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**Negative and Positive Integration
in the Political Economy
of European Welfare States**

FRITZ W. SCHARPF

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**Scharpf: *Negative and Positive Integration in the
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Jean Monnet Chair Papers

Negative and Positive Integration in the Political Economy of European Welfare States

FRITZ W. SCHARPF

1995

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I. Introduction

The process of European integration is characterized by a fundamental asymmetry which Joseph Weiler (1981) accurately described as a dualism between supranational European law and intergovernmental European policy making. Weiler is also right in criticizing political scientists for having too long focused only on aspects of intergovernmental negotiations while ignoring (or, at least, not taking seriously enough) the establishment, by judge-made law, of a European legal order that takes precedence over national law (Weiler 1994). This omission is all the more critical since it also kept us from recognizing the politically highly significant parallel between Weiler's dualism and the more familiar contrast between "negative" and "positive integration" (Tinbergen 1965; Rehlinger/Stewart 1984) - i.e. between measures increasing market integration by eliminating national restraints on trade and distortions of competition, on the one hand, and common European policies to shape the conditions under which markets operate, on the other hand.

The main beneficiary of supranational European law has been negative integration. Its basic rules were already contained in the "primary law" of the Treaties of Rome. From this foundation, liberalization could be extended, without much political attention, through interventions of the European Commission against infringements of Treaty obligations, and through the decisions and preliminary rulings of the European Court of Justice. By contrast, positive integration depends upon the agreement of national governments in the Council of Ministers; it is thus subject to all of the impediments facing European intergovernmental policy making. This fundamental institutional difference is sufficient to explain the frequently deplored asymmetry between negative and positive integration in EC policy making (Kapteyn 1991; Merkel 1993). The most likely result is a competency gap, in which national policy is severely restrained in its problem-solving capacity, while European policy is constrained by the lack of intergovernmental agreement. To the extent that this is true, the political economy of capitalist democracies, which had developed in Western Europe during the postwar decades, is being changed in a fundamental way.

II. Negative Integration: The Loss of Boundary Control

In the history of capitalism, the decades following the Second World War were unusual in the degree to which the boundaries of the territorial state had become coextensive with the boundaries of markets for capital, services, goods and labor¹. These boundaries were by no means impermeable, but transactions across them were nevertheless under the effective control of national governments. As a consequence, capital owners were generally restricted to investment opportunities within the national economy, and firms were mainly challenged by domestic competitors. International trade grew slowly, and since governments controlled imports and exchange rates, international competitiveness was not much of a problem. While these conditions lasted, government interest rate policy controlled the rate of return on financial investments. If interest rates were lowered, job-creating real investments would become relatively more attractive, and vice versa. Thus, Keynesian macro-economic management could smooth the business cycle and prevent demand-deficient unemployment, while union wage policy, where it could be employed for macro-economic purposes, was able to control the rate of inflation. At the same time, government regulation and union collective-bargaining controlled the conditions of production. But since all effective competitors could be, and were, required to produce under the same regimes, the costs of regulation could be passed on to consumers. Hence the rate of return on investment was not necessarily affected by high levels of regulation and union power²; capitalist accumulation was as feasible in the union-dominated Swedish welfare state as it was in the American free enterprise system.

- 1 The pre-World War I period and the 1920s were both times of open capital markets, free world trade, and a tendency toward capitalist crisis (Polanyi 1957). In the early 1930s, the major industrial nations responded to the Great Depression with protectionist or even autarkist strategies of competitive devaluation, capital export controls, import restrictions, and subsidized exports. As a result, the world economy collapsed. After the Second World War, it took more than two decades of GATT negotiations to gradually liberalize international trade, and it took two oil price shocks before the world capital markets were again freed from national control. In retrospect, this gradual transition from closed national economies to an uncontrolled world economy appears to have provided the optimal conditions for "social-democratic" solutions at the national level. Until the mid-1970s, at any rate, Western European societies were able to profit from the economic dynamism of capitalism while stabilizing its fluctuations through Keynesian macro-economic controls, and correcting its distributive inequities through union power and social-welfare policies (Ruggie 1982; 1995).
- 2 In the neo-marxist political-economy literature, much is made of declining shares of profit in the postwar decades as an indicator of the unresolvable contradiction between the capitalist economy and the democratic state. But since investment would cease when the rate of return on capital becomes negative, governments and unions would become aware of the risks of a profit squeeze for employment and growth - and economies with neo-corporatist institutional structures are in theory, and were in fact, quite capable of avoiding or correcting this strategic blunder (Wallerstein 1990; Scharpf 1991a).

During this period, therefore, the industrial nations of Western Europe had the chance to develop specifically national versions of the capitalist welfare state - and their choices were in fact remarkably different (Esping-Andersen 1990). In spite of the considerable differences between the "Social-Democratic", "Corporatist" or "Liberal" versions of the welfare state, however, all were remarkably successful in maintaining and promoting a vigorous capitalist economy, while also controlling, in different ways and to different degrees, the destructive tendencies of unfettered capitalism in the interest of specific social, cultural, and/or ecological values (Scharpf 1991a; Merkel 1993). It was not fully realized at the time, however, how much the success of market-correcting policies did in fact depend on the capacity of the territorial state to control its economic boundaries. Once this capacity was lost, through the globalization of capital markets and the transnational integration of markets for goods and services, the "golden years" of the capitalist welfare state came to an end.

Now the minimal rate of return that investors can expect is determined by global financial markets, rather than by national monetary policy, and real interest rates are generally about twice as high as they used to be in the 1960s. So if a government should now try to reduce interest rates below the international level, the result would no longer be an increase of job-creating real investment in the national economy, but an outflow of capital, devaluation, and a rising rate of inflation³. Similarly, once the territorial state has lost, or given up, the capacity to control the boundaries of markets for goods and services, it can no longer make sure that all competing suppliers will be subject to the same regulatory regime. Thus, if now the costs of regulation or of collective-bargaining are increased nationally, they can no longer be passed on to consumers. Instead, imports will increase, exports decrease, profits will fall, investment decline, and firms will go bankrupt or move production to more benign locations⁴.

Thus, when boundary control declines, the capacity of the state and the unions to shape the conditions under which capitalist economies must operate

- 3 Conversely, national monetary policy does have the power to attract capital, by setting national interest rates above the international level. But in doing so, it will raise the exchange rate, which decreases the international competitiveness of the national economy.
- 4 In theory, they could still be passed on to consumers through a devaluation of the national currency. However, regulations and wage settlements tend to affect specific branches of industry, rather than the economy as a whole. The loss of competitiveness may thus not be general enough to be fully compensated (from the point of view of the affected industry) by adjustments of the exchange rate. Moreover, under the conditions of global currency speculation, export competitiveness is no longer the most important factor determining exchange rates. In addition, an independent central bank whose primary goal is price stability, is perfectly capable of stabilizing the exchange rate at a higher level than would be justified by the international competitiveness of the national economy.

is also diminished. Instead, countries are forced into a competition for locational advantage which has all the characteristics of a Prisoner's Dilemma game (Sinn 1994). The paradigmatic example of this form of "regulatory competition" was provided, during the first third of this century, by the inability of "progressive" states in the U.S. to regulate the employment of children in industry. Under the "negative commerce clause" decisions of the Supreme Court, they were not allowed to prohibit or tax the import of goods produced by child labor in neighboring states. Hence locational competition in the integrated American market prevented all states from enacting regulations that would affect only enterprises within their own state (Graebner 1977). In the same way, the increasing transnational integration of capital and product markets, and especially the completion of the European internal market, reduces the freedom of national governments and unions to raise the regulatory and wage costs of national firms above the level prevailing in competing locations. Moreover, and if nothing else changes, the "competition of regulatory systems" that is generally welcomed by neoliberal economists (Streit/Mussler, 1995) and politicians, may well turn into a downward spiral of competitive deregulation in which all competing countries will find themselves reduced to a level of protection that is in fact lower than preferred by any of them.

If nothing else changes - but what might change is, again, illustrated by the child-labor example. In the United States it was ultimately possible - after the "constitutional revolution" of 1937 - to solve the problem through legislation at the federal level. Similarly, in Europe there is a hope, at least among unions and the political parties close to them, that what is lost in national regulatory capacity might be regained through social regulation at the European level. Against these hopes, however, stands the institutional asymmetry of negative and positive integration, which was mentioned in the introduction.

