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The European Union: Governance and Budget

Threats, Opportunities and Perspectives of the European Integration

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Abstract

The current economic crisis together with the Sovereign Debts crisis have emphasised the numerous limits of the European Union, especially the ones concerning the effectiveness of solving internal issues and giving answers to the financial markets and its investors. It the last five years, the financial markets have highly influenced the economy and the institutions' decisions, thus it is even more important for governments and supranational institutions to give tangible and fast answers to problems. This is essential to have a positive impact in the financial markets, and thus towards the economy as well. The European Union is currently characterised by a highly complex governance which makes problems difficult to tackle in a short term. Together with this governance issue, the EU is facing a cohesion issue. This is because, since the beginning of the European Monetary Union (EMU), the EU has experienced difficulties managing the Member States' macroeconomic requirements, in particular the ones concerning Sovereign Debt and national Budget. Those issues could be, for some extent, linked to a weak European Governance, but also to an imperfect allocation of the European resources over the years. Many scholars have analysed the European Union Governance and its Budget, trying to point out their limits and threats, but also their opportunities and perspectives. The following dissertation will discuss scholars' opinions concerning the European governance, decision-making and budget. It will also describe the *Social Choice Theory* and the *Multi-Person Cooperative Game Theory* analysing them in relation to the Council of the European Union decision-making process.

This thesis is divided in three parts. In the first part, a general picture of the European Union is outlined. In particular, the European history and, specifically, its integration process, from a political point of view, is described. The EU institutional framework, the interaction between the institutions and the decision making process, therefore the European Governance, are then analysed. In conclusion of this first general part, the European Budget is shown and explained, not mainly from the economic point of view, but from the decision-making point of view, as the Budget has been important in the development of the European Governance.

In the second part, the different economic models within the European Union are outlined. This step is particularly important to understand the dynamics that emerge from the voting processes. These are in fact analysed in the third and last part of this thesis. As well as the voting process, this last part focuses on the Social Choice Theory, thus the Arrow model, and the Multi-Person Cooperative Game Theory, hence the voting coalition behaviour and the voting power. Three different voting methods used in the Council of the European Union are then criticised applying Social Choice The-

ory's and Game Theory's tools. Concluding, perspectives about the European Governance's future are made.

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Part II: The European Union Member States

1 Introduction

In the last four years the EU has seen the Sovereign National Bond rating decreasing, since 2008 (in chronological order) Ireland, Greece, Portugal, Italy, Spain and France have been downgraded. The worst sovereign bond has been the Greek one, during the summer of 2011, it has reached the lowest grade in the ranking scale. In addition to this, due to the difficult political situation, Greece is now getting close to a possible default and to an eventual exit from the European Union (EU). In the same year, the Portuguese, Spanish, Belgian and Italian Bonds' rating was downgraded. Italian Bonds, in particular, have experienced a speculative attack, during the summer of 2011, which has caused many economic and political difficulties in the country, which are still on going. Because of this the EU economic and political power and credibility is decreasing and its economic and political stability is under attack.

In a moment when the economic environment needs a concrete and uniform answer to the future of the EuroZone, the EU needs to find a permanent solution to solve its structural problems, instead of giving temporary answers to an imminent question, as it has done in the latest years. Therefore, it is clear that the current European Governance cannot find a long-term solution to cope with the EU problems.

1.1 Why Does the European Union Need a Change?

The current circumstances highlight the limits of the EuroZone Confederation, which is characterised by a common currency (the Euro), thus common monetary policies, and many different national public policies, thus different fiscal policies. The discrepancy between the fiscal and monetary polices is one of the causes of the economic and political instability of the EU. To tackle this gap between these two different policies, both of them should be set at the “same policy level” (national or confederetional), in order to have a more rational and efficient management of the public resources and of the public institutions. This discrepancy between the European Central Bank’s (ECB) policies and the EU Member States’ national fiscal policies claims for a change towards a “same policy level” governance, where monetary and fiscal policies’ decisions are taken by the same institutional level. Hence two are the possible solutions between which the EU can choose: on one side, the EU can decide to make a step back to the national currencies and monetary policies, on the other side, to go forward to a complete European integration.

