

**DEMOCRATIC LEGITIMACY UNDER CONDITIONS OF
REGULATORY COMPETITION.
WHY EUROPE DIFFERS FROM THE UNITED STATES**

Fritz W. Scharpf

Estudio/Working Paper 2000/145
March 2000

Fritz W. Scharpf is Director of the Max Planck Institute for the Study of Societies, Cologne. This paper is based on a seminar he presented at the *Center for Advanced Study in the Social Sciences*, Juan March Institute, Madrid, on 10 December 1999, entitled "Governing in Europe: Effective and Democratic?"

Abstract

The paper examines the implications of European economic integration for the effectiveness and the democratic legitimacy of government at European and national levels. In contrast to the situation in the United States, welfare-state functions were fully developed at the national (state) level before economic integration was completed, and these functions have come to define a basic social contract between citizens and their state that has a high normative salience. European economic integration creates conditions of regulatory and tax competition among member states which reduces the capacity of national governments to respond effectively to the demands and expectations of their citizen. However, and again in contrast to the United States, there is no prospect that welfare-state functions could be effectively Europeanized (federalized). The paper explores ways in which European policy could nevertheless help to facilitate national responses by reducing the pressures, and regulating the practices, of regulatory competition among EU member states.

1. Introduction: Is there a European Democratic Deficit?

Unlike the United States, the European Community was not, and could not have been, founded as a democratic nation state. Originally, the legitimacy of its limited governing functions was solidly based on *intergovernmental* agreement. Among the — democratically legitimated — governments and parliaments of the Six, the political commitment to create a common market was unequivocal, and the *supranational* actions of the European Commission and the European Court of Justice to promote market integration were justified by that fundamental commitment even where they went against the preferences of individual governments in the given case (Garrett 1992; Moravcsik 1998).

Ostensibly, that was also true of the Single-Market program of 1986, even though the intergovernmental basis of legitimacy was weaker because of the more active role of the Delors Commission in designing the agreement, and the less complete understanding of its far reaching implications among some governments and ratifying parliaments. Even the move toward Monetary Union and the establishment of a *supranational* European Central Bank was an *intergovernmental* project promoted by France when it was realized that its commitment to a hard currency had made French monetary policy dependent on choices that were made by the *Bundesbank* with a view to the state of the *German* economy — rather than to the European economy that was in fact governed by it (Verdun 1996; Moravcsik 1999; Dyson and Featherstone 1999).

So why is it that the legitimacy of the supranational institutions that were created through intergovernmental agreements ratified by democratically legitimated national parliaments is now under challenge? Why is it that seemingly academic concerns about a “European democratic deficit” (Williams 1991) were raised to the status of a serious constitutional issue in the Maastricht decision of the German Constitutional Court? Why have they motivated the Amsterdam Summit to greatly enlarge the competencies of the European Parliament? And why did the Cologne Summit put the issue of a European Constitution on the agenda of the next Intergovernmental Conference? In my view, there are two explanations for

the remarkable political salience of the alleged democratic deficit of the European Union, one pragmatic, and one more fundamental.

Pragmatic Reasons

The pragmatic reason is that the European institutions, designed to organize a mere customs union among six member states, are considered inadequate for a Union with 15 members and a vastly expanded range of competencies, and that they will become totally unworkable when Eastern enlargement will further increase the number of governments represented in the Council and the number of Commissioners among whom the Union's portfolio must be subdivided. It is also realized, however, that even the changes which everybody considers minimally necessary for the continued performance of the Union's present functions — fewer Commissioners and a general move to majority decisions in the Council — will reduce the control of individual national governments over European policy choices to an extent that would finally destroy the plausibility of the intergovernmental legitimation arguments that still must support the exercise of European powers.

The European Trilemma of the Democratic Welfare State

If these pragmatic concerns explain the current search for institutional fixes that might convey independent legitimacy on Union decisions that can no longer be said to be under the control of democratically legitimated national governments, the second argument sees the democratic deficit arising from a more fundamental political-economic trilemma of European integration. It exists because of characteristics of the European constellation that are quite different from the situation in American federalism:

The first horn of the trilemma arises from the fact that the democratic legitimacy of European nation states is much more closely associated with welfare-state achievements than is true of American states. There, the creation of a nation-wide "internal market" had preceded efforts to build a welfare state. At the state level, these efforts were largely impeded by economic and legal constraints. On the one hand, economic competition among producers in

different states created conditions of “regulatory competition” among state governments which practically prevented all of them from adopting regulations (for example, regarding the employment of child labor) that would have reduced the competitiveness of local production. On the other hand, the “Negative Commerce Clause” doctrine of the Supreme Court prevented states from protecting local producers against imports from other states that were produced under less stringent regulations. As a consequence, even in states with “progressive” majorities, welfare-state provisions remained at a minimal level (Skocpol and Amenta 1986).