In the abstract, the desirability of negative integration, or liberalization, is not seriously challenged in the member states of the Union. The basic commitment to create a "Common Market" was certainly shared by the governments that were parties to the Treaties and by the national parliaments that ratified these agreements. It found its legal expression in the "primary law" of Treaty provisions requiring the elimination of tariff and non-tariff barriers to trade and the establishment of a system of undistorted competition. What may not have been clearly envisaged in the very beginning were the doctrines of the direct effect and supremacy of European law that were early on established through decisions of the European Court of Justice. Why national governments should have acquiesced in these decisions has become an interesting test case for competing approaches to integration theory⁵. In the present context, how-

5 Garrett (1992; 1995) interprets the case law of the European Court of Justice in an "intergovernmentalist" frame as the focal point of a latent consensus among governments, whereas Burley and Mattli (1993) point to the existence of serious conflicts of interest. In their ("neofunctionalist") interpretation the emphasis is on the relative autonomy of the

ever, the explanation is less interesting than the effect of their acquiescence. Once the direct effect and supremacy of European law was accepted, the Commission and the Court of Justice had the opportunity to continuously expand the scope of negative integration without involving the Council of Ministers⁶. At the same time, under the Luxembourg Compromise of 1966, measures of positive integration could be blocked in the Council by the veto of a single member government.

The political-economic significance of this institutional asymmetry becomes clear when it is compared to the situation under national constitutions. Even in the Federal Republic of Germany, where neoliberal theory has gained the greatest influence on the constitutional discourse, the neoliberal concept of a "social market economy" does not imply the singleminded perfection of a competitive order, but has been defined, by its original promotor, as the combination of the "principle of market freedom with that of social compensation" (Müller-Arnack 1956: 243). Moreover, the German Constitutional Court has consistently refused to grant constitutional status to any economic doctrine, neoliberal or otherwise, insisting instead on the "neutrality of the Basic Law in matters of economic policy". Thus, economic freedom is protected against state intervention only within the general framework of human and civil rights, and the goals of competition policy have no higher constitutional status than all other legitimate ends of public policy. Accordingly, market-creating and market-correcting measures are equally legitimate in principle, and - witness the uneven history of cartel legislation and practice - both have to cope with the same difficulties of finding political support, in a highly pluralistic political system. This is also true in other member states of the European Community where, generally speaking, public policy is even less constrained by doctrines of the "economic constitution" type.

It does not follow from the text of the Treaties of Rome or from their genesis that the Community was meant to abolish this constitutional parity between

legal system and its effectiveness as a "mask and shield" against direct political intervention. See also Weiler (1993; 1994) and Mattli/ Slaughter (1995). What Garrett seems to ignore, within his own frame of reference, is the importance of institutional decision rules: The Court (and the Commission, for that matter) is effectively able to impose outcomes that would not find a qualified majority in the Council of Ministers - but which cannot be corrected by the Council as long as the opposing governments are not themselves able to mobilize a qualified counter-majority (or, when the Court's decision involves an interpretation of the Treaty, unanimous action) in the Council.

⁶ Negative integration was and is pursued by the Commission primarily through "decisions" and "directives" under Arts. 89 and 90 of the Treaty and through action against national infringements of Treaty obligations under Art. 169. Of at least the same practical importance is the direct application of European law in ordinary legal disputes before national courts and the possibility, under Art. 177, of preliminary rulings of the Court of Justice at the request of any (even inferior) national court. Again, the Council of Ministers is not involved, and national governments will typically appear before the Court only in the role of defendants.

the protection of economic freedom and market-correcting intervention (VerLoren van Themaat 1987; Joerges 1991; 1994a; v.d. Groeben 1992). Nevertheless, through the supremacy of European law, the four economic freedoms and the injunctions against distortions of competition have in fact gained constitutional force vis-à-vis the member states (Mestmäcker 1994: 270) while the corresponding options for social and economic intervention (which at the national level would have competed on an equal footing) are impeded by the high level of intergovernmental consensus required for positive integration at the European level⁷.

III. Positive Integration: The Limits of Intergovernmentalism

While negative integration was advanced, as it were, behind the back of political processes by the Commission and the Court, measures of positive integration require explicit political legitimation. As long as the Luxembourg Compromise was still applied, indirect democratic legitimacy could be derived from the necessary agreement of all national governments in the Council of Ministers. The price of unanimity was, of course, an extremely cumbersome decision process. The Single European Act of 1986 was supposed to change this by returning, for harmonization decisions "which have as their object the establishment and functioning of the internal market" (Art. 100A), to the rule of qualified-majority voting in the Council. As a consequence, the decision process has in fact been accelerated, since it is now no longer necessary to bargain for every last vote (Dehousse/Weiler 1990). However, voting strengths and voting rules in the Council are adjusted in such a way that groups of countries united by common interests can rarely be outvoted. In any case, the veto remains available as a last resort even to individual countries, and the unanimity rule still continues to apply to a wide range of Council decisions. Thus, the need for consensus remains very high for measures of positive integration.

Nevertheless, the Community is actively harmonizing national regulations in such areas as health and industrial safety, environmental risks, and consumer

⁷ According to neoliberal theorists, the Community was meant to do no more than to establish and safeguard the postulates of economic freedom and undistorted competition in the European market. Hence the expansion of the European mandate, brought about by the Maastricht Treaty, in the fields of environmental protection, industrial policy or social cohesion, is viewed most critically by authors of this school (Mestmäcker 1992; Behrens 1994). In order to minimize potential damage, it is now also postulated that "the rights of individuals, granted by the Treaty of the European Communities, to participate in commerce across national borders [must] not be encroached upon by measures in the service of the newly established competencies" (Mestmäcker 1994: 286). If this were accepted, the constraints on positive integration would not only be political, but constitutional as well.

protection (Joerges 1994b; Majone 1993), and it had in fact begun to do so long before the Single European Act (Rehbinder/Stewart 1984). It is also reported that these regulations are indeed defining high levels of protection in many areas (Eichener 1993; Voelzkow 1993; H eritier et al. 1994). How can these findings be reconciled with my claim that positive integration is impeded by the high consensus requirements in the Council of Ministers?

In order to resolve this apparent puzzle, it is necessary to examine the underlying constellation of interests among governments represented in the Council of Ministers⁸. Unanimity or qualified majority voting rules institutionalize veto positions - and it is analytically true that - *ceteris paribus* - the existence of multiple veto positions reduces the capacity for political action (Tsebelis 1995). But whether this will in fact result in blockages depends on the actual constellations of interests among the participants. If these are harmonious ("pure coordination games") or at least partly overlapping ("mixed-motive games"), unanimous agreement is possible in principle, and effective solutions can be reached in spite of high consensus requirements. Blockages are only to be expected in constellations of conflicting interests - and even then, agreement may be achieved if the losers can be compensated through side payments or package deals (Scharpf 1992b). Thus, if positive integration in Europe should run into insurmountable barriers, the likely explanation will be conflicts of interests among member states that are too intense to be settled within the institutional framework of the European Union.

Such conflicts do in fact exist, but they are not everywhere, and there is no reason to think that they are always virulent in areas that substantively and procedurally would be defined as positive integration. In order to show this, I will concentrate on the regulative policies of the Community (thus neglecting the fields of foreign policy and security policy, justice and home affairs, common agricultural policy, technology and industrial policy or the social funds). Disregarding for the moment ideological differences, one may generally assume that rationally self-interested national governments will consider three criteria in evaluating proposed regulations at the European level: (1) the extent to which the mode of regulation agrees with, or departs from, established administrative routines in their own country; (2) the likely impact on

⁸ I will limit myself here to the simplest form of "intergovernmental" explanation. It is of course true, as has been pointed out by several critics, that actual interaction patterns are much more complex. In addition to national governments (or the ministries represented in specialized Councils) they include at least the "supranational" Commission and "subnational" interest organizations and firms as players in connected games. I also do not rule out the possibility that, in order to explain specific decisions, two-level games and perhaps much more complex models must in fact be employed. Pragmatically, however, it still makes sense to first exhaust the explanatory power of simple, and hence transparent, models - and to add further complications only when necessary. And at any rate, the agreement of the national governments in the Council of Ministers has remained the critical bottleneck in EC decision processes.

the competitiveness of national industries and on employment in the national economy, and - where these are politically activated - (3) specific demands and apprehensions of their national electorates.

