 2005).

The Sapir report (Sapir *et al* 2004) recommended a transformation of Europe's budget and its existing funds (the CAP and different structural funds) into three new funds, more closely tailored to its current needs: a Growth Fund (to promote R&D and cross-border infrastructure); a Convergence Fund (to be allocated to low-income countries – a substantial shift from present structural-fund focus on 'poor' regions, including those in rich countries); and a Restructuring Fund (that would shift resources from farm subsidies and income support to a more general programme for redeploying manpower) (see Pelkmans and Casey 2004 for a sympathetic critique).

The success of all other EU economic growth and adjustment initiatives hinges on such reform, and yet the political will to tackle the issue is distinctly lacking.

There are numerous proposals as to how to transform the budget and the funds, given predictable opposition from veto players (in both governments and interest organisations) who will fight to preserve the status quo. These proposals include: giving the European Parliament the power to allocate categories of spending (though it is hard to see why this would end the current distributive deadlock) (Gros and Miscossi 2005); means-testing the CAP and subjecting structural funds to strict conditionality requirements (Baldwin 2005); and introducing a new 'public goods budget' with entirely different voting rules from the present status-quo-preserving combination of qualified majority rule on the spending side and unanimity on the revenue side (Blankart and Kirchner 2003).

The last proposal suggests a positive way forward by leaving part of the current system intact, thereby defusing some of the opposition to change. But mobilising support even for a reform of this kind would require the investment of considerable energy in pan-European alliance-building and intergovernmental bargaining. The domestic politics of extensive budgetary reform would also be intense, and, in some countries, especially those that are the largest current recipients of agricultural funding, potentially explosive.

As for the pre- and post-Lisbon OMCs, the Sapir report argued that the OMC should be restricted to those areas where there is no alternative, due to subsidiarity constraints and the absence of core EU competencies, for example labour markets, taxation, welfare, education, innovation and R&D. But there was no detailed consideration as to how the OMC could be made more effective.

The fact is that the circumstances under which policy influence and transfer can work are few, in the absence of coercion or strong material incentives (Citi and Rhodes forthcoming, 2007). Those conditions include the presence of strong policy externalities (for example, functional interdependence between countries, as in cross-border pollution control); acute policy failure and uncertainty; clarity and consistency in the external policy 'message'; and strong domestic incentives (for example, electoral benefits) for policy adoption. In order to work, a combination of these factors and their perceived benefits must exceed the material or reputational costs of policy transfer.

The most important OMC – the European Employment Strategy – scores poorly on all of these points, regardless of its Treaty base and the political commitment and energies devoted to it. Should the OMC therefore be scrapped? Not necessarily. The problem with the Employment Strategy is that the policy message is unclear (as argued in greater detail below, its advocacy of active labour market policy and ‘flexicurity’ – combining employment flexibility with employment security – translates poorly into real-world labour markets), and domestic policy environments unfavourable, due to the distributive stakes at the heart of labour market reform.

There are other areas, however, in which a reinforced system of OMC policy transfer could work – including education policy, especially at the university level, and human capital development in general. There are good reasons to focus on these areas. First, raising skills levels would contribute powerfully to achieving the Lisbon employment target of 70 per cent, even in the absence of labour market reform (Gros 2006). Second, promoting adult education and on-the-job learning can achieve relatively short-term success in increasing a country’s human capital endowment (Ederer 2006).

Third, the distributive issues at stake in education and human capital policies are much lower than in the sensitive area of employment policy. And fourth, although posing their own problems, models of university organisation, professionalisation, academic recruitment and student funding, and lessons from more successful systems, are simpler and easier to transfer than controversial employment reforms, as are initiatives to diversify the funding and reduce government control of higher education institutions.

Moreover, as recent research confirms (for example, Schleicher 2006; Jacobs and Van der Ploeg 2006; Lambert and Butler 2006), without such reforms to higher education, there can be no sustainable improvement to Europe’s systems of research and innovation. Gros (2005: 6) argues that ‘without more scientists it does not make sense to increase spending on R&D’ and it ‘is pointless to focus on a [Lisbon agenda] target like “increasing R&D spending to 3% of GDP by 2010”’. The kind of institutional investment made since the 1990s in the European Employment Strategy ought to be deployed behind these objectives instead.

As they currently stand, the post-Lisbon research and innovation and education coordination programmes are among the weakest of the OMCs. Even if reinforcing them means facing some of the same problems as the Employment OMC, stemming from the diversity of member states, and the difficulties of implementing pan-European initiatives in member states, there is, at least, the potential for economies of scale and the facilitating force of cross-border externalities in research, innovation and education that do not exist elsewhere.

Thus, there are obvious economies of scale to warrant the Europeanisation of innovation promotion through the creation of a single patent for the EU – a Community Patent – under the jurisdiction of a European Patent Court: the fact that initiatives to do so, to date, have failed is arguably due to the protectionism and vested interests at work in national patent industries (Van der Horst *et al* 2006).

The externalities of improving R&D spending – in both quantity and quality, and from both private and public sources – stem from the fact that there can be cross-border spillovers into productivity gains from one country’s R&D investments to the next (Keller 2004; Ederveen *et al* 2005).

Without such reforms the Lisbon strategy is bound to fail: as Denis *et al* (2005: 48-49) have calculated, if the Lisbon strategy’s objective of an increase in the EU’s R&D intensity from two to three per cent over the decade to 2010 had been set instead in 1990, for attainment in 2000, and if the EU had continued its trend investment in traditional high-tech industries (for example, cars and chemicals) instead, ‘it would have gained relatively little in terms of closing the productivity gap with the US’.

Material incentives for reshaping national innovation systems could be provided by a restructuring of European research funding; by the coordination and rationalisation of national civilian and military R&D (see section four below); and by the devolution of the spending currently envisaged for the European Institute of Technology (EIT). The latter is a European flagship project, which risks creating a supranational organisation with little in the way of productive links into sub-national clusters of innovation – where the key weaknesses in the EU lie, as compared to the US ‘model’ (Owen-Smith *et al* 2002) – and little impact on Europe’s sclerotic and failing systems of higher education.

Although the Sapir report also recommended the creation of an independent European Agency for Science and Research, to stimulate rigour and independence in European scientific research projects, that proposal, and the EIT project that has emerged over the last year or so, ignore the bigger problem of duplicative

waste and the frequent avoidance of excellence in national R&D spending; this has been noted by numerous analysts (for example, Pelkmans and Casey 2004; Tindemanns 2006).

As for the contribution that a reformed European fiscal policy could make towards facilitating structural change, to recap my earlier discussion, the reform paradox in these countries derives from the fact that EMU-related public spending constraints and cuts only make reforms harder to achieve – reforms like more liquid capital markets and more fluid labour markets, sustainable public finances and a recalibration of welfare states.

The problem is not that the European Central Bank (ECB) has been too conservative in its monetary policy, as argued by those who believe that Europe's problems can be explained by EMU and the ECB's ostensive inflation obsession. In fact, EMU has had growth-enhancing effects: it has delivered historically low interest rates and removed exchange rate costs from cross-border transactions. Moreover, monetary policy can only have short-run benefits; it cannot deliver long-term growth (Alesina and Giavazzi 2006).

However, new public investment is restrained in some of the core Eurozone economies by the Stability and Growth Pact, and, as argued above, competition-driven wage moderation among their firms has contributed to lower private consumption growth.

André Sapir (2006) argues that the supply-side reform required by those economies can more easily be delivered by national politicians when accompanied by monetary expansion (to offset its effects on aggregate demand) and fiscal relaxation (to compensate the losers). But he provides little indication of the ways in which those reforms can be implemented, given the Eurozone economies' veto-heavy policy systems, and, in particular, the still-powerful position within them of national trade union confederations.

One can imagine a way forward as follows. Coeuré and Pisani-Ferry (2005) propose a sustainability and growth pact, under which each country should present a plan with three components: a fiscal plan, which would target the government's net value (GNV) – this is the difference between its total assets and financial liabilities – and describe how the GNV value would be met; a reform plan, which would be like the Lisbon-related national reform programmes, but with a stronger link to budgetary policy; and a contingency plan, which would describe how budgetary policy would respond to positive or negative shocks (for example, an increase in tax revenues or recession).

The Coeuré/Pisani-Ferry scheme could be linked to national reform pacts that could help overcome the vetoes that bedevil distributive politics in most Eurozone economies.

Pontusson (2005) has suggested, for example, that government-union pacts could exchange wage moderation for fiscal stimulation. But one could go further and include labour market and pensions reforms, which are otherwise notoriously difficult to achieve. Such fiscal incentives would be permitted if government net value allowed scope for an increase in public spending, and prior commitments to reform by a range of policy actors convinced Eurozone finance ministers of the credibility of the government's reform plan. Of course, this raises the issue of precisely what kind of reforms to pursue, and whether the OMCs (especially the European Employment Strategy) still have any role to play here. Which brings us to Europe's 'social dimension'.