In Europe, by contrast, national welfare states had reached their full development in the early post-war decades, when advanced industrial democracies were still in full control of their national economic boundaries. In the absence of regulatory competition, the solutions could be much more generous than in the U.S., and they could also differ from one country to another in the type of functions assumed by the state, the level of generosity of the benefits provided, and in the institutional structures through which benefits were provided. But regardless of fundamental differences between universalistic Scandinavian welfare states, Continental varieties of “social-market economies” or the Beveridge model of Anglo-Saxon countries (Esping-Andersen 1990), citizens have come to base their life plans on the expectation that certain functions, but not others, would be provided by the welfare state — with the consequence that their fate and the fate of their families would in fact depend on the stability of these expectations. If these expectations were massively disappointed, the fundamental “social contract” and hence democratic legitimacy would indeed be in question.

The second part of the trilemma arises from the fact that the member states of the European Union have become irreversibly committed to a pervasive program of European economic integration whose very success is now confronting national welfare states with the same kind of regulatory competition that had impeded the development of social policies in the American states. There however, a solution became available after the New Deal constitutional revolution, when the Supreme Court finally allowed political responsibility for welfare state functions to be exercised at the federal level. In Europe, by contrast, the transfer of welfare state functions to the EU level is effectively ruled by pragmatic and by normative reasons. The trilemma, in short, exists because EU member states cannot want to shed their welfare-state obligations without jeopardizing the bases of their legitimacy; they cannot want

to reverse the process of economic integration which exposes national welfare states to regulatory competition; and they cannot want to avoid regulatory competition by shifting welfare-state responsibilities upward to the European level.

It is the third horn of the European trilemma which I will primarily discuss here. In doing so, I will begin with a brief theoretical discussion of the preconditions of democratic legitimacy; then I will explore how these are affected by European integration; and I will conclude with an examination of European policies that could strengthen national efforts to cope with the constraints of regulatory competition.

2. Legitimacy: Effective Problem Solving and Democratic Accountability

Legitimacy is here understood as a widely shared belief that it is my moral duty to comply with requirements imposed by state authorities even if these requirements violate my own preferences or interests, and even if I could evade them at low cost. In the absence of such beliefs, compliance would depend exclusively on the effectiveness of controls and the anticipation of sanctions — which, as the decline and fall of socialist dictatorships demonstrated once again, greatly reduces the efficiency of governing.

As Max Weber has shown, there is — theoretically and historically — a considerable variety of beliefs on which the legitimacy of government may be based. Yet in this day and age, and in Western societies, “democratic” legitimation has come to be seen as the only game in town — which of course does not rule out disagreement about the specific conditions that could support claims to this type of legitimation. In my own view, it is useful here to distinguish between two types of legitimating arguments. On the one hand, “input-oriented” claims presuppose that in a democratic polity the powers of government must be exercised in response to the articulated preferences of the governed — which, in the language of Abraham Lincoln’s Gettysburg Address, refers to “government *by the people*”. On the other hand, “output-oriented” legitimation arguments demand that democratic government should advance the common good by dealing effectively with those problems that are beyond the reach

of individual action, market exchanges and voluntary cooperation among individuals and groups in civil society — which, in Lincoln’s terms emphasizes the dimension of “government *for the people*”.

In constitutional democracies, the capability for *effective* action is thought to be assured by the potentially comprehensive authority of the territorial state over the resources and action choices of its subjects, exercised through powers of legislation and taxation whose enforcement is backed by the monopoly of legitimate coercion. To assure the responsive and public-interest oriented exercise of these powers, democratic constitutions rely on free media of communication, public debate and political parties, on the electoral accountability of key office holders as well as on institutionalized checks and balances. But while democratic constitutions vary greatly in the way, and in the extent, to which the exercise of public power is circumscribed by the institutionalization of judicial, legislative, and federal veto positions, no polity would be considered democratic that does not make office holders invested with authority to exercise public power directly or indirectly dependent on, and hence responsive to, the (anticipated) preferences and the subsequent judgment of constituents, expressed in free and general elections.

2.1 The Problem: Loss of Effective Control at the National Level

The “European democratic deficit” is usually discussed with reference to institutions and policy processes at the European level, where the preconditions for direct democratic accountability are clearly not realized. Its primary effect, however, is felt at the national level, where European integration is weakening the problem-solving effectiveness as well as the accountability of governments with seemingly impeccable democratic credentials.

2.1.1. Economic constraints and regulatory competition

The main impact of European integration is economic. With the completion of the internal market, and now with the Monetary Union, national boundaries have lost their effectiveness as obstacles to the free movement of goods, services, and capital. As a consequence, the nation state has lost the power to protect national producers against foreign competitors producing under more business-friendly regulatory and tax regimes. By the same token, producers and investors are now free to choose the most attractive location in Europe without jeopardizing their access to the home market. Since governments depend on producers and investors to assure employment and incomes of their citizens, economic integration creates conditions of regulatory competition which reduces the effective capacity of all member states to tax mobile factors of production and capital profits and to impose market-correcting regulations that are considered a burden on business. To the extent that such policies had responded to the political aspirations of constituencies, the new constraints are also experienced as a loss of responsiveness and democratic accountability.

2.1.2. Legal constraints of “negative integration”

In order to bring about economic integration, the European Community had to develop legal prohibitions — corresponding to the “negative Commerce Clause” doctrines of U.S. constitutional law — that did not only abolish national tariffs and quantitative restrictions on imports, but also all other measures that had the effect of restricting or distorting free international competition in the European markets for goods and services, or the free movement of capital across national borders.