The exceptional importance of the expected costs of administrative and procedural adjustment in countries that are committed to active regulation, has been identified in studies by Adrienne Héritier and her collaborators (Héritier et al. 1994). It explains conflicts even between countries that have a common interest in high levels of regulatory protection. However, if agreement is reached at all, it is unlikely to reduce existing levels of protection⁹. In the following analysis, I will therefore concentrate on conflicts over economic and political interests¹⁰.

There, the boundary separating consensual and conflict-prone constellations can be roughly equated with the conventional distinction between product-related and process-related regulations (Rehbinder/Stewart 1984, 10). In the case of product-related regulations, the continuation of different national quality and safety requirements would perpetuate the very fragmentation of European markets which the Treaties of Rome and the Single European Act were designed to overcome. Since all countries agreed to the creation of the single market, it can also be assumed that the common economic interest in unified European standards outweighs divergent interests. Thus, while countries might differ in their substantive and procedural preferences, agreement on common standards is in the end likely to be reached. That is not true for process-related environmental and safety regulations¹¹, and it is even less true for social regulations of the processes of production (Leibfried/Pierson 1992;

⁹ Héritier interprets these conflicts as a "regulatory competition", where certain "high-regulation countries" attempt to influence the mode of European regulations in order to reduce their own adjustment costs. In the present context it is useful to point out that this is not the (Prisoner's-Dilemma-like) "competition among regulatory systems" whose most likely outcome is competitive deregulation. In the processes studied by Héritier, all member states would prefer agreement on European regulations at high levels of environmental protection, but they differ about the style of regulation that the Community should adopt. Thus, their competition resembles the "Battle of the Sexes" game discussed below.

¹⁰ More differentiated analyses are possible, and may be indispensable in the study of specific cases. In the area of environmental policy, for instance, governments of economically highly developed and ecologically highly impacted countries must respond to the cross pressures of employment interests in the industrial sector and of environmentally sensitized voters. In less developed countries, by contrast, employment interests may be reinforced by the resistance of consumers to price increases caused by stringent environmental regulations. In either case, of course, government responses should also depend on the relative importance of the affected industries in the country in question.

¹¹ Streeck (1993: 10) is correct in pointing out that process-related environmental and safety regulations may create obstacles to trade in the market for machine tools and production plants. For that reason, he includes these in his definition of "market making", as distinguished from "market correcting", regulations.

Lange 1992). Since they increase the cost of production, national regulation is rendered increasingly difficult under the dictates of international competition. So it is here that "social-democratic" aspirations for re-regulation at the European level would seem to be most pertinent. But it is also here that economic conflicts of interest among member states must be most acute. In order to justify this proposition, a somewhat more precise analysis of interest constellations seems useful.

In the case of product-related regulations, the interest constellation is shaped by the institutional framework: Under Art. 30 of the Treaty, "quantitative restrictions on imports and all measures having equivalent effect" are prohibited between member states. Under Art. 36, however, such measures are nevertheless allowed if they are "justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants..". In other words, if national regulations should in fact serve one of the purposes specified in Art. 36, the default outcome in the absence of a common European regime would result in the continuation of fragmented European markets. Assuming that this is a prospect which all countries will want to avoid, they will still differ with regard to the aspiration level of common European regulations. Rich countries will generally prefer higher levels of consumer and environmental protection than poor countries would like to impose on their own consumers. Thus, the resulting constellation of interests is likely to resemble the "Battle of the Sexes" game (Figure 1) - a game in which negotiated agreement is generally difficult, but not impossible to achieve¹².

Moreover, even when European regulations have been harmonized, Art. 100A (4) gives countries with a preference for high levels of protection with a chance to introduce national regulations applying even more stringent standards. This changes the default outcome in favor of high-regulation countries and increases their bargaining power in negotiations about the common standard. Thus it is indeed plausible that, by and large, the harmonization of product-related regulations should in fact have achieved the "high level of protection" envisaged for "health, safety, environmental protection and consumer protection" in Art. 100A (3) (Eichener 1993).

For process-oriented regulations, however, the institutional framework and the interest constellations are very different. Such regulations do not affect the useability, the safety or quality of products so produced. Steel from furnaces with high sulphur dioxide emissions is indistinguishable from steel produced with the most expensive emission controls - and the same is true for automobiles produced by workers with or without paid sick leave in firms with or

¹² Moreover, product-related standardization profits from procedural innovations which minimize the need for consensus in the Council of Ministers by restricting its decisions to the definition of safety principles - whose detailed specification is then left to "corporatist" committees representing the affected industries and national standardization organizations (Voelzkow 1993; Eichener 1993; Scharpf 1994).

		Rich Countries	
		High	Low
Poor Countries	High	2 3	1 NA
	Low	1 NA	2 3

Figure 1: Preference for high or low European-wide standards in product-related regulations. In case of non-agreement (NA), no common standard is adopted.

without codetermination. As a consequence, there is no way in which Art. 36, or any of the other escape clauses contained in the Treaties, could justify excluding, or taxing, or in other ways discriminating against, products produced under conditions differing from those prevailing in the importing state.

Just as in the American child-labor example, the obvious implication is that in the absence of common European regulation, all member states would find themselves in a Prisoner's-Dilemma constellation, in which all would be tempted to reduce process-related regulations, and to cut back on the welfare state, in order to improve their competitive position. By itself, of course, that would facilitate, rather than impede, the adoption of common European standards. The Prisoner's Dilemma loses its pernicious character if binding agreements are possible, and since this is assured in the European Community, European re-regulation at the level desired by member states should be entirely possible. Yet it is here that the difficulties begin.

There are, first, the differences among national styles of regulation that Adrienne Héritier (1993; 1994) discovered in the field of air quality regulations. As was suggested above, this would constitute a Battle-of-the-Sexes game superimposed on the Prisoner's Dilemma¹³ which, by itself, would not rule out agreement. Greater difficulties arise from manifest ideological differences. Some governments may not share "social democratic" or "green" preferences for high levels of regulation, and may actually welcome external competitive pressures to achieve deregulation which they could not otherwise push through at home. But since these difficulties may change from one election to the next, they will not be further investigated here. What is unlikely to change from one

¹³ Heckathorn and Maser (1987) have labelled this constellation, in which a "cooperative" solution to the Prisoner's Dilemma requires agreement on one several options that differ in their distributive characteristics, a "Divided Prisoner's Dilemma".

election to another are conflicts of interest arising from different levels of economic development¹⁴.

After its Southern expansion, the European Community now includes member states with some of the most efficient economies in the world alongside others that have barely risen above the level of threshold economies. This contrast manifests itself in large differences in (average)¹⁵ factor productivity. Thus, if the economically less developed countries are to remain competitive in the European internal market, their factor costs - in particular their wage costs, non-wage labor costs, and environmental costs - have to be correspondingly lower as well. And in fact, industrial labor costs in Portugal and Greece are, respectively, one sixth and one fourth of those in Germany¹⁶, and differences in the levels of social-security systems (Sieber 1993; Ganslandt 1993) and in environmental costs (Fröhlich 1992) are of the same magnitude.

Now, if these costs were raised to the level of the most productive countries, by harmonizing social-welfare and environmental regulations, the international competitiveness of the economies with lower productivity would be destroyed. If exchange rates were allowed to fall accordingly, the result would be higher domestic prices and hence, impoverished consumers. If exchange rates were maintained (e.g. in a monetary union), the result would be deindustrialization and massive job losses - just as they occurred in Eastern Germany when the relatively backward GDR economy was subjected to the full range of West German regulations under a single currency. The more enterprises are subject to international price competition¹⁷, the less democratically accountable politicians in the economically less developed countries could agree to cost-increasing harmonization initiatives¹⁸. And this is even more true since - in contrast to the relation between East and West Germany - the rich EC countries would certainly not be willing (or even able) to compensate the victims of the industrial catastrophe through massive transfer payments.