3. 'Social Europe'? The future of the EU's social dimension

The notion of a 'European Social Model' is more myth than reality. Many view it, nevertheless, as a useful myth; one that can be deployed rhetorically to mobilise support for a further elevation of social welfare policies from the national to the European level. But, regardless of evident concern in many quarters that European welfare states do need reform, the notion is also responsible for a degree of unwarranted smugness and hubris regarding European social achievements, a focus on unrealistic policies and a diversion of attention away from the more important problems facing the continent.

Above all, it obfuscates the differences between countries and disguises the problems of the largest continental European economies, which are anything but a 'model'. Their low levels of employment, frequently high levels of unemployment and the emergence of dual labour markets between heavily-protected core workers and flexible part-time and temporary workers do little to preserve social equity or make their welfare systems sustainable.

Meanwhile, politicians in many European countries have become highly adept at blaming these ills on 'neo-liberal Europe' – a significant source of Euroscepticism everywhere and a major factor behind the French rejection of the Constitutional Treaty (Brouard and Tiberj 2006). For European public opinion is highly malleable. Such political elites provide their citizens with 'domestic cognitive short-cuts' for 'understanding' complex realities (in other words, they frame the issues for them), by alluding to the ills supposedly induced by 'Europe'. This thereby reinforces voters' 'negativity bias' regarding the EU (Kumlin 2004).

Welfare entitlements have been built up over decades, and powerful client groups are strongly attached to them. But, unless they are well-informed, citizens have little conception of the real trade-offs that underpin the achievement of welfare state generosity and sustainability: they want more welfare not less, but do not want to pay more to sustain what they already have (Boeri *et al* 2001). And politicians, with their eyes on the next elections, are understandably loath to challenge them. How useful, then, to transfer the blame to the twin bugbears of 'neo-liberalism' and 'globalisation'.

The phrases 'social Europe' or 'European social model' (both propagated by politicians, pundits and European Commission officials – and heavily exploited by anti-European issue entrepreneurs in national settings) rely heavily on the rhetorical device that Europe is everything that the neo-liberal United States is not. But this notion of an 'anti-model' has been fully debunked by recent research comparing different parts of Europe to the US along key welfare indicators.

As Jens Alber (2006) demonstrates, although it is true that US income inequality and incarceration rates are higher than anywhere in Europe, and the share of public revenue in the welfare system is less, US employment rates are well above the 70 per cent Lisbon target (which only four EU countries – the UK, Denmark, the Netherlands and Sweden – exceed) and have been there for some time. Long-term rates of unemployment in the US are lower and fertility rates higher than those in the EU; and its GDP per capita in purchasing power parities is 50 per cent higher than the average for the EU25. In terms of education and cognitive skills, only the Nordic countries match the US in their rates of adults with upper secondary education: 75 per cent of the 25-64 population have at least upper secondary education in the Nordic countries (the US figure is around 80 per cent), falling to 67 per cent in the continental countries, 60 per cent in the UK and Ireland, and only 39 per cent in the Mediterranean (Sapir 2006).

It is also worth noting that, albeit from lower starting points, over the 1980s and 1990s there were larger increases than in the US in the Gini coefficients of income inequality in the UK, Austria, and Italy, and similar increases in Sweden and Finland (Pontusson 2005: 38).

As important for the distinction frequently made between the 'European social model' and the US or 'Anglo-Saxon' 'anti-model' are the disparities in welfare state characteristics and outcomes in Europe itself. Alber (2006: 411-412) also clearly demonstrates that:

'...the notion of a European social model cannot be based on a set of key features that all member states of the European Union would have in common. The variety in Europe is so vast that the difference between the European mean and the United States usually pales beside the magnitude of the differences found in the EU.'

But, beyond issues of accuracy, the use of the term 'model' in European social policy rhetoric is responsible for much misunderstanding regarding the status and sustainability of individual welfare systems and the

need to defend them against any kind of reform – even when it is equity-enhancing and secures the benefits of future welfare recipients. As one French politician remarked, how can his country's 'model' be a model when it so badly needs reform, and no one else wants to imitate it?

A long tradition of analysis of Europe's various types of welfare system has revealed some by now very well-known features of 'social Europe', and most of them are far from being 'models'. The continental and southern European systems suffer from the worst efficiency and sustainability problems, related primarily to low levels of employment and high levels of passive benefit spending. Benefits tend to be proportional to earnings and financed through social security contributions, which impact heavily on non-wage labour costs. Benefit replacement rates are generous and benefit duration tends to be long. Employment protection is high – though for a decreasing core of workers on permanent contracts.

The Anglo-Irish systems are quite sustainable at present levels of expenditure, enjoy high levels of employment but also suffer from high levels of inequality. The UK is a higher social spender than Ireland, and spending growth has recently been higher than the EU15. Wage subsidies also supplement the incomes of low-paid workers and their families, and a minimum wage in the UK and national wage agreements in Ireland help prevent the proliferation of 'working poor'. Benefits – which are flat rate – are modest, and social protection tends to be targeted and means-tested, and replacement rates low. Public and family services are less developed than in Scandinavia and the continental countries. Levels of employment protection are low.

The welfare states of Central and Eastern Europe are minimal and low-income, and some are heavily biased towards pensions, but given typically low employment rates, apart from the very low spending Baltic countries, their sustainability at present levels is in question. Hungary, Poland and Slovakia are among the worst employment performers in the EU, while Slovenia, the Czech Republic, Estonia and Latvia are close to France and Germany.

Only the Nordic systems manage high levels of both equity and sustainability – primarily because their expensive and universal systems of social protection and redistribution are underpinned by very high levels of employment and education. Besides generous replacement rates, these systems offer a wide array of public social services beyond health and education. Employment protection is not high or extensive in these systems. But generous, though short-duration, unemployment benefits, together with active labour market programmes, encourage and sustain high levels of both male and female employment. Public sector employment is also extensive (Esping-Andersen 2002; Ferrera *et al* 2001; Hemerijck *et al* 2006).

And only the Nordic welfare states can be considered a 'model'. But it is one whose lessons and potential for policy transfer to other countries are limited given their dependence on an unusual degree of consensus supporting very high levels of taxation and public spending (borne of decades in which the social democratic image of 'welfare society' has been firmly established as central to Scandinavian political identity), and very high levels of employment (Denmark and Sweden have employment rates between 72 and 75 per cent; those of France, Germany and Italy are 63, 64 and 57 per cent respectively).

If 'social Europe' is a far-from-useful fiction, a 'social dimension' to the European project surely does exist, and has been put in place over several decades. It involves European legislation on minimum employment and working standards agreed to intergovernmentally in the Council of Ministers, an expanding body of European Court of Justice (ECJ) case law, framework agreements between European trade unions and employers' organisations, and, more recently, the 'open method of coordination' (OMC). The latter marks a major departure from the standard 'community method' of policymaking in seeking to influence member state policies via 'soft methods' of policy transfer across a wide range of issues, from employment policy through social exclusion, pensions and education.

Over time, the emphasis of the Commission has switched from legislation to social agreements, and then to the OMC, in order to avoid the vetoes of certain groups of member states to a more fully developed European social dimension. But, in the process, the legitimacy and effectiveness of intergovernmental agreements, legislation and the backing of ECJ jurisprudence has been lost, even if that older mode of policymaking is still extant, though harder to use, in a Europe of 25 member states with very different social systems and levels of economic development (Rhodes 2005).

Although the main new instrument to emerge from the Lisbon summit in 2000, and valuable, perhaps, as a means of diffusing awareness of the challenges facing European economies, and the gaps between the EU's reform ambitions and achievements, the OMC has proven to be weak in practice. This is due to its

overwhelming reliance on elite deliberation and experimental methods of benchmarking and peer review.

Even in those areas where the OMC is most institutionally well-supported, and where a certain level of elite consensus exists (for example, social inclusion and employment), there is little evidence of any real impact: analysts note the creation of deliberative forums for non-governmental organisations (NGOs) and social actors; the provision of new EU databases that have improved on their earlier national counterparts; and a limited reorganisation of public administrations (Citi and Rhodes 2007). But these are meagre results.

The Employment Strategy (EES) and the Social Inclusion OMC (OMCincl) were introduced to placate the opponents of 'neo-liberal' Europe, and to correct a presumed imbalance between 'negative market integration' and 'positive social integration'. In reality, there was little evidence to support their claims that Europe's welfare systems were endangered by 'social dumping' or 'races to the bottom' in spending and benefits – the sources of consensus-creating externalities, had they indeed existed (Castles 2004; Alber 2006).

Moreover, given the lack of consensus on their associated policy goals, and the provision of real resources to underpin them, both OMCs have been based on a deliberative, experimental conception of governance that was bound to fail. Far from alleviating Europe's 'legitimacy problem', they may well have contributed to it, given their ambitious, but unachievable, targets.