In fact, however, the “negative integration” of European markets has gone much further, requiring the abolition of national subsidies to declining regions or industries and the liberalization — and in practical effect, the privatization and deregulation — of a wide range of infrastructure services and facilities (for example, telecommunications and postal services, airports and airlines, railroads and road haulage, electricity and natural gas, or job placement

services) which in most European countries had been provided directly by the state, by licensed monopolies, or by highly regulated cartels. In addition, the Monetary Union has eliminated national control over interest rates and exchange rates, and it has severely constrained the capacity of national governments to employ the remaining instruments of macro-economic policy for employment-increasing strategies.

In the judgment of most economists, these changes did increase economic efficiency, and many of them have clearly benefited European consumers (usually at the expense of employment in hitherto protected and hence less efficient branches). But there is also no question that the range of available policy choices, and hence the capacity of governments to respond to the preferences of their citizens (which may emphasize values that cannot be reduced to measures of economic efficiency), have been significantly constrained. This is not only true of macro-economic, industrial and regional policies but also of the capacity to tax mobile factors of production and capital incomes, and of the capacity to regulate employment conditions with a view to strengthening workers' rights or to equalize primary incomes. Intense competition and high capital mobility rule out cross-subsidization, so that in principle each job must be able to earn its own cost plus adequate profits in competitive markets. If governments and unions should still try to intervene through minimum-wage laws or solidaristic wage policies, the outcome would not be greater equality but the loss of those jobs which are priced out of the market.

In short, European integration has significantly reduced the range of policy instruments available, and the range of policy goals achievable, at the national level. To that extent, the effectiveness as well as the responsiveness of government, and hence democratic legitimacy, are seen to have been weakened — at least in those countries which, in contrast to Britain, have not completely converted to neo-liberal preferences.

2.2. European Solutions?

There is a hope, certainly among unions and left-of-center political parties, but also among the members and staff of the Commission and the European Parliament, that the American experience of the New Deal period (Skocpol 1995) could be repeated in Europe — namely, that the regulatory capacity that was being lost at the national level might be regained through regulations at the European level. Economically, the parallel is, of course, not perfect because the U.S. in the 1930s was practically decoupled from the world market, whereas the EU is part of the WTO free-trade regime and completely integrated into worldwide capital markets. Nevertheless, the EU internal market is so much larger than the national markets of member states that regulatory options which are economically unfeasible at the national level could indeed be realized by European legislation.

2.2.1 *Status quo: A problem-solving gap*

Under the present institutional conditions of the European polity, however, such hopes are mostly disappointed. The Community started out as an intergovernmental negotiation system whose decisions, under the Luxembourg compromise, depended on unanimous agreement of member governments in the Council of Ministers, and hence were easily blocked by conflicts of interest among these governments. Nevertheless, the Commission and the European Court of Justice were able to advance European integration through direct legal action against the violation of (extensively interpreted) Treaty provisions which, under the doctrines of “supremacy” and “direct effect”, were able to override national legislation. But these legal strategies were mainly effective in expanding the reach of “negative integration” in order to remove national barriers to trade and free competition. Market-correcting policies of “positive integration”, by contrast, continued to depend on political agreement in the Council of Ministers.

There, however, European problem-solving capacity is severely constrained by multiple vetoes since decisions must be taken either unanimously or by qualified majorities — a

condition that was in no way improved by the expansion of co-decision rights of the European Parliament, which mainly had the effect of strengthening another veto position and weakening the agenda-setting power of the Commission (Tsebelis 1994). That is not meant to say that positive integration must generally end in a “joint-decision trap” (Scharpf 1988) where divergent national interests lead to blockage or will at best allow solutions at the “lowest common denominator”. There are indeed policy areas where national interests converge sufficiently to allow even very demanding European regulations. This is particularly true for the harmonization of safety and environmental standards for industrial products, where governments were often willing to accept the demands of countries with high national standards in order to assure uniform conditions and free access throughout the internal market (Eichener 1997; Pollack 1997). Similarly, once some countries were forced by ECJ judgments to allow foreign competitors in their protected public-service branches, their governments tended to support Council directives requiring the general liberalization of these services (Schmidt 1998). By contrast, in policy areas where national interests do in fact diverge, as was true for the European regulation of industrial relations (Streeck 1997), decisions at the lowest common denominator are indeed the best that can be expected.

It is possible to state with some precision in which policy areas national problem-solving capabilities are most severely affected by the economic and legal constraints of European integration, and in which policy areas European problem-solving is most likely to be blocked by conflicts of interest among national governments (Scharpf 1997). In effect, both of these constraints tend to overlap in a limited range of policy areas which, however, includes precisely those instruments of market-correcting policy that have been of critical importance for the legitimation of democratic welfare states — social policy, industrial-relations policy, and the taxation of business profits and capital incomes. In these policy areas, located in the lower-left quadrant of Figure 1, European integration does create a problem-solving gap. Here the nation state is most constrained by the economic pressures of international competition and capital mobility as well as by the legal prohibitions of negative integration. At the same time, however, it is also in these policy areas that agreement on the European level is most constrained by conflicts of interest and of ideological preferences among member governments.