- 14 In their discussion of environmental policy, Reh binder and Stewart (1984: 9) focus instead on the distinction between "polluter states" and "environmental states". This appears to be less useful as an explanation of voting behavior in Brussels, since highly developed countries produce more pollution and also have an interest in more stringent, European-wide, environmental regulations.
- 15 Naturally, Portugal and Greece (just like eastern Germany - Hank 1994) also have islands of above-average productivity, especially in new plants of multinational corporations.
- 16 According to surveys conducted by the Swedish employers' association (SAF), overall costs of a man-hour in industry ranged in 1993 between 33 Swedish krona in Portugal, 56 krona in Greece, and 204 krona in Germany (Kosonen 1994).
- 17 Of course, the intensity of price competition varies between sectors. For example, in agriculture, "Southern products" hardly compete with "Northern products".
- 18 Thus, it is not only the opposition of enterprises that stands in the way of a European social policy (Streeck 1993). Governments in economically weaker state: must, on their own account, anticipate and try to avoid the exit option of capital.

Nor would agreement be easier if the costs of social or environmental regulations were not imposed on enterprises, but financed through higher income or consumption taxes. As long as average incomes in the poorest EC country amount to less than one fifth of average incomes in the rich countries, the less-developed EC countries must defend themselves against the European harmonization of environmental and welfare regulations at levels of protection which may perhaps reflect the aspirations and the willingness to pay of citizens in the rich member states, but which are beyond the means of economically less developed countries. And unlike East Germany in the process of German unification, these countries are fully aware of their own best interests, and the constitution of the European Union provides them with an effective veto. The resulting interest constellation is represented as a game matrix in Figure 2.

		Rich Countries	
		High	Low
Poor Countries	High	(1) 3	(2) 2
	Low	(4) 2	(3) 1
		1	3 NA
		3 NA	2

Figure 2: Preference for high and low European-wide standards in process-related regulations. In case of non-agreement (NA), no common standard is adopted.

As an illustration, take the case of air pollution control applied to industrial emissions. Highly industrialized and highly polluted rich countries are likely to have a clear preference for European-wide standards at high levels of protection (cell 1), which would also protect their own industries against "ecological dumping", and they would least like to have have common (and binding) standards at low levels of protection (cell 3). For the poor countries, by contrast, high standards (cell 1) would amount to the destruction of less-productive branches of industry. But even common rules imposing uniformly low standards (cell 3) would be unattractive, since the less-productive, indigenous enterprises would then be exposed to the sharper competition of deregulated competitors from countries with high productivity. So, for them, the best outcome would be non-agreement (cells 2 and 4) which would also be the second-best outcome for the rich countries. As a consequence, the status quo is likely to continue¹⁹.

19 If the affected branches of industry do not play a major role in the less developed member states, the damage done by European regulations at a high level of protection may be small enough to be compensated by side payments from the structural and cohesion

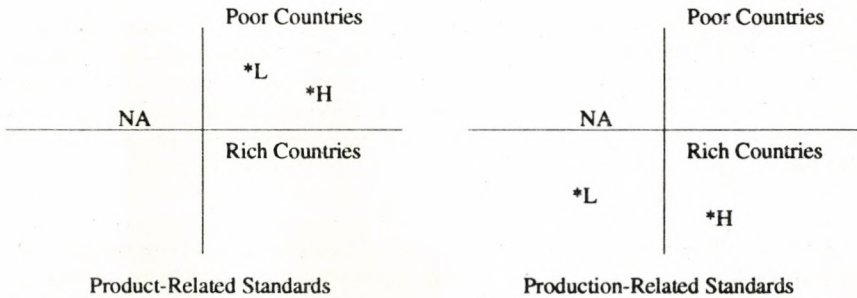


Figure 3: Negotiated agreement on high (H) and low (L) European standards as compared to non-agreement (NA) in the case of product-related and process-related standards.

The differences between negotiations over product and process-related regulations may become even clearer if the options are represented in the form of two-dimensional negotiation diagrams in which the horizontal and vertical dimensions represent utilities associated with particular outcomes for rich and poor countries, respectively (Figure 3). Points H and L represent the location of binding agreements on high standards and low standards, respectively. However, since the origin (NA) is chosen to represent the best outcome that each country could achieve if no agreement on European standards is reached (so that national standards will continue to apply) the negotiation space is effectively limited to the “Northeastern” quadrant above and to the right of the origin.

In the case of product-related regulations, rich countries would prefer agreement on high standards (H), while poor countries would prefer agreement on low standards (L). But both groups of countries would prefer either solution to the outcome associated with non-agreement (NA). Hence both solutions are located within the negotiation space, and agreement on one of them, or on a compromise rule located between H and L, ought to be possible in principle. Of course, under the unanimity rule, bargaining over relative advantage might still drag on, and under unfavorable conditions, negotiations might even fail. Thus it appears completely rational that governments, in the Single European Act, finally agreed to move toward qualified-majority voting specifically for the harmonization of product-related regulations (Art. 100A). It permits them to avoid deadlocks and speed up negotiations in constellations where they generally prefer agreement to disagreement.

The situation is different in the case of process-related regulations. Here there is no solution in the upper-right-hand quadrant that would be preferred

funds. It is also sometimes suggested that the agreement of some member states to relatively demanding environmental regulations may be a reflection on relatively less demanding practices of implementation.

to the status quo by both, rich and poor countries. From the point of view of the poor countries, even the adoption of common European standards at a low level of protection would be worse than the status quo. The rich countries, on the other hand, would prefer to improve their situation by introducing European-wide high-level standards, but this solution could not be imposed against the resistance of poor countries²⁰.

To summarize, positive integration at the European level has achieved remarkable progress in the harmonization of product-related regulations, but the harmonization of process-related environmental and welfare regulations is proving much more difficult, while negative integration is effectively restricting national capacities for dealing with the problems generated by the integration of markets for capital, goods and services. If that state of affairs is considered unsatisfactory, one may logically seek for solutions in two directions - either by increasing the capacity for problem-solving at the European level, or by protecting national capacities for effective action even under the conditions of transnationally integrated markets.

IV. Solutions I: Increasing European Problem Solving Capacity?

In the face of pervasive conflict of interest, problem solving on the European level might be facilitated either through institutional reforms that would increase the capacity for conflict resolution, or through the search for substantive or procedural strategies that are able to reduce conflict to more manageable levels.

1. Majoritarian Solutions?

Obviously, the capacity for conflict resolution would be most directly strengthened if the Union would continue the move toward majority voting in the Council of Ministers that began with the Single European Act, and gained more ground in the Maastricht Treaty. If decisions generally could be reached by simple majority, the high-productivity countries could, at least for the time being and provided that they are able to agree among themselves, impose high standards on the rest of the Community. But, of course, constitutional changes in the European Union continue to depend on unanimous agreement, and the fact that the Northern enlargement of the Union nearly foundered on the voting issue shows that the presumptive losers are unlikely to agree to a regime in

²⁰ Even though the Maastricht Treaty did generally allow for qualified-majority voting on environmental measures (Art. 130S), any five of the six countries with the lowest wage and non-wage labor costs in the Union (Portugal, Greece, Spain, Ireland, Britain and Italy) can easily muster a blocking minority against regulations that would damage their competitive position.

which they might be consistently outvoted. In this regard, the “joint decision trap” (Scharpf 1988) is still in good repair.

Moreover, if it were possible to move further toward majority voting in the Council of Ministers, the debate about the “democratic deficit” in the European Union would resume with a vengeance. As long as the democratic legitimacy of European governance must rest primarily on the agreement of democratically accountable national governments, the citizens of countries whose governments are outvoted have no reason to consider such decisions as having democratic legitimation²¹. In fact, even the cautious expansions of qualified-majority voting in the Single Act and in the Maastricht Treaty have triggered judicial responses and public debates in the member states which are so critical of the legitimacy of majority decisions in the Council that any further progress will need to be based on more solid foundations of legitimation (v.d. Groeben 1992; Weidenfeld 1995)²².