Many would contest this conclusion. Yet there is plenty of good social science to underpin it (see Citi and Rhodes 2007 for a survey). As already discussed above, there are only certain conditions under which a 'soft' process of policy transfer, such as that attempted by the social and employment OMCs, could possibly succeed. But hardly any of them pertain in these areas of policymaking.

Thus, there is no obvious functional interdependence among economies in employment or social policy; policy failure is a characteristic of some (continental) EU economies, but not others; there is no external conditionality – of either a negative or positive character – attached to the EES or OMCincl; the policy message – attempting to square the circle between labour market flexibility and employment security (and leaving employment protection largely intact while focusing on 'activation policies') – has hardly been consistent; and, given the sensitivity of employment policy, reflecting often deep-seated distributive conflict, national policy environments are hardly open and receptive to such external interference.

Finally, the costs of policy transfer – both economically and politically – can be very high, outweighing any perceived benefits. Employment and social policy are, therefore, among the least likely areas for non-coercive, 'soft' policy processes of the OMC type to work. Moreover, extensive analysis alerts us to several other provisos concerning their utility (Citi and Rhodes 2007). First, 'bounded learning', in which the analytical skills of actors are limited and subject to cognitive biases, is the norm. 'Rational learning', by contrast, in which analytical capabilities are maximal and shared by all actors, leading to a convergence in policymaking on specific norms or practices – as sought by the social and employment OMCs – is extremely rare.

Second, there are many reasons why even 'bounded learning' may go wrong, including the fact that policymakers (like most individuals) are 'cognitive misers', and often have difficulty assessing the consequences of various policy options (Ryfe 2005). And, third, for these reasons, strong evidence suggests that simple policy emulation – a 'blind' act that lacks the degree of reflection required to map 'best practice' or to consider the precise consequences for policy outcomes – is much more common than either rational or bounded learning (Dolowitz and Marsh 2000; Elkins and Simmons 2005; Meseguer 2005).

The only way to correct for these deficits is to reduce the pan-European scope of the employment OMC, abandon its 'network governance' and 'policy learning' pretensions, and deploy it, instead, as a targeted policy tool. As such, it could complement the kind of European fiscal policy/national reform process referred to in section one above.

It is often claimed that the OECD's national economic assessments already provide a more sophisticated analysis of European systems than the OMC, as well as more incisive reform proposals. Deriving real value-added from an OMC-type process would, therefore, require that it be a less 'open', leaner, more expert-driven version, more closely focused on acute problems in hard-to-reform policy systems, and backed up with fiscal sticks and carrots.

The reforms to the budget suggested above could feed into this new type of multi-level policymaking. This would be less 'politically correct' than pretending that all European countries have something to learn from each other (Italian labour markets and most areas of Greek public spending are clearly cases meriting

emergency-room treatment), but it might actually have a chance of working.

If the EU truly wishes to resolve its core employment problems, and make serious inroads into poverty and social exclusion, then there are two obvious directions to take. The first concerns combating the tendency for the core Eurozone economies – Germany, France and Italy – to re-regulate their labour markets by following the path of least resistance: leaving the core, mainly male and unionised workforce heavily shielded by high levels of employment protection, and creating a growing ‘periphery’ of underprotected, part-time and temporary workers, with little potential to move into more secure, merit-based career paths.

Analyses of such dual labour market strategies from Spain, Sweden and France all reveal that leaving employment protection legislation largely intact for one set of workers, while relaxing the use of fixed-term contracts and reducing social security contributions for others, has perverse effects: less investment in human capital, lower labour productivity and a more unequal distribution of unemployment. While creating new jobs, these policies may also increase the overall rate of job destruction (Zhou 2006).

At 20 per cent of jobs, part-time employment in Germany is almost at the British level of over 25 per cent, and employment protection in this secondary labour market is low. Meanwhile, five million Germans remain unemployed. In France, reducing restrictions on part-time and temporary employment (for example, via *le contrat nouvelle embauche*, introduced in 2005) has created a sizeable secondary market without the benefits or job security enjoyed in the public sector and most parts of the private sector.

At 12 per cent in 2006, French unemployment, nevertheless, remains persistently high (Hall forthcoming, 2007). In Italy, official unemployment figures have only been brought below 12 per cent by creating a similar tier of workers with flexible status (on *Co.co.co – collaborazione coordinata e continuativa* – contracts) with lower protection and benefits.

Moreover, the evidence on using such jobs as a ‘bridge’ into more secure forms of employment is mixed: even in Germany, where the public labour administration is likely to be more efficient than in certain neighbouring countries, the impact of public-private partnerships between temp services and employment services on getting temporary workers into full-time employment, or the unemployed back to work, has not been substantial (Turmann 2006). Resistance to further such reform has logically increased: in May 2006, for example, massive demonstrations forced the French government to withdraw its plan to introduce new short-term labour contracts for those under the age of 26.

Much of the focus of the European Employment Strategy has been on improving active labour market policies of all kinds (retraining, work reinsertion policies, improved employment services) to get the unemployed into work. Although many aspects of their ‘Nordic model’ cannot easily be transferred, one lesson to be taken from the Scandinavian social-democratic countries is that such spending does, indeed, help. But, as one recent in-depth analysis of those economies also points out, ‘active labour policy does not by itself constitute an “employment strategy”, and beyond a certain point, the payoffs of government spending on active labour market policy are likely to diminish’ (Pontusson 2005: 128).

The key lessons in terms of policy transfer from the Nordic economies to the continental economies are, first, that higher rates of employment will underpin higher levels of welfare. The second is that, in addition to active labour market policy, higher rates of employment can be achieved by the following: lowering the level of job protection to increase employer flexibility in favour of greater employee support through retraining and promoting employability; and shifting resources from the apprenticeship-based, vocational-type training that predominates in the continental countries to enhanced levels of transferable industrial skills training and general education. (France, Italy and Germany are currently placed eighth, 10th and 13th, respectively, out of 13, on the European Human Capital Index, compared to Sweden, Denmark, the United Kingdom and the Netherlands in positions one through four (Pontusson 2005; Ederer 2006).)

Although there have already been moves in this direction, there also needs to be a faster, general (rather than targeted) shift from payroll taxes as the major source of funding for social security, which weigh heavily on employment costs in these countries, especially for smaller, lower-productivity, service-sector employers, to general income taxation. This would help stimulate demand for lower-skilled labour and would also render the welfare state more distributive, because income taxation tends to be more progressive than payroll taxes (Scharpf 2000; Pontusson 2005).

Achieving such changes may prove easier in some countries than in others. In Italy, where unemployment compensation is low, and high levels of job protection a poor functional equivalent, a ‘social pact’ (backed up, perhaps, by reformed European fiscal policy incentives, as discussed in the previous section) could

trade job protection for more unemployment spending. Where unemployment protection is already quite high (for example, Germany and France), and where trade unions tend to defend payroll taxes as less susceptible to erosion than income taxes, more imaginative solutions will be required (Pontusson 2005).

A second obvious step for the EU to take – this time in combating poverty and social exclusion – is to focus on putting a floor under family and child poverty. Even the supporters of the social policy OMC (OMCincl) (for example, Daly 2006) have to admit that the practical outcomes are few, and provide evidence, for example, of an increase in NGO participation in policy deliberation (a process result rather than a policy outcome) in their search for tangible consequences.

It would be far better to concentrate on one core ambition instead, or at least establish a list of priorities that could be approached via the more standard Community Method of EU legislation, with the politically most feasible course of action that has the greatest potential impact at the top. This would have the advantage of promoting clear divisions between supporters and opponents, among and within the member states and in the European Parliament, and of being amenable to the same kind of Commission-led coalition building that produced successful European social policy initiatives in the past (Rhodes 2005). The initiative may initially fail; but, unlike the amorphous and publicly invisible OMCincl, it would at least have the *potential* for identifiable success, and would, ultimately, acquire the democratic legitimacy and credibility to be derived from the EU's tradition of hard law policymaking.

A basic income for Europe's children is an obvious candidate. It already has considerable support among social policy experts and in European Commission circles as the key to both social inclusion and investment in the future of the knowledge economy (CEC 2005). Esping-Andersen (2002: 55) explains the basic rationale for child-orientated social investment as follows:

'If childhood poverty translates into less education, inferior cognitive skills, more criminality, and inferior lives, the secondary effect is a mass of low-productivity workers, highly vulnerable to unemployment and low pay in the 'new economy' [...] It is clear that there is a strong case in favour of activation and lifelong learning strategies. But, and this is the crucial point, such strategies are unlikely to work if not accompanied by a broader attack on childhood deprivation.' (Emphasis in original)

A strategy for dealing with childhood deprivation with a 'child basic income' (CBI) has been proposed and its effects simulated by Levy *et al* (2006). They argue for setting a CBI as a proportion of national median household income, financed by a flat tax, set for the EU15 with a common rate applied everywhere, levied on all non-benefit income, including pensions. They show that a flat tax of 2.3 per cent would fund a CBI set at around 20 per cent of median income, and would at least halve child poverty in all countries except Italy and the UK. The outcomes would improve in line with a higher flat-tax level.