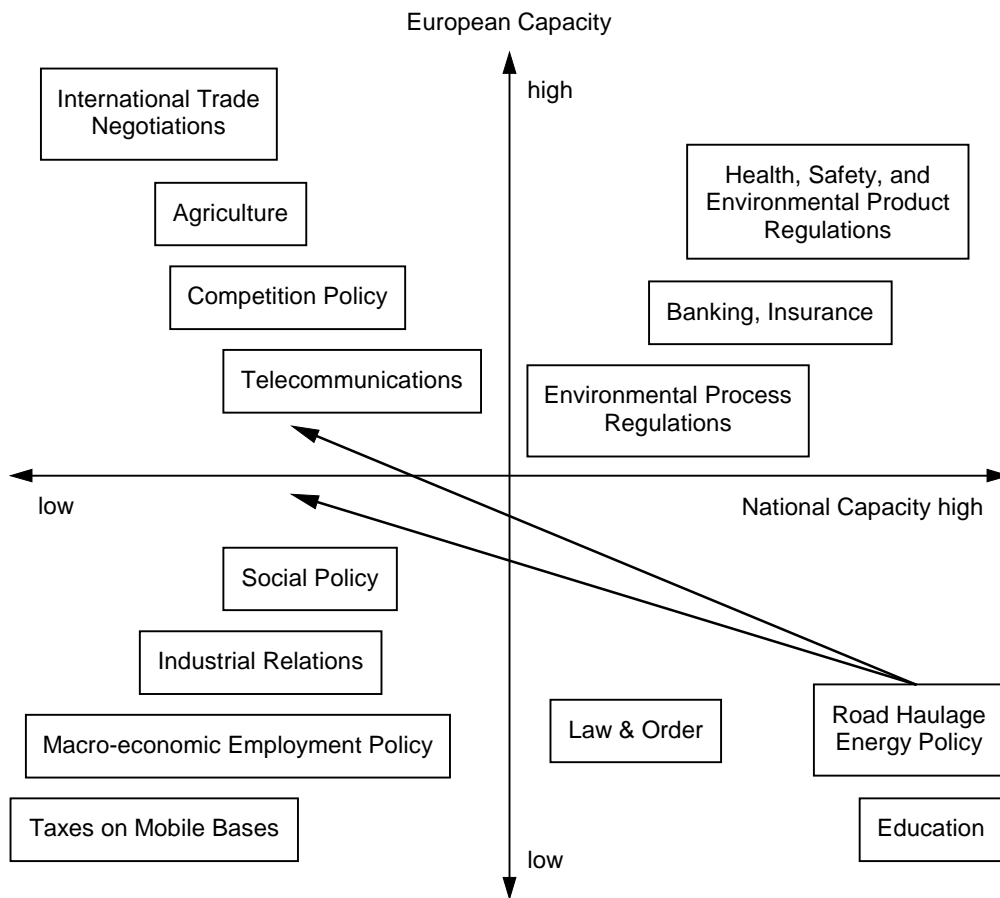


Figure 1: *National and European Problem Solving Capabilities*
(Source: Scharpf 1999: 117)

The reasons are easy to see: EU member states differ in their level of economic development — with the consequence that the level of social protection offered by, say, Denmark, would be completely unaffordable in Greece or Portugal. Moreover, even countries at the same level of economic development differ greatly in the levels and the structures of social provision. For British citizens, who have made private arrangements to complement very lean public benefits, the Swedish “full-service” welfare state would be as unacceptable as British industrial-relations rules would be for workers and union accustomed to German co-determination rights. In short, there is no chance that common, Europe-wide solutions could replace national welfare and employment regimes under institutional conditions where these would depend on the agreement of national governments.

2.2.2 *The institutional preconditions of effective European action*

Under these circumstances, it is tempting to think that the European problem-solving gap might be closed through constitutional changes that would simultaneously increase the capacity for, and the democratic legitimacy of, effective action at the European level. In order to realize this hope, so it is thought, Europe would need to transform its present constitution — which, essentially, is still that of a confederacy governed by negotiations among member states — to that of a federal state whose decisions cannot be blocked by the opposition of a few member governments. In other words, the European Union would have to become more like the United States — or at least more like the German federal state (Scharpf 1988). Presumably, a (consolidated) Council of Ministers would have to be retained as a second legislative chamber, but what would matter is the transformation of the Commission into a European government that is politically accountable to the European Parliament, legislation by simple majorities in both chambers, and the authority of the Union to raise its own taxes (preferably the taxes on business profits and capital incomes that member states have difficulty collecting).

Assuming that this constitutional revolution could be enacted, the institutional capacity of the European Union for effective action would be at a level that is roughly comparable to that of federal systems like Switzerland and Germany — still impeded by more veto positions than in unitary states, but with a central government that is legitimated by a Europe-wide political majority, that is acting from a Europe-wide perspective, and that is able to employ considerable resources in trying to win the support of majorities in both chambers for its legislative initiatives.

2.2.3 *The non-institutional preconditions of majority rule*

As a practical matter, the record of past Intergovernmental Conferences and European Summits suggests that there is little or no chance that European constitutional reforms could go this far. What concerns me here, however, is the normative question of whether one could

even wish that they should. Put more precisely, the question is whether parliamentary majorities could actually legitimate decisive action in those areas where European policy is presently blocked by major conflicts of interest or preferences among member governments?