Many of the critics still assume that the most appropriate solution was defined by the Spinelli draft constitution which would have transformed the European Community into a federal state with a bicameral legislature, consisting of the directly elected European Parliament as the first chamber with full legislative and budgetary powers, and the Council as a second chamber representing member-state interests in the fashion of the German *Bundesrat*. The Commission would then take the place of a European government, elected by and accountable to the European Parliament (Williams 1991; Featherstone 1994). What stands in the way is, of course, the institutional egotism of member-state governments that are unwilling to relinquish their own control over European policy making. But that is not all. Proposals of this type also rest on weak foundations in democratic theory.

Democratic legitimacy is, after all, not merely a question of the formal competencies of a parliament. Representation and majority rule will assure legitimacy only in the context of (a) the preexisting collective identity of a body politic which may justify the imposition of sacrifices on some members

21 The theoretical background of this proposition can only be suggested here (Scharpf 1970). A need for legitimation arises when decisions override the preferences of some affected parties. Until recently, the European Community was able to rely primarily upon an “output-oriented” form of legitimacy, for which the maximization of common welfare and the fair allocation of costs and benefits are crucial criteria. But as European interventions have become more frequent, more important, and their allocative effects more visible, “input-oriented” legitimacy (involving democratic discourse and the democratic accountability of decision makers) have gained in salience.

22 This is not meant to deny the possibility of non-majoritarian forms of legitimation (Majone 1994a; 1994b; Dehousse 1995). But the respect for expertise, impartiality and procedural fairness which may legitimate the decisions of courts, central banks, or American-style independent regulatory commissions, is unlikely to do much for the legitimation of the results of political horse-trading in the Council of Ministers.

of the community in the interest of the whole; (b) the possibility²³ of public discourse over which sacrifices are in fact to be imposed for which purposes and on whom; and (c) the political accountability of leaders who are visible to the public and are able to exercise effective power.

In the history of democratic governance, these preconditions have so far not yet been satisfied anywhere above the level of the nation-state (Calhoun 1993; Dahl 1994). They are not now satisfied in the European Union, and it is certainly not clear that they could be created in the foreseeable future (Grimm 1992; Kielmansegg 1992; Scharpf 1992a, 1993). As of now, in any case, the political-cultural identity of the European Union is still very weak (Wilson/Smith 1993); the lack of a common language is a major obstacle to the emergence of a European-wide public discourse (Gerhards 1993); and as a consequence, we have no European-wide media, no European-wide political parties, and no political leaders with European-wide visibility and accountability. These conditions are not easily changed by constitutional reforms²⁴, and as long as they prevail, majority votes in the European Parliament will not do much for the acceptance of decisions in countries or groups whose interests are being sacrificed.

For the time being, at any rate, it is then unlikely that institutional reforms could greatly increase the capacity for conflict resolution on the European level. Thus Weiler's (1981) diagnosis, cited at the beginning of this paper, will continue to hold: In contrast to the legal processes defining and enforcing the supra-national law of negative integration, the political processes required for positive integration will retain their intergovernmental character and are easily blocked when national interests diverge. If that is so, however, it seems worthwhile to also explore the possibility that conflict-minimizing European

23 It is often argued that the European Community should not be held to ideal, but unrealistic standards of democratic practice which are frequently violated in all member states. In my view, this misses the point. Under modern conditions, democracy can only be defined as a potential or, as it were, a fleet-in-being. It is neither possible nor necessary that every matter be dealt with in the full light of public attention, as long as office holders must reckon with the possibility that *any* case may become politicized. When that is assured, the "law of anticipated reactions" must do the rest.

24 In my view, further increases in the legislative competence of the European Parliament are not the most promising short-term strategy, since they would also render European decision processes even more cumbersome than they are now. Instead, if the President of the Commission were elected by, and fully accountable to, the European Parliament, this would help to focus media attention on a highly visible position of political leadership; it would require parties in the EP to present candidates with a European-wide appeal; and it might, in due course, lead to the formation of European-wide political parties (Weidenfeld 1994). As Dehousse (1995) points out, however, the introduction of party-political orientations in the Commission might render its relations to national governments in the Council more difficult than they are now - an argument that finds ample support in the practice of German Federalism.

strategies might nevertheless be able to deal effectively with problems that can no longer be handled at the national level.

2. Conflict-avoiding Solutions?

There is in fact a whole range of such strategies (Scharpf 1994). One has already been mentioned above. In the harmonization of product-related standards, agreement is facilitated by restricting Council involvement to the formulation of "principles", and by leaving details to be worked out in corporatist standardization bodies. Moreover, in process-related environmental regulations, Art. 130T now generally allows any member state to maintain or introduce more stringent protective measures, provided that they "must be compatible with this Treaty" (i.e. with negative integration). Thus, one way to overcome the blockage described above would be to agree on minimum levels of protection that are just barely acceptable to the poor member states, while the economically more advanced countries remain free to maintain the higher standards which they consider necessary. But how could this be considered an effective solution? For countries that had very low standards to begin with, it is true, the common standard might well require substantial improvements. But high-standard countries would still find themselves in the Prisoner's-Dilemma-like "competition among regulatory systems" that had prevented the American states during the first third of this century from adopting child-labor regulations.

For this problem, a partial solution was provided by the Commission's switch from German-Type emissions standards to the air-quality standards favored by the British government (Héritier et al. 1994). Since, on the whole (but in metropolises like Athens), air pollution is more of a problem in the highly industrialized regions of the Community, the seemingly uniform standard will generally require the economically more advanced countries to adopt more stringent anti-pollution measures than are needed in the less developed countries. Thus, the differential impact of air-quality regulation will not only facilitate the agreement of poor countries to higher standards, but it will also protect high-regulation countries against the temptations of competitive deregulation.

But, of course, the lucky accident by which the intensity of the pollution problem varies directly with the ability and willingness of countries to pay for solutions, cannot always be relied upon. It would not have worked, for instance, in the paradigmatic case of child-labor regulations. Nevertheless, there may be a generally useful lesson to be learned from air-quality regulations: It is not necessarily true that European harmonization, in order to be useful, must have the same impact on all member states or regions of the community.

3. Regulation at Two Levels?

More specifically, I am suggesting that the obstacles to agreement on process-related regulations might be considerably reduced by a variant of the idea of a "Europe with variable geometry" which, as far as I know, is not being considered in present discussions of institutional reform of the Community²⁵. This suggestion is based on the assumption that the Prisoner's Dilemma game that European countries are forced to play against each other, in the presence of negative integration and in the absence of European-wide harmonization, is not played with equal intensity among all member states. The competition among regulatory systems is likely to be most acute between countries that are in direct economic competition because they produce the same type of goods at similar levels of productivity and of production costs. By contrast, countries producing at very different levels of productivity and production costs are generally not directly competing against each other in the same markets. If this is true, the failure of adopting a single European-wide standard would imply that at least two separate Prisoner's Dilemma games are being played, one among the economically most efficient countries that are able to compete on productivity, and the other one among the less efficient economies that must compete on factor costs.

On this analysis, the solution seems obvious: In order to stop the pressure toward competitive deregulation²⁶, there is clearly a need for the harmonization of process-related regulations at the European level - but there is no need for a single, uniform standard. Instead, what would be needed is an explicit agreement on two standards offering different levels of protection at different levels of cost. The rich countries could then commit themselves to the high-standard regulations that are in keeping with their own levels of environmental and social aspirations, while the less developed countries could establish common standards at a lower level that would still protect them against the dangers of ruinous competition among themselves. In the course of their economic development, the lower standard could of course be raised, step by step, and brought into line with the higher one.

25 Overviews of earlier discussions and actual practices are provided by Nicoll (1984) and Langeheine and Weinstock (1984). There have also been proposals for a "Europe of relativities" which would generally define common European standards in terms of criteria that are sensitive to differences in the level of economic development. For example, the revenue to be raised by an EC-wide environmental tax might be defined as a percentage of gdp in order to avoid disproportional burdens on the less developed member states (v. Weizsäcker 1989). Similar models are also being discussed in reference to social policy.

26 Remarkably, negative integration in the European Community includes elaborate injunctions against distortions of competition created by subsidies, preferential public procurement and other forms of "affirmative action" favoring national producers - but apparently none against the practices of competitive deregulation.