Since nowadays a strong step back to a simple free-trade agreement among countries is not possible, it is time to do a step forward into a new European governance. European politicians and world scholars have claimed for a further European integration to face the European continent's and its countries's future challenges. The Italian President, Giorgio Napolitano, himself has openly testified:

> *"La crisi della moneta unica significherebbe la crisi del progetto comune europeo. Dopo un passo avanti di tale portata non si torna indietro indenni - nessuno. Mi sembra che, dopo mesi convulsi, questo sia stato finalmente capito, da tutti. Ma se il mercato unico non avrebbe potuto reggere senza la moneta unica, è venuto ora il momento di assicurare la stabilità dell'euro attraverso una rafforzata governance dell'economia europea, le cui basi sono state gettate dagli ultimi Consigli Europei, e in definitiva attraverso un deciso avanzamento in senso politico dell'Unità europea."[1] (Napolitano, 07/14/2011)*

To fulfil this project there are many problems to face, most of which are political. But, as said by Szemiér, "*the actual financial and economic crisis can be a milestone for EU reform. […]. [As] in the mid-1950s the political conflicts pushed very young construction of the integration process into a deep crisis. However, a jump ahead in 1955 in Messina solved many of the then actual problems and opened entirely new prospects for the integration process*" (Szemiér: 137, 2009).
Thus, the European Union should take an important step forward, as the lack of a strong governance upon a complex market, such as the European one, is leading the weak European economies to a collapse. This step forward is needed in particular after the current Greek crisis – which is getting stronger and stronger, the imminent Portuguese crisis and after the rating agencies' attack to the Italian, Spanish, Belgian Bonds rating. All together, these are signals of a political instability within many EU countries and in the EU itself.

This work will analyse the European weaknesses and opportunities linked to the European political and economic instability, giving a general description the historical-political EU Member States' arrangement, the European Institutional and Budgetary framework, the Member States' economic

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1 "The common currency's crisis would mean the common european project's crisis. After such a forward leap it cannot be possible to go backward unharmed - for nobody. I've the impression that, after two convulsive months, this has finally been understood, by everyone. But if the common market could not have borne without the common currency, now it's time to ensure the Euro stability through a strengthen European economy governance, which bases were set during the lasts European Council, and through a marked political enhancement of the European Union"

diversities, and lastly focusing on what will be shown as the "core issue" of the European Governance.

1.2 In the Following Chapters

The current work is divided in three main parts. The first one concerns the European Union political history and its current situation. Hence, the history of the European Union from the very beginning – the end of World War the Second – its evolution over the years, and the reasons why the European Union has changed, will be shown. The EU history will be analysed from the economic and the political point of view, a further analysis of the main European Treaties will be made to better understand the ratio which has led the development of the European Union over the years. In the first part, it will be also explained how the European Union is currently organised under the political (thus the European Institutions such as the European Parliament, the Council of European Union, the European Commission), economic and financial (such as the European Union Court of Auditors, the European Central Bank, the European Investment Bank, the European Investment Fund) point of view; moreover the European fund (such as the European Regional Development Fund, the European Financial Stability Facility), the European public policies and the European budget will be shown. This part will be very important, in particular, for the definition and explanation of the European decision-making process, focusing on the main issues that involve the European policy-making process, which is essential to understand the "core issue" of the dissertation.
After a wide view on the EU structure and management, the second part will focus more on the different economic models within the European Union. Since the EU is an economic system made by very different countries with very different capitalistic models, it is very important to analyse and understand the differences between these models. The deep comprehension of diversities (historical, cultural and economic) inside the EU is the key to understand the different approaches of each country to the decision-making process, and to comprehend, in particular, why there is a determined voting coalition behaviour.
In the third part, starting from the European decision-making, the *Social Choice Theory* and *Arrow's Impossibility Theorem* will be shown, in order to have a welfare economics view on the matter of voting and decision-making, which is useful to understand the different voting methods and the implications of adopting different kinds of majority voting. Subsequently, the *Multi-Person Cooperative Game Theory* will be adopted to explain voters' and coalitions' behaviour during a decision voting, in particular voters' and coalitions' voting power will be defined and made clear. After the ex-

position of this theoretical knowledge, the European Member States' voting power within the European Council will be computed under three different voting methods (the Treaty of Nice Model, the Treaty of Lisbon Model and the Jagiellonian Model). Only the European Council's voting behaviour will be investigated because, as it will be largely explained later, it is the most crucial voting institution within the European decision-making framework. In the light of the computation results and the previous chapters' knowledge, a critical analysis of the different Member States' behaviour in the European decision-making will be giving. In particular, the last part of the sixth chapter will focus on the different results that each voting method give, showing how each method could deeply change the voting results and the coalition formation, nevertheless the policy stability and, thus, the policy responsiveness in the European decision-making process. Thanks to the coalition formation simulation it will be possible to give hypothesis about the European Union decision-making future, keeping in mind the latest political changes in France and Greece, which can radically change the composition of the European Council's coalitions.