Note that a single-rate flat tax is proposed by its advocates for reasons of simplicity and lower incidence than alternatives on government, employer and taxpayer administrative costs. It should not be confused with right-wing proposals for a regressive flat-rate income tax.

The distributive dimension of the flat-rate tax/CBI would be important, transferring between generations and across countries. Careful monitoring of welfare spending in those countries that would make the major gains would be important to avoid any substitution of CBI spending for national social spending. But this problem has long been controlled for (though not always successfully) in the deployment of the EU's structural and existing social funds. And a CBI proposal could also be assessed alongside other modest EU tax proposals – some suggesting a modification of the current system of national contributions (for example, Tsoukalis 2005: 136-137) – and included in a reorganisation of Europe's budgetary spending allocations and structural funds, as recommended in section two above.

4. Europe in the world

Regional integration in the EU has frequently been a reaction to external challenges. As Sbragia (2006: 239) notes, the dynamics of European integration have always been embedded in a larger international environment. They were driven forward by the Soviet threat and by early GATT trade negotiations in the 1950s; by the impact of de-colonisation on member states' commercial interests in the 1960s; by the sense that European firms were falling behind and the demise of Bretton Woods in the 1970s (the first leading to the Single Market, the second, eventually, to EMU); by the fall of the Berlin Wall, which led to eastward enlargement in the 1990s; and by the perceived need for greater military and political power during the Balkans crisis, producing movement towards a European Security and Defence Policy in the early 2000s.

The current period features major security and developmental challenges to the EU's east, in its immediate south west, and in the Middle East and North Africa. With the emergence of a militant Islamist terrorist threat, external and internal security issues have become intertwined, as have key dimensions of defence, foreign, security and aid policies. As the certainties of the Cold War have been replaced by a more fluid and more unpredictable set of security scenarios, the need for 'joined-up' policies in these domains has never been greater. They are also required by the changing nature of external security threats, by ongoing destabilisation on or near the EU's borders, and because of increasingly apparent duplication and waste in European defence and procurement budgets.

Moreover, moving forward with common European foreign, security and defence policies also conforms to the strong and consistent support of European publics for such initiatives. Regardless of traditional national, sovereignty-based resistance, this combination of external threat, public support, and the potential for realising considerable scale economies makes the foreign, defence and security domains the most susceptible of European policy areas to a new phase of enhanced integration.

There is much debate about whether Europe should exert 'hard' military power abroad or emphasise 'soft' civilian power via aid and trade promotion, with much criticism of the former (for example, Sangiovanni 2003; Manners 2006). This debate is entirely misconceived: the EU already combines both forms of power, but is unable to use either adequately. Regarding 'hard' power, arguments about whether Europe should 'go it alone' militarily (as suggested by Jacques Chirac after the early divisions with the US over the invasion of Iraq) or remain the 'handmaiden' of NATO in military dimension of the transatlantic relationship (for example, Cameron and Moravcsik 2003) are similarly misconstrued.

Some argue that there are structural reasons (the end of the Cold War) for the recent divide between the US and Europe, in addition to a shift in US perceptions of its interests, driven by the neo-conservative agenda. Thus, NATO's demise is inevitable, if not desirable. But the facts all stack up against this conclusion. These include the continued relevance of NATO-European operational and consultative links in the former Yugoslavia and Afghanistan; ongoing consolidation under NATO's aegis of democratisation in civil-military relations and defence denationalisation across the European continent; the contribution still made by NATO forces to European defence capabilities; and Europe's lack of preparation for independent self-defence and power-projection.

In any case, the neo-conservative influence is waning, and the transatlantic alliance is already in better health than several years ago. The EU has begun to make itself a more effective partner in that alliance, and a new relationship and division of labour with the US and NATO will, of necessity, be found. While the following analysis does not focus on the issue of NATO/EU relations, there is no reason to view them as inevitable competitors (Ojanen 2006). The EU, as argued below, may be able to anchor its core strength in its civilian-military capabilities (a combination of 'hard' and 'soft' power) and act as an effective and ongoing partner in combined operations with NATO. A good example comes from Bosnia, where NATO-led operations were transferred to EU control at the end of 2004.

The real issues that Europe confronts are, instead, those of rationalising its military, security and intelligence apparatuses; creating a unified defence budget; and developing an efficient industrial defence market to generate gains from trade and economies of scale and reduce the costs from duplicating R&D. Despite the disparaging remarks attracted by the emerging 'Brussels military-industrial simplex [sic]' (Manners 2006), and apart from the other benefits mentioned below, the latter could eventually play a major role in boosting demand for European research in theoretical and applied science.

To quote Alesina and Giavazzi (2006: 78):

'The superiority of the United States in research is largely due to the size and the composition of expenditure on defence. The US Pentagon's budget is not simply big: it accounts for more than one-half of all US government spending on research and development. Europe's defence budgets are so very small in comparison, and they are divided. Europe's inability to create a unified defence budget [...] is a big reason it lags behind the United States in R&D.'

Aggregate defence spending for the EU25 is currently just under 50 per cent of that in the US, but those spending the most (the UK and France) are only at 10 per cent of the US level (Hartley 2006).

As for the EU's 'soft' or 'transformative' power, this is another area replete with European policy hubris and journalistic catchphrases of the 'Americans are from Mars, Europeans from Venus' variety. Celebrations of Europe's 'civilizing' mission and 'normative' power by Euro-idealists (for example, Leonard 2005) ignore the failure of EU civilian power and means of persuasion in preventing the Yugoslav tragedy of the 1990s; play down the evident shortcomings of the Barcelona Process for development and democratisation in the Euro-Mediterranean region; and are largely based on the success of eastern enlargement and its accompanying democratisation and economic transformation in the former Soviet satellite states.

Of course, the promise of real membership played a major role in the latter (Vachudova 2005), and is one that cannot be extended much further beyond the current 25, plus Romania and Bulgaria. And one should not forget that not all core members of the EU15 (notably France) were natural 'enlargers' in the first place: they had to be won over by persuasion and package deals from an alliance of states led by the UK and Germany. Nor should one forget the critical role played by NATO in eastern enlargement and democratisation, especially, but not only, in reforming civil-military relations (Epstein 2005).

Ultimately, there were real interests driving enlargement, not just a belief in bringing the East back into the democratic fold. There are real interests, as well, rather than a simple and superior 'civilising mission', in Europe's relations with countries further to its east and to its south. In this regard, there is little difference between the problems and dilemmas faced by the EU, and those facing the US or the Bretton Woods institutions (the World Bank and IMF) in pursuing those same relations – especially regarding trade and aid, and realising their associated development and democratisation goals.

For, if the EU suffers from a general problem of conditionality and policy influence internally – due to an insufficient and distorted resource base, and the problems of developing policy instruments that effectively span its multi-level structure – so, too, do its external and 'Neighbourhood' policies. Indeed, the two are often closely linked: if, as argued above, the EU's agricultural policies are the major impediment to a more balanced European economic and growth policy, they, and the national and vested interests that underpin them, are also a major obstacle to the EU's trade and development efforts.

Beginning with 'hard' power, a coordinated defence/industrial policy makes sense for numerous reasons. While market pressures are pushing European states toward greater defence industry integration, both within Europe and beyond Europe's borders, budgetary pressures across the EU also require a rationalisation of expenditure, more competitive procurement markets, and an avoidance of the waste created by duplicate defence spending.

But, until recently, Europeans have been deeply divided on the politics of defence-related industrial policy, as reflected in the early exclusion of the defence industry from the common market under Article 223 of the Treaty of Rome, and the latter's reaffirmation in 1992, when the Amsterdam Treaty preserved Article 223 (renamed Article 296), and allowed member states to continue protecting their national defence industries.

That protectionism is now strongly challenged: national governments are no longer necessarily the biggest purchasers of systems and components originating in their own countries; cross-national defence industry integration is increasingly the norm; states now prefer to foster quality and price competition at the expense of supply self-sufficiency; and firms are seeking to survive by increasing their global market shares, rather than political favouritism (Epstein 2006b).

These trends present an opportunity for the EU to reduce overcapacity, increase competitive efficiency and diminish costs. By developing an integrated industrial base, it could transcend long-standing political conflicts over *juste retour* (that is, equal shares – in employment and output – in returns from collaboration), security of supply and information, and definitions of national interest. Defence industry consolidation, and the creation of three major players – the Franco-German-Spanish EADS, British-American BAE Systems, and Franco-British Thales – should, in theory, provide the industrial basis for harmonisation in defence planning and procurement.