Compared to the difficulties of reaching agreement between rich and poor countries on European-wide uniform standards, negotiations on double standards should be much easier (Figure 4). Moreover, in contrast to other proposals for a two-speed Europe, the club of high-regulation countries would have no interest at all in excluding applicants who think that their country is able to conform to the more demanding standards. The most difficult choice would have to be faced by countries "in the middle", like Britain or Italy, who would need to decide whether they dare to compete on productivity or must compete on cost.

		Rich Countries					
		High		Low		Double	
Poor Countries	High	4		2		2	
		1		3	NA	3	NA
	Low	2		1		2	
		3	NA	2		3	NA
	Double	2		2		3	
		3	NA	3	NA	4	

Figure. 4: Process-Related Regulations with the Option of a Double Standard. NA = Outcome in the Case of Non-Agreement

4. But What if Institutions Matter?

So far we have looked only at the negotiations between rich and poor countries, and we have assumed that within each of these groups agreement should be relatively unproblematic - provided that national differences in the styles of regulation are not of very high salience. But what has been said applies fully only to the harmonization of process-related environmental regulations. In the case of industrial-relations and social-welfare regulations, by contrast, even harmonization at two levels would run into enormous difficulties because of the much greater salience of qualitative and institutional differences. Thus, while it may be assumed that all countries would prefer a less polluted environment if they could afford it, that assumption of common aspirations cannot be made in the industrial-relations and welfare fields (Esping-Andersen 1990).

Sweden and Switzerland, for example, are economically among the most highly developed countries in the world, and yet they differ greatly in the

share of gdp which they devote to publicly provided welfare transfers and services. And while Germany and Britain have similar levels of union density, they have different structures of union organization and radically different collective bargaining systems. Even more important is the fact that German industrial relations are embedded in highly developed, and judicially enforced, systems of labor law, collective-bargaining law and co-determination law, while British labor relations have, from the beginning of this century, developed under the maxim of "free collective bargaining" and on the understanding that the law of the state should not interfere with the interactions between capital and labor. Thus, it may be true that, quite apart from any cost considerations or possible side payments, any kind of legal regulation of industrial relations at the European level would be unacceptable not only to employers but also to unions in Britain. By contrast, unions in Germany, or in Austria and France for that matter, have come to rely precisely on the legal effectiveness and judicial enforceability of state regulations (Crouch 1993). And, of course, these institutional differences are defended by politically powerful organized interests which no government could lightly disregard.

In the fields of social welfare and industrial relations, therefore, the constellation of interests even among countries at high levels of economic development cannot be interpreted as the relatively benign Battle-of-the-Sexes game which we postulated in the field of environmental regulations. Instead, if we assume that the high-regulation group of countries includes two qualitatively different types of institutional arrangements, we would have a game constellation in which both sides might prefer non-agreement over agreeing to a harmonized system of different characteristics (Figure 5).

		Type 1 Countries	
		1	2
Type 2 Countries	1	3	2
	2	1	2 NA
		2	1
		2 NA	3

Figure 5: Harmonization of Welfare and Industrial-Relations Regulations among Countries of a Similar Level of Economic Development, but with Different Types of Institutions. NA = Non-Agreement.

Potentially quite similar constellations of interest are likely to exist in all areas where institutional differences between member states are of high politi-

cal salience - either because powerful interest groups will defend the institutional status quo, or because the traditional institutional structure has become an element of social and political identities. This is most obviously true of political and administrative institutions themselves, but it is also true of the institutional structures in a great many other sectors which, in all countries, have been protected, in one form or another, against the operation of market forces by the territorial state. Traditionally, at least in Western Europe, these "sectors close to the state" (Mayntz/Scharpf 1995) would have included education and basic research, health care, radio and television, telecommunications, transportation, energy and water supply, waste disposal, financial services, agriculture, and several others.

This is a heterogeneous set, in which the justifications for state involvement vary as widely as the modalities - from the direct provision of services and infrastructure facilities by tax-financed state agencies through customer-financed public or highly regulated private monopolies, and state-supported forms of professional self-regulation, all the way to the state-subsidized private provision of marketable goods and services. What is common to all of them is some form of insulation against unlimited market competition. And what matters here is that the attenuation of market pressures combined with the variety of possible forms of state intervention have generally facilitated the evolution of remarkably different institutional arrangements governing the provision of identical goods and services in the member states of the European Union (see, e.g. Alber/Bernardi-Schenkluhn 1992).

From the point of view of the European Community, practically all these institutional arrangements could be considered as non-wage barriers and, certainly, as distortions of competition. So the logic of negative integration implies that they should be removed - as is currently happening in telecommunications, in air transportation and in financial services. On the other hand, not all of these restrictive and protective institutional arrangements may be without valid justification, so that - under the logic of Arts. 36 and 100A, or of Art. 76 for that matter, the European harmonization of these sectoral regimes might seem a more appropriate response.

But, then, how could the Council reach agreement on a common European system of financing and delivering health care that would replace the British, Italian and Swedish varieties of national health service systems as well as the French, German and Austrian varieties of systems combining compulsory health insurance and private health care provision with corporatist negotiations between insurance systems and organized providers? Here the obstacles to harmonization would be at least as great as they are in the field of old-age pensions, where the move from the German pay-as-you-go insurance system to a (perhaps more desirable) common system based on the British two-tier model combining tax-financed basic pensions and (voluntary or compulsory) supplementary private insurance is practically impossible, since the now active

generation would be required to pay twice - once for the present generation of pensioners under the old system, and once for their own life insurance under the new system.

A particularly instructive example is provided by the comparison of the telecommunications and energy sectors which appear rather similar in most economic respects (Schmidt 1995). In both sectors, monopolistic structures had prevailed unchallenged until the mid 1980s, and in both the Commission has been working toward liberalization since then. But while in telecommunications the combination of European liberalization, national deregulation and privatization, and cautious re-regulation at the European level, did succeed with remarkable speed (Sauter 1995), the Commission's repeated attempts to liberalize the European electricity market have so far failed in the Council. As Susanne Schmidt has shown in her comparative study, one of the two important factors explaining the different trajectories of liberalization is institutional differences (Schmidt 1995)²⁷. Whereas in telecommunications, institutional structures in all West European countries had, by the 1970s, converged on a single model of public PTT monopolies which were the owners of the physical networks as well as the suppliers of all services and terminal equipment (Schneider 1995), the electricity sector is characterized by considerable institutional heterogeneity. While there are network monopolies everywhere, these may be nationwide, regional or local; they may be owned by the state, or by private investors; they may be restricted to the generation and distribution of electricity, or they may also distribute gas and other forms of energy. Moreover, there are also considerable differences in the regulatory regimes under which these monopolies operate, and in the basic logic of their pricing structures; and there are, of course, also fundamental differences in the way in which the conflict over nuclear energy is handled in each of the member states. As a consequence, liberalization would affect suppliers in different countries in rather different ways, while the call for "harmonization before liberalization" would confront national governments with the even more unpalatable task of challenging vested institutional interests head on.

The short of it is that there are in fact important sectors for which the European-wide harmonization of national regulatory and institutional systems may not be a feasible option. The question there is whether negative integration should nevertheless be allowed to run its course in all sectors in which existing institutional structures can be interpreted as restraints on trade or distortions

27 The other factor Schmidt (1995, 18) identifies are differences in the vulnerability to international competition. In telecommunications, if there were no coordinated liberalization at the European level, the "default condition" which countries would have to face would be a choice between either national liberalization or a loss of business to more efficient foreign competitors who, as a consequence of technological changes, could invade national markets. In electricity, by contrast, the economic viability of national regulations and network monopolies has not been undercut by recent technical developments.

of competition? If so, existing balances of values and interests incorporated in specific national institutions will be upset. In some sectors, these costs have been considered politically acceptable - but there is no reason to assume that this will be the case everywhere²⁸. Where it is not, negative integration will either be forcefully resisted or its consequence may well be social disintegration and political delegitimation of the kind that was caused in East Germany by the destruction of indigenous institutions.