Part I:

The European Union

2 The European Union: the History

The current European Union is the result of a long integration process that started after the end of World War the Second (WWII). This process, which is still in progress, is a complex and non-obvious result of governments' will of the European countries, which at the very end of WWII decided to cooperate in order to avoid the possibility of another war. The hostility between the European countries was, in fact, one of the main causes of the two XX century World Wars.
Because of a political will, a new era started in Europe (Mantovani et al, 2008). This political will has achieved its tangible realisation through an economic action. Hence, the European Union development should be described carefully step by step, in order to understand why nowadays the European Union is organised and managed in such a way. A leap backwards to the end of WWII is needed to comprehend the reasons why such events have happened.

2.1 Before the Common Markets

As it is written in the European Union website, "*The historical roots of the European Union lie in the Second World War*" (Europa.ue, 07/24/2011). Even though the European Commission's claim seems extremely reductive, it is, on the contrary, very meaningful. It gives, indeed, the precise historical and socio-political background in which the European Union was born.
Many were the reasons why after WWII the European Governments and the world powers, thought about a cohesive and united Europe. For sure, the horrors of WWII had a worldwide effect and, as the World Wars started because of European conflicts, there was a common feeling that something to cool down the European Continent had to be done. In the meantime, the UK, the URSS, the USA and France were looking for an agreement in order to manage the governance of the postwar Germany, trying to avoid a dissatisfactory political and military policy between the parts, which would have led to a new conflict. After WWII, the World was living a new period of radical changes under an unstable military and political equilibrium. This background resulted in a new conflict between the two new super powers: the URSS and the Anglo-American bloc.
The difficult relationship between Western Countries and the Soviet Union was already clear during the Treaty of Peace with Germany, in 1945. In 1947 in London, during the Conference of the Foreign Ministers of the Nations which were occupying Germany, the Western Alleys and the URSS

ended their relationship in a definite way.
This international background changed the European Countries in the postwar: the European Nations were determined to prevent destructions such as the ones created by the World Wars and to never let conflicts, like the one that had just ended, happen again. During a public speech at the University of Zurich about the "The tragedy of Europe", Sir. Winston Leonard Spenser-Churchill, British Prime Minister, claimed for a "United States of Europe" (USE). The USE, from Churchill's point of view, should have gathered every European Nation and should have been created on a regional level.

> *"Our constant aim must be to build and fortify the United Nations Organisation. Under and within that world concept we must re-create the European family in a regional structure called, it may be, the United States of Europe, and the first practical step will be to form a Council of Europe. If at first all the States of Europe are not willing or able to join a union we must nevertheless proceed to assemble and combine those who will and who can. The salvation of the common people of every race and every land from war and servitude must be established on solid foundations, and must be created by the readiness of all men and women to die rather than to submit to tyranny"* (Churchill, Zurich 19 September 1946)

This apparently visionary view of a new kind of relationship among the European countries found its first step towards concreteness at the Congress of Europe convened in The Hague on May 1948 with delegates participating from Europe, and observers from Canada and the United States. Three different positions on a new way of imagining the European Continent emerged at the Congress (Mantovani and Marattin, 2008). The first one was the so called "*confederative*" position, which claimed a strong connection and cooperation among the European Countries but keeping unchanged the National Sovereignty. This European cooperation would have not excluded the existence of supranational organisations to realise confederetional objectives, but these organisations would have been subjected to the Member States' will. Without their unanimous agreement, indeed, it would have been impossible to express the collective will. Numerous politicians supported this way of viewing Europe, in particular Sir Winston Churchill and Charles De Gaulle (Olivi and Santaniello, 2010).
The second main stream of European ideals was the "*federalist*" one. This trend of thoughts was more pugnacious and militant than the first one. The main idea was to establish a federal state "*destroying*" the National States, which were responsible for having led the European population into two costly wars. This new federal state should have torn down the barriers between the European

Nation-States, in order to lay the foundations of a new social cohabitation. For many Federalists a "Constituent Congress" elected by the European citizens would have been essential to start off the Federation. The most important idealists which supported this stream of thoughts were Altiero Spinelli, Henri Brugmans and André Voisin (Olivi and Santaniello, 2010).