But, as the recent problems of EADS Airbus reveal, political interference and *juste retour* remain extant, even in this most successful (civil aircraft) example of European collaboration. In defence collaboration (for example, the Eurofighter Typhoon) there has been much criticism of the inefficiencies created by the absence of a single prime contractor and work-sharing arrangements, which could be diminished by a more rational set of arrangements (Hartley 2006).

The biggest (and politically most achievable) gains are likely to be made through a combination of defence market liberalisation within the EU – by modifying or abolishing Article 296 – and replacing national procurement agencies with an EU procurement agency (Schmitt 2003; Hartley 2006). It should be noted that the projected gains and savings of these two policy initiatives alone are in the billions of euros (currently some Eur 180bn are spent annually by the EU on defence).

Such savings would allow more spending on some of the other critical areas of policy need mentioned above (education and child poverty foremost among them) and/or reducing the Eurozone's large budget deficits that create a drag on growth. Defence industry integration could also provide the material base for a uniform and enforceable arms export code, would endow the EU with increased bargaining power vis-à-vis the United States, and enhance its capacity to defend its territory at home and interests abroad.

A number of such initiatives have already been undertaken. Together, they suggest that the EU, as a union of 25 member states, has the capacity to 'square the circles of unity and diversity, of inclusiveness and dynamism in this, the toughest policy area of all: security and defence policy' and ensure that there will 'not be a multi-speed Europe, nor variable geometry, and above all *no* Europe à la carte' (Howarth 2004: 24; cf. Grant 2006).

Regarding procurement, Germany, France, Italy and the UK created the Organisation for Joint Armaments Co-operation (OCCAR) in 1996 to improve the efficiency of collaborative projects. OCCAR manages a number of joint European projects, including the A-400M transport aircraft, a combat helicopter and air defence and anti-tank missile programmes.

1998 saw two further steps forward, when these countries, plus Sweden and Spain, signed the Letter of Intent (LoI) aimed at facilitating the cross-border restructuring of the defence industry, ensuring the security of supply and information, and harmonising export procedures, and all 15 EU member states agreed to the terms of an EU Code of Conduct on arms sales. EADS was created by France, Germany and Spain the following year.

The European Defence Agency (EDA) was created in 2004 to develop defence capabilities in crisis management, promote arms cooperation, strengthen the EU's military-industrial complex and create a more competitive market in defence equipment. In 2005, France called for an EDA-backed procurement code to better exploit the EU's equipment market (for example, there is a need for 10,000 new armoured fighting vehicles but some 23 existing programmes to develop them) (Epstein 2006b; Hartley 2006; Allen and Smith 2006).

These initiatives do not yet add up to a coherent political and economic response to present challenges and opportunities. Article 296 presents a major impediment to defence market competition and the realisation of scale economies in defence procurement. With respect to the LoI, states still try to cling to the premise of national autonomy on issues such as 'security of supply'.

The EU Code of Conduct on arms exports is impressive on paper, but is not legally binding regarding arms sales and proliferation on the part of European member states. It is not clear, for example, that a key feature of that Code – bilateral consultations on export licenses that have been denied – has had any real effect on 'undercutting', that is, the practice whereby an EU state steps in to fill a contract that another has rejected on the grounds of proliferation, human rights or terrorist risk (Epstein 2006b).

The EDA has a small budget (Eur 20m), has only 80 staff and has encountered numerous turf battles in its early years of operation. And most of the organisations with which it has to coordinate – such as OCCAR and the LoI – operate outside of any stable EU institutional framework (Howarth 2004).

Pursuing these policies will contribute to the success of other European efforts within the ambit of the new European Security and Defence Policy (ESDP). These include the development of a European military capability for crisis management, peacekeeping and rescue missions, the most concrete manifestations of which have been the 2003 launch of the European rapidly deployable force of 100,000 personnel; the development by 2005 of 18 'battle groups', with the aim of being able to conduct two operations

simultaneously and within five days of a Council decision; and the establishment by Spain, France, the Netherlands, Italy and Portugal, in 2005, of a *gendarmerie* force, headquartered in Italy, that can be deployed to fill the gap between military operations and reconstructions in unstable theatres (Allen and Smith 2006; Alber *et al* 2006).

Shifting our focus towards the 'soft' power complements of these developments, two further initiatives must now be pursued to consolidate the EU's civilian crisis management (CCM) capabilities. The first, and most important, is the creation of a European civilian expert reconstruction corps, referred to in most discussions, since the concept was launched in the mid-1990s, as a 'European civil peace corps', or ECPC, though it has nothing in common with the American Peace Corps of young volunteers.

The ECPC would enhance the EU's capacity to act in civilian crisis management by replacing the current and fragmented system of co-ordinating consultant or specialist NGOs with a common service or corps of expert volunteers, to be linked to a European Peace-building Agency, and managed by the Commission, member states, specialist organisations, or a combination of all three. Two feasibility studies, Gourlay 2004 and Robert *et al* 2005, have both found in the ECPC's favour.

The second initiative, much closer to the US Peace Corps in inspiration, was set out in the draft Constitutional Treaty (Article III-223) as a 'European Voluntary Humanitarian Aid Corps' (EVHAC) 'to establish a framework for joint contributions from young Europeans to the humanitarian actions of the Union'.

The US Peace Corps, created in 1961, has become a shadow of its earlier self, and has failed to live up to its founder John F. Kennedy's original aspirations: afflicted by Congressional budgetary constraints (100 per cent of its funding comes from the federal budget), in 2005 it had just 7,810 volunteers in 72 countries, compared to 15,000 at its peak in 1966 (Rieffel and Zalud 2006). In developing its own version of a humanitarian corps, the EU has a major opportunity to extend its 'soft power' abroad, bring home the practical dimension of European 'values' to young Europeans (already the most 'European' of the EU's citizens), and enhance public recognition of what the EU can achieve through a broader set of international and humanitarian interventions.

Turning now fully to the EU's 'soft' power capacities, a careful examination of EU influence beyond its borders reveals, first, the same capabilities gap that one finds with the new generation of internal integration policies. This is compounded – in both cases, it should be noted – by the EU's skewed budgetary and protectionist agricultural policies. For, if farming subsidies and income support prevent a redeployment of funding to 'new economy' priorities, agricultural protection is also a formidable obstacle to the fulfilment of the EU's development and 'Neighbourhood' agendas in the south (Dodini and Fantini 2006).

Second, the experience of Europe's aid and trade policies demonstrates similar mistakes to those made by international organisations and the development industry over decades: top-down, technocratic agendas for change, linked to vague and sometimes contradictory conditionality requirements, and driven primarily by commercial interests within the EU. Those policies have delivered little in the past and continue largely unchanged in the present – regardless of apparent recent policy shifts, as in the inclusion and transformation of the Barcelona/Euro-Med partnership process in the new (2003) European Neighbourhood Policy (ENP).

In 1993, the Maastricht Treaty formally recognised that development co-operation should be a shared responsibility between the member states and the EU. Under Article 130u, their joint ambition became fostering 'the sustainable economic and social development of developing countries and their gradual integration into the world economy'. But assessments at the end of the 1990s painted a dismal picture.

The EU had had limited success in realising its development policy goals – except, notably (and we return to this point below) for certain localised projects where there had been a close involvement of civil society. International donors pursued competing objectives, programmes were duplicated and recipient government administrations overburdened. Decision-making was centralised in a fragmented Brussels bureaucracy; there was little effective monitoring or evaluation (Dearden 2005).

Poor levels of compliance in trade, aid and democratisation deals, under the Euro-med partnership (EMP) association agreements, had been the consequence, largely, of contractual provisions that were weakened by the absence of tangible and more immediate trade concessions by the EU, especially in agriculture and processed foods. Financial aid took the form of income transfers, rather than a means of firmly anchoring policy reform in the countries of the region (Tovias and Ugur 2004).

Jones and Emerson (2005: 19) argue that the use of positive incentives to encourage democratic and human rights reforms has been limited by 'uncertainty over the EU's future budget, opposition towards agricultural trade liberalization [and] the reluctance of member states to extend large mandates to the Commission in matters of conditionality [...]'.

Gavin (2005) maintains that, although under Euro-med partnership policies there was the promise that some essential 'region building' would take place, no institutional framework was ever created for that purpose. In the economic partnership, the emphasis was on North-South integration and market opening in the Mediterranean partner countries to accommodate EU interests. Critically, there were no institutional incentives to promote the growth of a regional Mediterranean market that would foster interregional trade among its members, attract foreign direct investment (FDI), and create a sustainable foundation for future economic growth and development.

It was not clear that the situation had improved much by 2006. Part of the problem, as Meunier and Nicolaïdes (2006: 920-921) have recently argued, stems from the very idea of 'soft' or 'normative' power itself:

'The EU speaks the language of shared norms developed through consensus and co-operation. Yet, trade power is about using carrots and sticks to enforce such norms on trading partners [...] Is there not a contradiction as the EU seeks to export norms of its making, predicated on voluntary co-operation between states by using its quasi-coercive leverage through trade?'