That question presupposes that decisions by majority, which allow dissenting minorities to be overruled, may not be normatively acceptable under all conditions, and that their capacity to create a moral duty of voluntary compliance depends on non-institutional preconditions that legitimate the majority rule itself. In Lincoln's Gettysburg triad, these preconditions are addressed in the reference to "government *of the people*". I interpret this to mean that majoritarian democracy presupposes the "we-identity" of a *Demos* — a collectivity in which the identification of members with the group is sufficiently strong to override the divisive interests of subgroups in cases of conflict. If that were not true, secession or civil war would be an ever-present danger — and in polities where that sense of a collective identity is in fact weak or lacking (think of Northern Ireland, Bosnia, the former Czechoslovakia or even of Belgium and Canada), the mere counting of votes was never considered sufficient to create a moral duty to comply among outvoted minorities. Instead, it would set off disintegrative and even explosive dynamics of resistance and repression.

As of now, nobody seems ready to claim that the multi-ethnic, multi-lingual, multi-cultural and multi-institutional peoples of the European Union have yet achieved a robust we-identity that is more salient than existing cleavages and conflicts of interest. This is of course not meant to say that a common *ethnic* identity should be considered an indispensable prerequisite of democratic majority rule — the United States and Switzerland show that this is not so. But in its place, the multi-ethnic polities have developed a national fierce patriotism, based on a strong historical sense of common fate and common destiny — conditions which surely are also not yet realized among the fifteen nations of the present Union, and that will take even longer to develop after Eastern enlargement. And even if common identity were considered less essential, it must matter for the input-oriented legitimation of European policy choices that the peoples of Europe do not yet constitute a common European public; that there are as yet no Europe-wide media of communications, no Europe-wide political parties, no Europe-wide candidates for political office, and no Europe-wide political debates and controversies.

Under these conditions, the most that one could hope for in a revised European constitution are institutions, decision rules and practices of mutual accommodation that surely must be even more protective of minority interests than is true in “consociational democracies” in those nation states like Canada or Belgium that must also deal with deep cleavages through accommodation, rather than through straightforward majority rule. But if that is so, the potential gain, in terms of majoritarian capacity for decisive action, of any normatively defensible constitutional reform will be quite limited. That is not meant to suggest that such reforms are undesirable or could not help to facilitate the slow progress toward greater public attention to and participation in election campaigns for the European Parliament, debates about European issues, and the selection of European office holders.

3. National Democracy: Coping with the Loss of Boundary Control

These, however, are hopes for the longer term. In the immediate future, Europe will have to make do with its present constitution, and thus with its dependence on broad agreement among national governments for any major policy initiatives. As a consequence, it is also unrealistic to hope that the control over the international economy that was lost at the national level could soon be regained through market-correcting European policies. But does that mean that the erosion of democratic legitimacy at the national level is inevitable, as governments must either accept the continuing decline of their economies or accept retrenchments of the welfare state, of worker rights, and of social equality, which neither they nor their constituents would have freely chosen? I think not.

In order to support this conclusion, I must once more turn to the normative foundations of democratic legitimacy discussed above. In public debates, and under fair-weather conditions, governments as well as opposition parties often tend to equate (input-oriented) responsiveness with wish fulfillment, and (output-oriented) effectiveness with omnipotence. But these are populist misunderstandings (Riker 1982). Instead, democratic legitimacy is about good reasons that should persuade me to comply with policies that do not conform to my own wishes. Its true test comes when the going gets tough. What matters then are the in-

stitutional conditions that allow citizens to trust that governments will choose among *feasible* options in such a way that the policies adopted will, *under the circumstances*, be responsive to expressed citizen preferences and effective in pursuing the common interest.

If circumstances will no longer allow the state to control its economic boundaries, and if regulatory competition increases, that is not the end of politically salient and legitimacy-enhancing choices in national economic, employment and social policy, even though the overall set of feasible choices may be narrower and less attractive than before. There is no question that the adjustment may be painful, especially for those countries (Sweden, for instance) where the state had in the past been very effective in steering the national economy by exercising control over interest rates and the allocation of credit, over wages and working conditions, or over the direction of industrial research and development. In a thoroughly Europeanized economy, most of these opportunities for political steering and control are gone. They have been replaced by international capital markets and by the dominant orientation of managers to the benchmarks of shareholder value. Moreover, the welfare-state policy legacies in some states are considerably more vulnerable to international competition and capital mobility than is true of others (Scharpf, forthcoming).