The third and last position on the future of the European continent was the "*functionalist*" one. *Functionalists* claimed that Nation-States would have had to gradually leave their sovereignty power thanks to a sectorial integration which would have given the foundations to a different structure of the powers in Europe. This sectorial integration could have been seen as a perfect mix between the confederal point of view and the federal one: on one side, the States would not have lost all of their sovereignty suddenly, but, on the other side, they would have gradually given part of it to create a "sectorial supranationality". The *functionalist* supporters, such as to Robert Schuman and Jean Monnet, will be the ones to give birth to the first tangible attempt of European unification: the European Coal and Steel Community (ECSC) (Olivi and Santaniello, 2010).

The Congress finished with no formal decision neither with tangible results. For this reason it cannot be considered as the first step in the creation of the European Union, but, nevertheless, it has been very important as it laid the foundation of a European integration debate, which revealed itself fundamental in the following years. In 1949, the West European Nations, thanks to the unionist will of Sir Churchill, created the Council of Europe.

In the meanwhile, due to the Cold War, France was subjected to the growing power of the Soviet Union and the USA. Moreover, after the birth of the German Federal Republic and the end of the 'Block of Berlin', it was clear that Germany's rebirth, as a recovered Sovereign State, was imminent (Olivi and Santaniello, 2010).

Hence, France needed to find a "*new way*" to regain the political initiative power it had lost. The new "European feeling" that had been growing since the Congress of Europe helped France to find this "new way". France, indeed, decided to use the new idea of a United Europe in order to reach its aim (Olivi and Santaniello, 2010). A public administration élite, gathered around Jean Monnet (France's President), worked for a new and savvy proposal to give back the initiative to France. The idea was to build up a new project for Western Europe focusing on a new relationship between France and (West) Germany. On the other hand**,** West Germany, with its Chancellor Konrad Adenauer, wanted to link the new growing German Federal Republic to the Western World and increase its position among the European Countries (Olivi and Santaniello, 2010).

The French idea of an economic cooperation between France and West Germany was to focus on the coal and steel industry, which was considered the strongest industry in West Germany set in the

Rhineland. In this way, both sides of the cooperation would have received advantages for the partnership. On one side, France would have gained back its initiative power and, moreover, it could have had economic advantages from the German coal and steel industries. On the other side, West Germany would have had the possibility to get out from its position of inferiority due to the WWII defeat. In this way, the Rhineland region, which in the past had been the cause of wars and conflicts, became now the reason of an international cooperation between two countries, which had been enemies in the past (Olivi and Santaniello, 2010).

2.2 The French Initiative and the Common Markets

This background situation led to the important Schuman Declaration (9 May 1950). The authors of the Declaration were Jean Monnet and a team of French experts and public managers (Olivi and Santaniello, 2010). The Declaration was the very first step towards a new way of diplomacy and cooperation between the European Countries, which has led to the nowadays European Union.

Robert Schuman, the French Minister of Foreign Affairs, had the political strength to make the Declaration approved by the French Council of Ministers and to propose it to Germany and the other Western European Countries.

The Schuman Declaration proposed a new organisation of the international relationships in the European continent. The idea was to create a central supranational authority which ruled and coordinated the coal and steel industries of all the countries who signed the treaty. Jean Monnet's ideas and the Schuman Declaration brought to the Treaty of Paris, which**,** on 8 april 1951**,** established the European Coal and Steel Community (ECSC) and became effective on 27 July 1952. The first countries which decided to join ECSC straightaway were: France, Germany, Italy, the Netherlands, Belgium and Luxembourg (Benelux).

Italy decided to join the ECSC as it was a great opportunity to be part of Western Europe, in particular as it was still fragile and divided after WWII.