Under the new Neighbourhood Policy (ENP), bilateralism has increased and the incentives for partnership have, ostensibly, also improved, depending on the country, including enhanced political co-operation, a reduction of trade barriers, increased financial support, and participation in the EU's internal market. Action plans with 'reciprocal' engagements and dialogues are central to the ENP, as is the idea of a 'socialisation' of domestic actors into accepting EU democratic and human rights norms. But the domestic conditions for 'policy transfer' are not exactly conducive: the region is marked by economic stagnation, political stalemate and a widening human development deficit, not to mention the spread of Islamic militancy.

What is clear from wider experience is that trade alone will not work in spreading the norms and institutions underpinning democracy and the extension of human rights to the Middle East and the wider Mediterranean. Analysts of US trade deals in the region note that they tend to underpin rather than undermine pre-existing social and political arrangements, while conditional trade and aid risk producing hostility and unconditional aid threatens to do little more than entrench already powerful and self-serving elites – and thereby undermine the prospects for peace and prosperity (Moore and Schrank 2003).

Some (for example Dearden 2005; Gavin 2005) have argued in favour of creating an OMC for the region that would encourage the socialisation of local elites in European norms via 'policy learning'. But, as Kelley (2006: 51) observes, the ENP countries have extensive human rights abuses, no democracy, are poor and feature few of the domestic political conditions (including political competition) that were critical for the success of enlargement to the CEE countries, let alone the conditions for policy transfer and norm diffusion that exist in the older EU member states, but where OMCs have still achieved little. In ENP countries, notes Kelley, the 'obstacles to successful learning and its application are [therefore] many'.

Improving the influence of the EU's 'soft' power beyond its borders requires a different kind of change – and one, firstly, within its own frontiers. Breaking down protectionism in agriculture and textiles and opening EU markets in those sector's products would make a great deal of difference – both to EU leverage over the domestic democratic and human rights policies of its partners and to those countries' economic prospects. But the EU cannot 'buy' democratic convergence; that of the CEE countries was encouraged by the prospect of full EU membership – a prize that is not on offer in the Euro-med region, and perhaps not even in other Eastern countries.

Another major change required is to the kind of domestic policies promoted. A core target of financial assistance should be education policies, not the kind of projects that provide markets for European producer interests. Regional institution building is a further critical step, thereby promoting a common market among the countries of the region, stimulating trade and economic activity across their own borders, and helping them attract foreign investment.

And, as with the development programmes of the international organisations and NGO-supported aid efforts worldwide, a shift must be made away from the top-down policies and aid flows to developing country governments, which have proven so disappointing in their outcomes to date, towards bottom-up assistance

for local infrastructure projects, and for human capital and micro-finance promotion (Easterly 2006).

Finally, and this applies equally to the non-democratic countries to the EU's east, a major investment must be made in promoting civil society organisations and pro-democracy, grass-roots social movements (Emerson and Noutcheva 2005; Raik 2006). As noted above, successes in EU development policy in the past have occurred in precisely those areas where efforts were targeted at local projects, and where civil society was involved. And that is precisely where the attention of future aid and development programmes should be focused.

5. Political Europe

Very little has been said up to now about Europe's current obsession – the draft Constitutional Treaty and its apparent demise after the 'no' vote in the French and Dutch referendums in 2005. This is because little in the draft Treaty impinged on the critical issues that, I argue, currently face the European Union. Had it been ratified, only the provisions on a common defence and security policy and the creation of the post of a Union Minister for Foreign Affairs would have made a significant difference.

Regardless (or perhaps because) of the 18 months or so of 'conventioning' devoted to the Constitutional Treaty, it did not produce a substantial set of changes. Its ratification failure has, therefore, had little impact on the day-to-day functioning of the Union. As Dinan (2006: 65) remarks, 'to the extent that the EU was handicapped operationally [...] the underlying cause was political posturing on the part of national governments rather than intrinsic institutional sclerosis'.

Some of the Treaty's innovations were important in themselves: a conciliation committee to reconcile the views of the Council and Parliament in the annual EU budget procedure, making co-decision between the Parliament and the Council the default decision-making procedure (except for external policies); the amended procedure for appointing the president; the appointment of a full-time President of the European Council; the enhanced co-operation clause; and the new double majority system of voting, based on majorities of 55 per cent of member countries and 65 per cent of the Union's population (with a minimum of four countries to form a blocking majority).

But none of these institutional changes would, in themselves, have facilitated the kinds of policy shifts recommended above (and the voting rules may have made them even harder to achieve).

No new 'exclusive' EU competences were provided for; the 'shared competences' laid out for the EU and its members states largely reflect existing practice; and even provision for a common foreign and security policy resurrected the wording contained in the Treaty on European Union (although a series of important provisos did set out the scope and limits of a common security and defence policy) (Phinnemore 2004).

It may be going too far to label it an 'exercise in public relations' (Moravcsik 2006), but the draft Treaty was in no respect a radical departure from the status quo. As argued above, given the challenge and opportunity represented by the eastern enlargement and launch of the Lisbon agenda, the time and energy devoted to constitutionalism might have been better deployed confronting the core issue of the Union's resource base and expenditure priorities instead.

But, reflecting the 'decision-trap' characteristics of the EU's institutional architecture (Scharpf 1988), the draft Treaty simply made marginal changes to budgetary procedures and maintained the status quo of Europe's special agricultural regime – suggesting to Majone (2005) that the EU has little capacity for fundamental reform when not under extreme pressure. History may judge the Sapir Report on an 'agenda for a growing Europe' (Sapir *et al* 2004), the more important document – and major missed opportunity – of the period.

Nevertheless, the nature of the Convention and the Constitutional Treaty and its rejection by the peoples of two core EU member states do raise a number of critical issues concerning the Union's 'political dimension' and the prospects for 'renewing the project' under present circumstances.

There are three core points to be made here. The first concerns the more general political context of which the Convention and Constitutional Treaty were part, and what that context tells us about the connection between elites and peoples in the contemporary EU. The second concerns the nature of political debate on European issues and what European publics 'want'. The third concerns the way forward: if, indeed, there is a 'democratic deficit', given the EU's peculiar post-national state character and the weakness of the European demos, where does the correct balance lie between politicising and depoliticising the EU?

Preceded by a Convention, and precluded by referendums, the debacle of the Constitutional Treaty was very much the product of its era, one in which the European Union has proceeded via two methods of dubious democratic merit: deliberation and plebiscite. As for the first, deliberation has become a general EU default option, if not standard operating procedure, when other, more standard decision-making channels are blocked or unavailable (as in the social and employment policy OMCs). It is a purported, though partial, solution to the EU's 'democratic deficit, and – in the more high-profile Constitutional Convention – a further means of delivering popular legitimacy to the Union.

But there are a number of problems with the 'deliberative turn' in the EU. Some pertain to deliberation as such. The legitimacy conveyed by deliberation may well lack real *political* legitimacy, both because it is divorced from the approval of general publics (that is, through elections) and from the genuine expertise of policymakers (Ryfe 2005). And, while those promoting deliberation believe it raises consciousness and fosters the search for 'truth', it may also generate the costs of 'wasted time, procrastination and indecision, stalling in the face of needed change, and unfair control of agendas' (Shapiro 2002).

Other problems pertain more specifically to the EU. As Moravcsik (2005; 2006) argues, given the lack of salient issues falling under the EU's ambit, the idea that democracy can be enhanced by citizens' involvement reflects 'a paternalistic utopianism' that they should pay the high costs of participation when little of EU policy output truly affects them. This may explain the lack of interest or understanding of Europe's citizens in the workings and outcomes of the Constitutional Convention – not to mention their almost total unawareness of, and complete media disinterest in, even the most high-profile OMCs.

Moreover, as revealed by Eurobarometer surveys, EU citizens have far greater trust in the European Parliament (59 per cent), national parliaments (56 per cent), the European Union (55 per cent) and even the European Commission (52 per cent) than in the 'stakeholders' – trade unions and NGOs (at 44 per cent and 43 per cent, respectively) – promoted by the EU's deliberative idealism (Eurobarometer 56.2, 2001, cited in Moravcsik 2006).

As for referendums, the French and Dutch votes were both symptomatic of the more general recourse to plebiscites on European issues in many countries in recent years, as well as the toxic blend of often unrelated national issues, and frequently distorted European sentiments and opinions, that are increasingly features of European referendum campaigns.

In France, the Treaty was defeated by an alliance of right-wing nationalists, who attacked the EU for non-existent 'social dumping', and the radical left that set out the case for a politically and economically infeasible 'social Europe'. The purported threat from 'Polish plumbers' and the EU's Services Directive united the two camps, and a pervasive opposition to President Jacques Chirac mobilised the middle. Socio-economic issues and the fate of the French 'social model' overwhelmed the debate, even though the draft Constitutional Treaty had nothing to do with them (Milner 2006; Brouard and Tiberj 2006).