But to say that there are tighter legal constraints and stronger competitive pressures is not the same as denying the existence of politically salient policy choices that do make a difference in the economic fate of the country and in the incomes, employment opportunities or material inequality of their citizens. Thus, small open economies have long learned to pursue very ambitious social policy goals while coping successfully with international product markets they could never hope to control. In the crisis period of the late 1970s and early 1980s, moreover, Britain and the Netherlands had competed for the title of being “the sickest man in Europe”. By the 1990s, however, both of these countries were held out as models of successful adjustment. Yet they have achieved their turnaround by pursuing very different strategies (neo-liberal versus neo-corporatist), and they have succeeded in reducing unemployment through very different methods and with different distributional consequences. Even more important, for present purposes, is the fact that although Dutch and British reform strategies had initially been extremely controversial in national discourses, these controversies and their outcomes have strengthened, rather than weakened democratic legitimacy in either country

(Schmidt, forthcoming). The same could be said of Denmark, Switzerland, Australia or even Italy. By contrast, countries like Belgium, France, Germany or Sweden, that had not yet found strategies in which political aspirations are matched to the economic options and constraints of the 1990s, seemed to be more affected by political uncertainty, self-doubt, discontent, alienation or radicalization — in short by a sense of malaise that threatened to erode public confidence in the responsiveness and problem-solving effectiveness of democratic government (Scharpf and Schmidt, forthcoming).

4. European Regime for Regulatory Competition

The implication is that if economic internationalization creates a challenge to democratic legitimacy, that challenge must primarily be met by responses at the national and sub-national level of European polities. But since, as I have argued, Europe is part of the problem, European policies can also help to alleviate it — provided that measures can be identified that will not be blocked by massive conflicts of interest among the member governments. Essentially these would need to moderate the intensity of regulatory competition among member states — which could be achieved, first, by allowing national policy makers greater freedom to pursue policies serving non-economic goals even if these have some limiting effect of market competition; second, by adopting a form of “proportional minimum standards” for total welfare spending; third, by providing institutional support for coordinated reforms among subsets of member states; and fourth, by allowing the Commission and the Court to develop a European case law of “unfair regulatory and tax competition.”

4.1 Softening the constraints of negative integration

Most important would be a selective softening of the legal constraints of negative integration. Since these have been created and extended primarily by legal actions of the Commission, reinforced by judicial activism during the period when Council decisions were still

blocked by the unanimity rule, they have been guided by a single-minded commitment to achieve economic integration and to maximize free competition against the protectionist machinations of recalcitrant member states. In many areas, negative integration in the European Union has gone much further than the legal constraints imposed on the American states by Congressional legislation or by the decisions of the U.S. Supreme Court under the “Negative Commerce Clause” doctrine.

Yet now, when the single European market has become a reality that no member state would want to dismantle again, the perfectionist application of the syllogisms of undistorted competition should give way to a more balanced approach that weighs the seriousness of an alleged infringement of market freedoms against the importance and normative validity of the purposes served by a given instance of market-correcting national regulations. In fact, recent decisions of the European Court of Justice are already moving in that direction. Moreover, it is also appropriate that in the application of this balancing test, the political judgment of the Council of Ministers or the European Council should have a legitimate role — examples for which can be found in several resolutions adopted at the Amsterdam summit.¹

4.2 *Proportional minimum standards*

Since the member states of the Union are locked in a constellation of regulatory competition with each other, reforms in one country are likely to be read as beggar-my-neighbor stratagems by others, inducing them to respond in kind, which in turn will persuade others to do likewise in order to avoid capital outflows and job losses. This is how Sweden and other Scandinavian countries ended up with a “dual income tax”, greatly favoring capital incomes in comparison with income from work, even though Denmark, that had first tried out the idea, soon had second thoughts about it. Tax harmonization, which would avoid such “races to the bottom” is, however, among the EU policy areas in which agreement has so far been notori-

¹ Examples are discussed in Scharpf (1999: 160-169).

ously difficult to achieve (Dehejia and Genschel 1999), and the same is even more true for the Europe-wide harmonization of highly diverse social-welfare systems.

As pointed out above, there are two reasons for this — differences among member states in the levels of economic development, and differences in welfare state structures. The first would allow at best the adoption of very low minimum standards that would not strain the ability-to-pay of the less advanced member states — which, however, would in no way reduce the much more important pressures of regulatory competition among the richer welfare states. Neither would it help to adopt two levels of regulations, since the enormous institutional and structural diversity among the more advanced welfare states would prevent these from agreeing on common and more demanding solutions, even if these applied only among the group of rich countries.

Empirically, however, it is also true that the member states of the European Union are remarkably similar with regard to *total social expenditures relative to their wealth*.² While countries differ greatly in the structure of social expenditures — that is, in the shares that are spent on pensions, health care, unemployment benefits or social services,³ their total social expenditures happen to be almost directly proportional to their per-capita GDP expressed in a common currency. Thus there seems to be a de facto consensus that richer countries should spend proportionately more on social welfare than less well-to-do countries. It seems not impossible, therefore, that this latent consensus might be translated into an explicit EU agreement on a lower proportional threshold of total social spending, defined for each country relative to its wealth position. If such an agreement were in place, all countries could engage in structural and institutional reforms of their welfare systems without setting loose a chain reaction of competitive welfare retrenchment. Since all countries, including the United Kingdom and Luxembourg, are presently close to the regression line on social spending, an agreement to maintain that relative position should be more easily reached than any attempt at harmonizing institutionally incompatible national welfare systems. Conceivably, a similar

² Data are presented in Scharpf (1999: 175-180) .

³ For more comprehensive comparative statistics, see OECD (1999).

quantitative agreement might also be achieved with regard to the share of GDP collected from all types of taxes on business and capital incomes.