V. Solutions II: Restoring National Boundary Control?

It seems useful, therefore, to also think about ways in which limits can be set to the unreflected and quasi-automatic advance of negative integration, motivated purely by considerations of economic efficiency, in the European Community. That is, of course, not much of a problem in areas where liberalization must in fact be achieved through decisions of the Council of Ministers. Governments that are seriously concerned about maintaining existing institutional structures are still quite capable of blocking Commission initiatives - as was just demonstrated again in the failure of attempts to liberalize the European markets for electricity. Governments have no formal power, however, to prevent the Commission from proceeding against nationally privileged "undertakings" by way of directives under Art. 90 (3) of the Treaty²⁹, and they have even less control over the Commission's use of its power to issue "decisions" against individual governments under the same article, or to initiate infringement procedures before the Court under Art. 169³⁰. Moreover, given the direct effect of primary European law, any individual or corporation could challenge existing national institutional arrangements before a national court, which could then obtain a preliminary ruling from the European Court of Justice under Art. 177.

Thus, political controls will not generally work - or more precisely, they work in a highly asymmetrical fashion. As long as the Council must proceed through qualified-majority or even unanimous decisions, a small minority will

- 28 In Germany, for instance, this might mean that compulsory user charges supporting public television will be successfully attacked as a subsidy distorting competition by private networks, and that the monopoly of private physicians in ambulatory health care could be invaded by American-style health maintenance organizations. While both changes might be considered highly desirable in some quarters, it is also clear that they would not find the support of democratic majorities at the national level.
- 29 On the other hand, governments which, for domestic reasons, might not wish to agree to a Council directive may actually prefer deregulation by way of Commission directives and decisions.
- 30 In the electricity field, the Commission has just initiated such actions against France, Denmark, Spain, Italy, Ireland, and the Netherlands. Also, the drive towards liberalization in telecommunications was initiated by a successful infringement action against British Telecom in 1985 (Sauter 1995).

be able to block positive action, but very large majorities would have to be mobilized to correct any extension of negative integration through decisions of the Commission³¹ or of the Court of Justice³². The question then is whether it may be possible to use legal instruments to limit the capacity of the Commission and the Court to extend negative integration beyond the limits of what the Council would also find politically acceptable.

In Maastricht, it is true, governments took care to exclude the Court from the areas of "a common foreign policy and security policy" and of "cooperation in the fields of justice and home affairs" (Article L). This is, surely, an indication that the Court's power to convert Treaty obligations into supranational law, and to interpret their meaning beyond the original intent of the contracting parties, has finally become a matter of concern to member states. It is also possible that similar concerns about the Court's role may have contributed to the inclusion of a "subsidiarity clause" in Art. 3B (2) of the EC-Treaty. If they did, however, that purpose is unlikely to be achieved through the clause itself (as distinguished from the change in the political climate which it symbolizes).

By restricting subsidiarity to "areas which do not fall within [the Community's] exclusive competence", negative integration - which, if it is to be practiced at all, must of course be an exclusive European competence - is left untouched - and as I have argued, it is negative integration where Commission and Court are able to exercise their greatest, and for national autonomy most damaging, power. Moreover, even with regard to positive integration the subsidiarity clause is unlikely to have much legal effect (Dehousse 1993). Given the heterogeneity of conditions and capacities among the member states, it is hardly conceivable that a court could strike down any European measure, that was in fact supported by a qualified in the Council of Ministers, by denying that "the objectives of the proposed action cannot be sufficiently achieved by the Member States". Thus, it is probably more realistic to see the clause primarily as a political appeal for self-restraint directed at the Council of Ministers itself³³.

- 31 For instance, when the Commission issued its terminal equipment directive under Art. 90 (3), France was joined by Italy, Belgium, Germany and Greece in initiating an (unsuccessful) Art. 173 action against key provisions of the directive. If the directive had not been issued by the Commission, but had been introduced in the Council under Art. 100A, the objecting group would of course have been strong enough to prevent its adoption (Sauter 1995, 101).
- 32 In fact, as Susanne Schmidt (1995, 25f.) argues, the mere possibility of "uncontrolled" liberalization by the Court may persuade opponent governments agree to "coordinated liberalization" through (less far reaching) Council directives - in the hope that these will be taken into account in the Court's own interpretation of the text of the Treaty.
- 33 This would not be meaningless, since member state bureaucracies may in fact use European directives to circumvent parliamentary controls at home. The same tendency of constituent governments to promote "overintegration" at the central level can also be observed in German federalism (Scharpf 1988).

What might make a legal difference, for negative as well as for positive integration, is indicated by the very decision which advanced negative integration by a giant step. In *Cassis de Dijon* (120/78 ECR, 1979, 649), the Court did not hold, as is sometimes assumed, that the "mutual recognition" of products licensed by other member states was an unconditional obligation of member states. Before Germany was ordered to admit the French liqueur, the Court had examined the claim that the German requirement of a higher alcohol content was justified as a health regulation, and found it totally spurious (Alter/Meunier-Aitsahalia 1994: 538-39). If that had not been so, the import restriction would have been upheld under Art. 36 of the Treaty which permits quantitative restrictions "justified on grounds of public morality, public policy, public security, the protection of health and life of humans, animals or plants...", provided that such measures "do not constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States."

Thus, the Treaty itself recognizes certain national policy goals that are able to override the dictates of market integration. Admittedly, the Commission, and the European Court of Justice even more so, have done their best to assure the priority of negative integration by applying extremely tough tests before finding that a national regulation is neither discriminatory nor a disguised restriction on trade. In fact, the Commission has followed a consistent line, according to which product-related national regulations either will be struck down, under *Cassis*, because they serve no valid purpose, or must be replaced by harmonized European regulations under Art. 100A (Alter/Meunier-Aitsahalia 1994). What matters here, however, is the reverse implication: National regulations restricting imports, that serve one of the valid purposes listed in Art. 36, must be allowed to stand unless, and until, European harmonization is achieved.

For product-related regulations, therefore, negative integration does not take precedence over positive integration, and the competency gap mentioned in the introduction is in fact avoided. However, that is not true of process-related regulations which, since they do not affect the quality or safety of the products themselves, would never justify exclusion under Art. 36. Moreover, such regulations must also not violate the rules of European competition law (Arts. 85ff), they must not insulate public service agencies against competition (Art. 90), and they must not amount to competition-distorting state aid (Art. 92).

What is important here is that these prohibitions apply regardless of whether prior policy harmonization at the European level has been achieved or not. One example is provided by European transport policy which, along with agriculture, was one of the two fields in which the original Treaty had envisaged a fully Europeanized policy regime (Arts. 74 ff). Since, in the face of massive conflicts of interest among the member states, the Council had failed to act for more than 25 years, it was ordered by the Court (in a proceeding initiated by the European Parliament under Art. 175) to establish at least the

conditions of negative integration according to Art. 75 (1) lit. (a) and (b). Moreover, the Commission and the Court have intervened against national regulations (such as the German levy on road haulage) that could be interpreted as a discrimination of non-national carriers (Art. 76). Against the original intent of the contracting parties, therefore, the European transport market is now being actively liberalized even though agreement on a common European regulatory regime is still not in sight.

If this state of affairs is considered unsatisfactory, one may need to go further in the direction indicated by provisions like those contained in Arts. 36, 48 (3), 56 (1), 66 and 100A (4) which allow restraints on the free movement of goods, persons and services if these restraints serve one of the "police-power" purposes of public morality, public policy, public security, public health, etc. In practice, however, none of these exceptions is still of great importance, since the Commission, and even more so the Court, have interpreted them in extremely restrictive fashion - and the same has been true of other provisions, serving similar purposes, such as the partial exemption of infrastructural or revenue producing national undertakings from the competition rules in Art. 90 (2) or the reservation regarding national systems of property ownership in Art. 222. In all these instances, the de-facto priority of negative integration over national policy preferences and institutional traditions has been re-established through judicial interpretation.

It remains to be seen whether the same fate is also waiting for some of the even more explicit reservation clauses introduced by the Maastricht Treaty, as for instance in Art. 126 (1) which permits the Community only a very limited entry into the education field, "while fully respecting the responsibility of the Member States for the content of teaching and the organization of education systems and their cultural and linguistic diversity." By its language at least, the clause will only set limits to the narrowly circumscribed educational competencies of the Community, but would not otherwise offer immunity against charges that national education systems might represent restraints on trade and distortions of competition in the market for educational services.