In the Netherlands, the split occurred between elites and voters, with the latter convinced that the Euro had damaged their country, that Europe was costing them too much and failing to deliver growth, and that Turkish membership would add to the Islamic threat to traditional Dutch freedoms, beliefs and culture (Aarts and van der Kolk 2006).

In both countries, the referendums weakened party control of voters, created conflict within parties, and allowed general social and cultural fears to be appropriated by single-issue entrepreneurs (Hooghe and Marks 2006). Voters were not rejecting the Constitutional Treaty as such, but rather a certain idea of 'Europe' and their own mainstream political elites.

This complex mix of factors makes it difficult to generalise about the deeper meaning of these events. Majone (2006) likes to think of them as a revolt of the masses against what he calls 'crypto-federalism' or 'integration by stealth'. Moravcsik (2005; 2006) employs them as evidence of the 'political maturity' of the EU (because the status quo is preferable to an ill-considered and unnecessary constitution). But these conclusions reflect those observers' own opinions, not those of French and Dutch voters. More perceptive are interpretations that link the defects of the referendum mechanism as a means of dealing with complex issues with a general sense of dissatisfaction with the EU. The latter may be confused and inchoate, but it is definitely perceptible among European publics.

For, as Taggart (2006) argues, there is something very about odd about politicians submitting complex questions of European integration to a simple yes/no vote when, nationally, they would never do that with education, housing or welfare policies. And Dinan (2006: 65) is probably closer to the truth than either Majone or Moravcsik in viewing the underlying problem of the referendums as one of a 'growing public misunderstanding of what the EU is and what it does', a situation compounded by the tendency of national politicians to blame 'Brussels' for their own political failings and for the consequences of European policies for which their own governments are ultimately responsible.

It is also clear from research that the deeper trend is less one of sudden decline in general support for the EU, than a decline in the cross- and inter-party European consensus that, in turn, has stirred up popular dissatisfaction. Hooghe and Marks (2005: 425-426) discover from their analysis of European public opinion

trends that, the more national elites are divided, the more citizens are cued to oppose European integration; that elite conflict has punctured 'passive support for European integration – transforming the "permissive consensus" that predominated during the EU's first three decades into a "constraining dissensus"'. Elite divisions are especially efficient in generating public disaffection for the EU in countries with more generous welfare states (Kumlin 2004).

As argued in earlier sections, uncertainty in public opinion and among interest organisations regarding 'Europe' has been created, in part, by a number of factors. These include the combination of reform pressures and budgetary austerity under EMU; the failure of the EU to deliver identifiable policies in areas that matter most in people's lives (public opinion research reveals that EU support is determined, in part, by material gains and losses from EU policy (Gabel 2003: 305)); and the pretence of European 'new modes of governance' that 'coordination', in the absence of solid resources or the requisite institutional mechanisms, could deliver growth and cure unemployment.

Yet this uncertainty does not translate into uniform views on the part of member state publics, or common motives for rejecting Treaties. Note that, while the French public wanted more 'social Europe' (and, therefore, one imagines, more social spending), a major theme in the 'no' campaign in the Netherlands was that the EU was already costing too much, and that the Dutch were paying too high a price (Taggart 2006).

Public opinion research confirms that those most affected by socio-economic change are likely to express anti-European positions (especially when they receive the appropriate cues from single-issue policy entrepreneurs), and that Euro-scepticism will be triggered by a range of different factors. Thus, the younger, educated, and more informed are more likely to embrace some form of European identity than the older, less educated, and less well informed (Hooghe and Marks 2006). And, while national and European elites want an EU that governs a large, competitive market and projects political muscle, citizens generally want a more caring EU to cushion them against capitalist markets (Hooghe 2003).

But skills levels, social class, political alignment and country context also combine to produce specific motives for opposing or supporting the EU. Brinegar and Jolly (2005) show that low-skilled workers in high-skill-endowment countries are less supportive of European integration; those with higher education in low-skill-endowment countries are less supportive than those countries' low-skilled workers; and higher-skilled workers in social democratic states are less supportive of the EU than their lower-skilled counterparts.

Support falls as a respondent's ideology shifts to the right in residual welfare states (that is, the UK and Ireland), but increases as it shifts to the right in social democratic welfare states. Contestation over Europe is characterised by left-right conflict in some countries and not in others, and it takes quite different forms, depending on the nature of the welfare state.

This discussion leads to several conclusions. The first is that plebiscites will tap different bases of support and opposition in different countries. When national distributive struggles meet the complex issues posed by grand treaties (Brouard and Tiberj 2006), the yes/no mechanism is better at revealing the ways in which those struggles, and the socio-economic stakes that feed them, mesh with general views of 'Europe', than in revealing informed preferences on the issues at hand. This suggests that the use of the referendum should be discontinued when complex choices are at stake. Specific innovations in the Constitutional Treaty should now be ratified piecemeal by member state parliaments.

Second, public opinion analysis also suggests that cross-national, OMC-type deliberation will mobilise quite different kinds of preferences from one country to the next, especially on issues such as employment, in which European policy initiatives meet representatives from different socio-economic interest groups (for example, trade unions). The views of those groups on the desirability of a particular type of labour market regulation will have as much to do with their own location within particular national welfare states, and the views on 'Europe' those positions produce, as with their opinions on employment policy. These diverse and complex preferences provide one explanation for the problems encountered by OMCs in promoting pan-European policy transfer.

But, third, public opinion analysis of the links between socio-economic background and pro- and anti-European positions also feeds into the wider debate on how to deal with the so-called 'democratic deficit' and renew the political project. The Brinegar/Jolly analysis and related research (see Bartolini 2005: 340-354) suggests that left-right divisions and positions on distributive questions (for example, social and employment regulation, levels of welfare spending and taxation) at the national level translate poorly into

common left-right political cleavages at the European level; and that by Europeanising these issues, different pro- and anti-European positions would also be mobilised. While left-wing citizens in France want 'Europe' as long as it also strengthens its 'social dimension', their counterparts in the Netherlands (and in Scandinavia) fear that more 'European welfare' might also mean less national welfare.

The interests of the people that European political parties seek to represent are still largely rooted at the national level, and find their natural expression in national parliaments and political parties (Moravcsik 2005; Majone 2006). Quite apart from this, as Bartolini (2006: 41) argues, the fact that pro- and anti-European positions 'are related to many and different issues and determinants in different countries, but nowhere are [those] attitudes significantly related to the left-right dimension' presents a further problem for those who propose correcting Europe's 'democratic deficit' by further politicising the EU agenda and its institutions.

This argument stems from a very useful debate now emerging around the issue of how ready European parties and the European Parliament are as institutions for mobilising consent and dissent from European publics. One camp (for example Hix *et al* 2003; Follesdal and Hix 2006; Hix 2006) argues that they are ready: that Euro-parties already represent and articulate left-right positions consistent with European public opinion and they are, therefore, capable of acting like a real parliament by electing the Commission and shaping its programmes. A small injection of majoritarianism would also help the EU overcome its institutional and reform gridlock. The way to link EU institutions to citizens' interests and preferences would be to allow the majority in the European Parliament to set the internal agenda of the Parliament, by opening the legislative process inside the council and by having a more open contest for the Commission President – none of which require fundamental reform of the EU Treaties.

The opposing camp (Bartolini 2005; 2006) argues that there is an enormous gulf between fragile, poorly coordinated Euro-parties and European political ideologies that are still nationally embedded, and a public opinion that is ill-informed on EU issues and institutions. Euro-parties are not strong enough or significant enough to be the gatekeepers of the politicisation process. For political mandates for reform are hard to develop within the narrow limits of the predefined goals of the Treaty, and there are few guarantees that politicisation will be contained this way.

Left-right politicisation would have to convert large pockets of distrust and anti-EU feelings into competing versions of the integration process, rather than undermining the institution as a whole. Politicisation may well generate excessive hopes and expectations that will only be frustrated and 'widen the gap between normative expectations and reality'. Democratisation, under these conditions, would be a cure worse than the 'democratic deficit' disease.

This debate helps define what is desirable and what is not in reforming the EU's political dimension. First, given both the necessity of preserving the link between citizens and their national parties and parliaments, and the absence of a single *demos* (Nicolaidis 2003), a key democratising reform should be one that, in the present phase of European integration, improves the input made by national parliaments into European decision-making.

A second reform should go some way towards the 'politicisation' position by increasing the powers of the parliament vis-à-vis the European Commission, thereby improving the quality of democracy 'at the centre'. Combined with the first reform, such an initiative would also deal with what Majone (2005; 2006) refers to as the EU's 'accountability deficit', stemming from the delegation of too many executive, legislative and quasi-judicial functions to the Commission.