4.3 *Co-ordinated reforms*

Coordination could become an even more effective way of taking the pressures of regulatory competition out of the reform processes which are necessary to adjust existing national policy legacies to the new economic environment. Given the differences among these legacies, however, no useful purpose would be served by attempts at Europe-wide co-ordination. But there are subgroups of countries belonging to the same welfare-state “family” — Scandinavian, Anglo-Saxon, Continental, Southern (Esping-Andersen 1990) — that have similar institutions and similar structures of financing and benefits, and that are facing basically similar problems (Esping-Andersen 1999; Scharpf, forthcoming). Given these similarities, policy changes in one country are most closely monitored, and most like to trigger a chain reaction of competitive responses, in countries belonging to the same group.

At the same time, however, these countries could benefit most from analyzing each others’ experiences, and from developing common reform strategies on that basis. Doing so could create complete-information conditions that would not only improve the quality of policy designs but would also offer the best protection against suspicions that might trigger beggar-my-neighbor strategies.⁴ Such coordination would be greatly facilitated if it could make use of the organizational resources and good services of the European Commission in providing trustworthy comparative information and analyses, and in monitoring the reform efforts of all parties involved. Unfortunately, however, the very restrictive rules for “closer cooperation and flexibility” adopted at the Amsterdam Summit seem designed to foreclose

⁴ Somewhat similar monitoring and trust-building functions may be performed by the national representatives in the hundreds of EU committees that are involved in the preparation and implementation of Council directives (Joerges and Vos 1999). Similarly, unions in Germany and some neighboring countries are now exchanging observers who are allowed to attend each others’ collective bargaining negotiations.

this option. It is to be hoped that the next Intergovernmental Conference will enlarge the opportunities for closer cooperation among subgroups of EU member states.

4.4 *Toward a European law of “unfair regulatory competition”*

Finally, it seems also possible to instrumentalize the legal instruments of negative integration and competition policy to create a European regime for controlling excesses of regulatory competition.

With the support of the Court, the Commission has made extensive use of the tools provided by the Treaty (Articles 90, 92 and 93) for scrutinizing state aids and other national measures that could be construed as a distortion of competition within the common market. At the same time, the Court has developed a body of case law that distinguishes subsidies serving legitimate purposes from illegitimate ones. Admittedly, it is not always easy to discern the dividing line between subsidies to Volkswagen in Saxony, and subsidies to Rover in England, but there is no question that the monitoring and policing functions of the Commission and the Court have a considerable effect in disciplining the otherwise massive incentives for competitive subsidization.

If that is accepted, there is no logical reason why Commission and Court could not also be empowered to monitor and police deregulation and tax concessions when these are employed in improper competitive strategies. Again, there will be legitimate reasons for both, but as in the field of subsidies there are also important instances where tax concessions and deregulation are precisely targeted to attract foreign businesses, company headquarters or financial operations to the disadvantage of other countries or domestic competitors. That the dividing line is unlikely to be a simple, hard-and-fast rule is not a major objection. The same is true in the private sector, where the dividing line between the (anti-trust) law of free competition and the law of unfair competition must also be worked out on a case-by-case basis by the courts. If an abstract guideline seems necessary, it could well be a variant of the Kantian “categorical imperative”: Competitive strategies involving deregulation and tax concessions

are improper if, even in the eyes of their initiators, they would be self-defeating if they were applied by all other countries as well.

From newspaper reports it appears moreover that during the Finnish presidency the ECOFIN ministers had come close to an agreement on some “code of conduct” governing discriminatory tax concessions, before negotiations failed altogether after the British veto against common rules on interest taxation. I take this incident, first, as demonstrating that it is indeed possible to formulate plausible and practicable rules distinguishing proper and improper practices of tax competition, and second, as providing strong support for an active role of the Commission and the Court in a field where competitive incentives are preventing political agreement in the Council. If there are good reasons to use legal, rather than political, processes for the control of state aids, these would also support the use of the same kinds of procedures for controlling the temptations of unfair regulatory competition.

5. Conclusions

What does all that imply for the European democratic deficit? My first conclusion is that there is no lack of legitimacy for what the Union has actually been able to do. This legitimacy is based on intergovernmental agreement, and the area of effective European action may still continue to expand as agreement is reached on additional purposes and means of European action. However, the democratic deficit would surely become a major, and potentially explosive, issue if the European constitution were now changed in ways that would allow the Union to act more effectively by simple majority vote in the face of strong objections from more than a very few member governments. That also implies, unfortunately, that Europe still will be unable to deal with the wide range of social problems — among them mass unemployment and the crisis of the welfare state — that are caused by economic integration but for which European solutions are blocked by major conflicts of interest or ideology among member governments. By necessity therefore, these problems will be left for the member states to cope with — where the failure of governments to come up with normatively

defensible and pragmatically effective solutions may indeed erode input-oriented as well as output-oriented democratic legitimacy.