If national policy preferences and institutional traditions should have a chance to survive, it seems that more powerful legal constraints are needed to stop the imperialism of negative integration. A radical solution would be to abolish the constitutional status of European competition law by taking it out of the Treaty altogether, leaving the determination of its scope to the political processes of "secondary" legislation by Council and Parliament. This would, at the European level, create a constitutional balance among competing policy purposes as it exists in all national policy systems. In addition, it might be explicitly stated that national legislation will remain in force unless, and until, it is shown to be in concrete conflict with a specific provision of European legislation. This is the law as it has stood in the United States since the demise of the "negative commerce clause doctrine" in 1937 (Schwartz 1957;

Rehbinder/Stewart 1984), and this is the de-facto state of European law with regard to product-related regulations in the market for goods. It could and should be extended to the markets for services, and in particular to transportation and financial services.

These would be changes which, unlike the subsidiarity clause, would really make a difference, and the Intergovernmental Conference in preparation for "Maastricht II" would have an opportunity to promote them. In addition, it might be worthwhile to specifically enumerate, in the Treaty itself, policy areas for which member states will retain primary responsibility. The most plausible candidates would be the areas discussed above - namely, education, culture, the media, social welfare, health care, and industrial relations - and, of course, political and administrative organization.

As I have argued elsewhere, this would give the constitution of the Community a bi-polar character, similar to the "Dual Federalism" which the American Supreme Court had read into the U.S. Constitution before 1937, or to the case law of the German constitutional court protecting the "*Kulturhoheit*" of the Laender in the fields of education and the media (Scharpf 1991b; 1994; Weidenfeld 1995). There is, of course, no hope that a clear demarkation line between European and national areas of policy responsibility could be defined. But the explicit dualism would force the Court and the Commission to balance the claims for the economic perfection of market integration against equally legitimate claims for the maintenance of national institutional autonomy and problem-solving capacity in the light of the concrete circumstances of the specific case. Instead of deciding against national regulations whenever the slightest distortion of competition can be identified, the Court would then have to weigh the degree of restriction of competition or mobility on the one hand against the importance of the measure for the realization of legitimate member-state goals on the other. What is required, in other words, is the "management of interdependence" (Dehousse 1993; Joerges 1994a) in ways which should deal, in the "vertical" relationship between national and European competencies, with exactly the same tensions between economic and non-economic purposes which, in the nation-state, are accommodated in the "horizontal" dimension, through interdepartmental conflicts that must be settled in the Cabinet or in Parliament.

But what difference would it make if such constitutional changes could be adopted, and if adopted, if they would have the desired impact on the judicial interpretation of negative integration? The European Community, after all, must remain committed to the creation of a common market, and so it also must retain legal instruments to defend the free access to national markets against the economic protectionism of its member states. Thus, prohibitions against quantitative restrictions on trade and against the discrimination of foreign suppliers would certainly need to remain in place. What could change is the degree of perfectionism with which they are being defined and their, as it

were, "lexicographic" precedence over all competing considerations. Even more important: constitutional changes of the type discussed here would protect, or reestablish, the power of national governments to take certain sectors out of the market altogether, or to organize them in ways that restrict the operation of market forces. If that should imply a loss of economic efficiency, it should not be the business of the Community to prevent member states from paying this price.

VI. Social Regulation in One Country?

But even if the legal straightjacket of negative integration should be loosened, and if some sectors should be allowed to remain under the more intense control of the territorial state, that would not generally reverse the fundamental changes in the political economy of capitalist welfare states that have occurred since the end of the postwar period. The larger part of the national economy is exposed to transnational competition, capital has become globally mobile, and enterprises are able to relocate production throughout Western Europe without risking their access to national markets. And as the mobility of economic factors has increased, the national capacity to reduce the rate of return on capital investments below the international level, either by lowering interest rates or by imposing additional costs on firms, has been irrevocably lost (Sinn 1993). In that sense, there is certainly no path that would lead back to the postwar "golden age" of capitalist welfare states.

From the point of view of political democracy, it would be dangerous to deny the existence of these economic constraints; but it would be equally dangerous to exaggerate their significance. It is true that the capacity for Keynesian macro-economic management is no longer available at the national level, and not yet available supranationally. It is also true that the rate of return from productive investment, which capital owners can claim, has increased considerably. Any attempt, by governments or unions, to reverse these losses by redistributive programs pursued in a national context would be bound to fail.

Beyond that, however, the basic character of the relationship between capitalist economies and democratic states is still the same. As I pointed out above, even in the postwar period, social regulation of the capitalist economy was successful only because costs of regulation that were, in the first round, imposed on firms could, in the second round, be passed on to consumers. As a consequence, returns on investment remained positive, and capitalism remained equally viable in the Swedish welfare state, in the German social market economy or in the American free enterprise system. In other words, the postwar symbiosis of capitalism and democracy could only be successful

because ultimately the costs of the welfare state were borne by workers and consumers, rather than by capital owners.

If this "impossibility theorem of redistribution" is accepted, the loss of national regulatory capacity reduces itself to the relatively technical question of where the costs of (new)³⁴ regulation should be placed in the first round. If they are placed on firms that are exposed to international competition, and if all other conditions remain the same, there will now be a loss of international competitiveness, and a concomitant fall in profits, investment, and employment. But, of course, other conditions need not remain the same. The rise in the costs of regulation could be compensated through wage concessions, through a rise in productivity or, as long as the European Monetary Union does not yet exist, through devaluation. In effect, these compensatory measures would, again, shift the costs on workers and domestic consumers.

However, the same result could be achieved more directly and with much greater certainty, if even in the first round, costs were not imposed on firms at all. If new social regulations, such as the German disability-care insurance, were financed through taxes on incomes and consumption, rather than through payroll taxes, enterprises would stay competitive and investments profitable. One example is provided by Denmark, where 85% of social costs are financed from general tax revenues. Since the international competitiveness of Danish enterprises is not affected, the (very costly) welfare state apparently does not play any role in current discussions about the international competitiveness of the Danish economy (Münster 1993)³⁵. Of course, consumable incomes will be reduced, but this is as it would, and should, be in any case.

I do not wish to claim, however, that all objectives of social regulation in the postwar decades could also be obtained in the future without endangering international competitiveness. Even less would I suggest that the growing tax resistance of voters would be easy to overcome³⁶. Compared to the postwar decades, the range of choices available to democratic political processes at the national level has certainly become more narrow. But it is not as narrow as the economic determinism of many contributions to the current debate would seem to suggest. Moreover, it can be widened to the extent that countries and regions succeed in developing the comparative advantages of their given institutional and industrial structures in order to exploit their own niches in in-

34 Presumably, if an economy has been viable so far, its regulatory costs are reflected in current prices and exchange rates.

35 The major threat to viability of the Danish model, incidentally, comes from European plans to harmonize VAT rates.

36 Here, in my view, is the real reason for the current crisis of European welfare states. Given lower rates of economic growth, rising costs of environmental protection, continued mass unemployment, and a growing retirement population, the willingness of blue and white collar voters to bear an ever rising tax burden has become the critical constraint on all policies dependent on democratic legitimation.

creasingly specialized world markets. The precondition, of course, is a high degree of policy flexibility, and a capacity to respond to specific locational conditions and changing market opportunities, at all levels of policy making, European, national, and subnational - as well as in management and industrial relations.

Thus, the European economy may indeed need the larger market, and hence common rules, in order to be able to keep up with American and Japanese competitors in branches of production in which economies of scale make a significant difference. But Europe will certainly fall behind if negative integration paralyzes national and subnational problem solving, while on the European level only unsatisfactory compromises can be reached after long and difficult negotiations.

To succeed in the global economy, Europe depends on more effective European policy making with better democratic legitimation. But it depends equally on the autonomous problem-solving capacities of national and subnational polities. While the debate about subsidiarity may help to limit the perfectionism and the rigidities of positive integration, we also need a debate about the need to limit the perfectionism of negative integration. Only if we succeed in both will we be able to combine the economic efficiency of the larger market with the problem solving capacities of political action on the European level and of democratic politics on the national and subnational levels.

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