The one innovation introduced by the Constitutional Treaty that could have made a difference regarding these issues was the 'yellow card' early warning system, which would have allowed a third of national parliaments to signal to the Commission that a particular legislative proposal was in breach of the subsidiarity principle, and to ask for a review. This is a weak version of the 'subsidiarity test' recommended by some as the best means of informing political decision-makers of the costs and benefits of EU policies, and countering unproductive populism in member states (Pelkmans 2006).

But, as several observers have commented (for example, Bellamy 2005; Cooper 2005; 2006), the Treaty proposal does not go far enough: it excludes areas that fall under the Commission's exclusive competence and allows a consideration of subsidiarity (if the Commission should act), but not of proportionality (how the Commission should act). As such, it will not promote the necessary dialogue between the Commission and national parliaments. Any future formulation of the reform should address this defect; indeed, the

Council has already asked the Commission to consider doing so.

A second innovation that was also lightly touched on by the Treaty concerns relations between the Parliament and the Commission. Good arguments (Moravcsik 2002) have been made that the present institutional architecture of the EU is perfectly democratic, given the limited range of policy areas that fall under its remit, the links between national governments and representation in the European Council, and the powers that now accrue to the European Parliament after a number of reforms that extend the co-decision procedure. Crombez (2003) makes a parallel argument: that the EU's policies are not undemocratic, as such, and that the composition of its institutions is not inherently less democratic than those of the US, a more fully-fledged federal system.

But, unlike Moravcsik, Crombez argues that there may be a lack of transparency and an excess of delegation in the EU, pointing to the fact that, while Parliament is directly elected, requiring one step of delegation, the Council requires two: voters vote for national parliaments and the latter delegate powers to national ministers, who also become Council members – one step of delegation too far from national publics. Crombez recommends two changes to correct this defect: open Council meetings and the direct election of the Commission president, who can then nominate the other Commissioners. Alternatively, the Commission could be appointed by the Parliament.

The Constitutional Treaty dealt with the first of these, by opening Council meetings when it deliberates and votes on draft legislative acts (a significant step towards greater transparency). However, it disappointed advocates of greater democracy 'at the centre' regarding the second. The Treaty solution is for the European Council to propose, by qualified majority, a candidate to the European Parliament, who will then be elected by a majority of its members. A new candidate will be proposed if the first is rejected. In a second phase, a list of potential ministers selected by the President-elect and the Council will be presented to the Parliament for approval (Phinnemore 2004).

It can be argued that this represents little improvement on the present system, since MEPs will be voting on nominations put forward by the Council, rather than their own nominees. Many arguments have been made in favour of a system with a more direct involvement of the Parliament, either by giving MEPs the power to elect the President (perhaps from a slate proposed by the council) and/or the entire College of Commissioners, or the election of the President by national MPs or a combination of national MPs and MEPs (see Smith 2004 for a survey) or through some kind of conciliation procedure (Crum 2005).

But negotiating a path between too much politicisation and too little under current institutional arrangements would counsel in favour of restricting the election of the President to the European Parliament, but from a slate proposed by the Council, and perhaps also of including a public debate on a presidential manifesto and Commission mandate, as proposed by Hix (2006: 24).

This would not turn the European institutions into the equivalents found in a democratic nation state, or in a fully-fledged federal system. But the EU is currently neither, and there is little to be gained by politicising its institutions and decision-making system as if it were. Given the limits on the EU as a source of influence and inputs in to the core policy issues of interest to member state voters, and given that its Parliament has no powers to tax and spend, initiate legislation or form a government, politicisation, as Bartolini (2005; 2006) persuasively argues, may well generate excessive hopes and expectations that will only be frustrated, and 'widen the gap between normative expectations and reality'.

6. Conclusion: renewing the project

This report began by arguing that renewing the European project should not involve new, grand schemes of deepening and widening, but should proceed by doing less and doing it better. The recommendations made in its subsequent sections have, therefore, been rather modest – but they will certainly not be controversy-free.

The overriding need at this stage in the EU's evolution is an acknowledgement by its elite of the limits to integration in a Europe of 25 member states, and a much greater degree of honesty in communicating those limits to the European people. One feature of the Constitutional Treaty's rejection by the French and Dutch was a large degree of misunderstanding about what the European Union does and what it can do. By presenting their publics with grandiose projects, with little real impact on their lives, while also using the EU's more important and significant innovations (especially EMU) as a scapegoat for their own problems, Europe's politicians have created a crisis of credibility and legitimacy that need never have existed.

That said, this report has also focused on the genuine feelings of disorientation experienced by European publics, especially in the Eurozone economies, due to the changes introduced by the EU that do impact on their lives. Foremost among the latter is EMU, which has become a powerful force for structural economic reform, but has also made it harder for governments to achieve it. Budgetary austerity has made it much more difficult to introduce reform.

In the absence of monetary expansion and fiscal relaxation, it is harder than ever to attract powerful organised interests, notably trade unions, to reform bargains, or gain the support of electorates for reform mandates. The innovations suggested above in linking a new kind of European fiscal policy to national reform processes would assist governments in their efforts to transform their economies and make EMU seem less of a constraint and more of an opportunity.

This report has also made much of what I call the 'capabilities gap' that has opened up between the EU's overambitious objectives and its means for achieving them. The Lisbon agenda is like the chronicle of a failure foretold. It was the result of a recognition that Europe really did have to confront some difficult structural reform challenges if EMU was to succeed in a sub-optimal currency area. But, while market liberals assumed that those changes could be achieved by the pressures of competition, social democrats believed that deliberation and benchmarking were the solution.

The outcome of this political and institutional 'fudge' was the OMC – a highly imaginative but heavily flawed approach to policy engineering, in the absence of any resources, institutional or otherwise. This enterprise has also contributed to Europe's credibility problems. Europe really only has one choice in rectifying this state of affairs: rein in and refocus its ambitions, as suggested in sections two and three above, and reoriented its limited resources towards them.

Making one step forward in this respect requires taking two steps back, tackling the EU's budgetary distortions and reorganising spending along the lines suggested by the Sapir report. It may also be necessary to provide more funds for Europe's emerging foreign and defence policies.

The Lisbon agenda was launched in 2000; the Constitutional Convention was launched by the Laeken declaration on the Future of Europe in mid-December 2001. Since then, and quite apart from their respective weaknesses, developments on the international scene and the emergence of new security threats have rendered both rather inward looking and Eurocentric. It is interesting that one of the major steps forward in the integration process over that period – the emergence of a European Security and Defence Policy – has been in precisely those areas of policymaking traditionally assumed to be the most sovereignty-bound of all. The innovations described in section four are just the beginning of a process that promises to have major repercussions for European defence establishments, budgets and markets.

The final section on 'political Europe' was also modest in its recommendations. But, given the failure of the Constitutional Treaty, this is not the moment for renewing the project by further deepening and widening (beyond the countries currently in the queue) or for new imaginative ways of recasting those ambitions – through formalised (rather than informal) 'enhanced partnerships', or by creating 'concentric circles' of membership.

One of the striking features of European policy punditry is the tendency to envisage new and often implausible futures while neglecting the very real problems and contradictions at hand. The same is true of Europe's policy-orientated academics: the funeral pyre of the OMC will be fuelled by the hundreds of

learned articles that have been dedicated to it, while cogent analyses of the EU's resource problems, the deadweight of agricultural spending and the failures of the structural funds have been relatively few.

Europe is in imminent danger of becoming a giant with feet of clay, and the substitution of fantasy for realism among European policy analysts has played a part in that outcome. As repeated many times above, rectifying Europe's core problems requires, first, revisiting the bargains of the past, and recasting them for the immediate future. It is to that project that the work of Europe's policy analysts should be dedicated.

Achieving that task politically will be extremely difficult, and the present political architecture of the EU may not be up to it. But, if one thing is clear from the French and Dutch votes, it is that such issues should not be dealt with by treaties and referendums. Nor will expanding the EU's deliberative forums or politicising its decision-making system help. Such steps will only increase the problems of gridlock and exacerbate the system's 'decision-trap' tendencies. As Moravcsik (2006: 222) remarks, the challenge for democratic systems is to design institutions that politicise and depoliticise in a way that generates more accountability, more desirable outcomes and more long-term popular support. But none of those goals will be achieved by the ad hoc instruments devised by the Union in recent years.

Renewing the project requires some rather unfashionable remedies instead: firm Commission leadership and coalition building, among member states and across the European institutions; a new generation of European leaders with the courage to recast the bargains of their predecessors via intensive intergovernmental bargaining; and the will to provide the EU with the collective goods and resources it so obviously needs, but of which it has been deprived by connivance between the politicians and powerful lobby groups of its member states.

It is to be hoped that this goal can be achieved within the present institutional architecture, perhaps with minor modifications. After all, that system provided Europe with the Single Market and EMU. It should not be beyond its powers to endow the European project with a more solid foundation of material resources and normative legitimacy.

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