In principle these solutions must be found and implemented at the national level. Nevertheless, Europe should and could have a role in enabling, facilitating and protecting national coping strategies, instead of single-mindedly maximizing the one goal — market integration and free competition — which the Union is able to pursue without the political agreement of member governments. This role would depend on the acknowledgment that regulatory competition is not the unmitigated good that neo-liberal economists claim it to be, and that there may be social values and political purposes that are more important than weeding out the last remaining national regulation that competition lawyers could construe to be a distortion of free competition. In this regard, the Commission and the European Court of Justice could learn much from the United States where the anti-trust law is applied much more vigorously against private monopolies than is true in Europe, whereas — after the post-1937 decline of the “negative Commerce Clause” doctrine — state legislation is generally not challenged by the anti-trust division or the federal courts unless it is in direct conflict with federal legislation.

In most other regards, however, the American situation is too different to allow direct lessons to be drawn for the European predicament. On the one hand, welfare-state functions have a much lower political salience in the American states than in European nation states, and the range of structural and institutional diversity in existing functions is considerably narrower than is true in Europe. On the other hand, the democratic legitimacy of decisions at the federal level is clear and strong, and the most important welfare-state functions — social security, medicaid, or the earned income tax credit — are shaped by federal law, rather than by the states. And even in those areas where the states have a role — unemployment insurance, social assistance, and active labor market policies — their choices are strongly conditioned by federal subsidies. Hence the incentives, as well as the opportunities to engage in regulatory competition, are relatively unimportant for the American states. The same is true for tax competition which is dampened by the partial setoff of state taxes against the federal income tax. None of these devices are available in Europe. In this regard, in short, cross-

Atlantic comparison serves primarily to highlight differences, rather than to provide lessons that could be put into practice on the other shore.

REFERENCES

- Dehejia, Vivek H., and Philipp Genschel. 1999. "Tax Competition in the European Union". *Politics and Society* 27: 403-430.
- Dyson, Kenneth, and Kevin Featherstone. 1999. *The Road to Maastricht. Negotiating Economic and Monetary Union*. Oxford: Oxford University Press.
- Eichener, Volker. 1997. "Effective European Problem Solving: Lessons from the Regulation of Occupational Safety and Environmental Protection". *Journal of European Public Policy* 4: 591-608.
- Esping-Andersen, Gøsta. 1990. *The Three Worlds of Welfare Capitalism*. Cambridge: Polity.
- Esping-Andersen, Gøsta. 1999. *Social Foundations of Postindustrial Economies*. Oxford: Oxford University Press.
- Garrett, Geoffrey. 1992. "International Cooperation and Institutional Choice: The European Community's Internal Market". *International Organization* 46: 533-60.
- Joerges, Christian, and Ellen Vos. eds. 1999. *EU Committees: Social Regulation, Law and Politics*. Oxford: Hart Publishing.
- Moravcsik, Andrew. 1998. *The Choice for Europe. Social Purpose and State Power from Messina to Maastricht*. Ithaca: Cornell University Press.
- OECD 1999. *Social Expenditure Database 1980-1996*. Paris: OECD.
- Pollack, Mark A. 1997. "Representing Diffuse Interests in EC Policy-Making". *Journal of European Public Policy* 4: 572-590.
- Riker, William H. 1982. *Liberalism against Populism: A Confrontation between the Theory of Democracy and the Theory of Social Choice*. San Francisco: W.H. Freeman.
- Scharpf, Fritz W. 1988. "The Joint Decision Trap. Lessons from German Federalism and European Integration". *Public Administration* 88: 239-278.
- Scharpf, Fritz W. 1997. "Introduction: The Problem-Solving Capacity of Multilevel Governance". *Journal of European Public Policy* 4: 520-538.
- Scharpf, Fritz W. 1999. *Governing in Europe. Effective and Democratic?* Oxford: Oxford University Press.
- Scharpf, Fritz W., and Vivien A. Schmidt. eds. (forthcoming). *Welfare and Work in the Open Economy. Volume II: Diverse Responses to Common Challenges*. Oxford: Oxford University Press.

- Scharpf, Fritz W. (forthcoming). "The Viability of Advanced Welfare States in the International Economy: Vulnerabilities and Options". To appear in *Journal of European Public Policy*, volume 7.
- Schmidt, Susanne K. 1998. "Commission Activism: Subsuming Telecommunications and Electricity under European Competition Law". *Journal of European Public Policy* 5: 128-145.
- Schmidt, Vivien A. (forthcoming). "The Role of Values and Discourse in Welfare State Reform: The Politics of Successful Adjustment". In *Welfare and Work in the Open Economy. Volume I: From Vulnerability to Competitiveness*, ed. Fritz W. Scharpf and Vivien A. Schmidt. Oxford: Oxford University Press.
- Skocpol, Theda. 1995. *Social Policy in the United States: Future Possibilities in Historical Perspective*. Princeton: Princeton University Press.
- Skocpol, Theda, and Edwin Amenta. 1986. "The States and Social Policies". *Annual Review of Sociology* 12: 131-157.
- Tsebelis, George. 1994. "The Power of the European Parliament as a Conditional Agenda Setter". *American Political Science Review* 88: 128-142.
- Verdun, Amy. 1996. "An "Asymmetrical" Economic and Monetary Union in the EU. Perceptions of Monetary Authorities and Social Partners". *Journal of European Integration* 20: 59-81
- Williams, Shirley. 1991. "Sovereignty and Accountability in the European Community". In *The New European Community: Decision Making and Institutional Change*, ed. Robert O. Keohane and Stanley Hoffmann. Boulder: Westview.