The Netherlands, Belgium and Luxembourg joined the ECSC as for such small countries such an important institutional environment would have been an occasion to grow politically (Olivi and Santaniello, 2010).

The ECSC was the first international process of integration between Nation-States – in the European continent – based on an economic integration. Before the ECSC, all the integration processes in fact, were based on a "political-military integration".

The ECSC provided for a sectorial integration, where each member of the community had to put its

sectorial resources. These were available for the independent supranational authority whose objective was to manage them.
The High Authority, the Council and the Court of Justice were ECSC Institutions. The High Authority was an independent board of nine members nominated by the Member States for a duration of six years. It was the Government of the Community and it acted under the control of a parliamentary Assembly. This Assembly was nominated by the member States' Parliaments and it had an advisory role.
The Council was charged to couple the actions of the High Authority with the Member States' ones. It was composed of the representatives of the member States' Governments.
The Court of Justice, constituted by seven judges, was charged to grant the right to respect the interpretation and the application of the Treaty of Paris.
The Schuman Declaration and the Coal and Steel Community gave a new method to the international relationships among the European Countries of the second post-war period. This Declaration was very important in the diplomatic history of this post-war period, as for decades it gave to France a forceful diplomatic power to control and sometimes to influence the rebirth of the German political and economic autonomy (Olivi and Santaniello, 2010).
In the following years the growing international strain due to the increasing conflict between the USA and the Soviet Union, brought the ECSC's Members to think about a new way to defend their territory from the powerful USSR. This fear led the European Countries to the possibilities to merge their military strength into a common army. Because of this political background, the project of an army linked to the European political institution, made by the French Prime Minister, Renè Pleven in 1950, became a tangible possibility. The Pleven Plan, created principally by Jean Monnet, proposed the creation of a supranational European Army as part of a European Defence Community (EDC). The Pleven Plan, which tried to control the rearmament of Western Germany and to create a tangible opportunity to reorganise the Community as a federation or a confederation of countries, was strongly furthered by the Italian Prime Minister, Alcide De Gasperi (Olivi and Santaniello, 2010).
De Gasperi's ideas were supported by the federalist Jean Monnet and Paul-Henri Spaak, which thought that both a political authority and a military integration should have beed created.
The EDC Treaty was discussed and approved during the first ECSC Council meeting, in October 1952. During this meeting the creation of an "Ad Hoc Assembly", chaired by Spaak, which had to developed a project for a European political Community was established. The project of a European political Community was approved by the Assembly on March the 10th 1953. The institutional

structure of this community would have foreseen a bicameral parliament (a Chamber elected with universal suffrage by the European Citizen and a Senate elected by National Parliaments). The executive power would have been exerted by an European executive Council and by a Council made of National Ministers. The executive Council President, elected by the Senate, would have named the other Council members.The European political Community would have foreseen also a Court of Justice and an advisory social and economic Council . In the spring of 1953, some European politicians wanted to make a step forward in the integration process: from a gradual sectorial integration they wanted to pass to a stronger political one. This proposal was subsequently abandoned due to the changing in the domestic and foreign affairs of each country (Olivi and Santaniello, 2010).

France, on the domestic affairs side, had seen an increase in the nationalism of its citizens, which did not want to loose their National-State independence. Moreover ,on the foreign affairs' side, it did not want to deprive itself from the possibility to manage its own army, in particular in that moment, when the French Colonies were fighting for their independence.

Germany, on the economic side, was growing very fast, moreover, with the death of Stalin, the Sovietic pressure was decreasing, and, for these reasons, it did not need the help of an European integration to improve its economic and military situation.

Whereas in the previous years, there had been Governments and public opinions that had supported an European cohesion and integration, at that time, there were Governments and public opinions that were claiming for a national sovereignty (Olivi and Santaniello, 2010).

On August the 30th 1954 the French Assembly did not approve the EDC Treaty, and that decision ratified the impossibility of a federal European structure. The French Assembly's vote underlined once again the importance of the French decision on the future of the European integration, and this result is even stronger recalling that the EDC Treaty was raised, supported and enthusiastically developed by the French initiative.

After the failure of the Pleven Plan, the only alternative to reach a European integration was the already experienced "sectorial integration way".

As the sectorial integration was still successful, after the Foreign Affairs Ministers Congress set in Messina in 1955, the Foreign Affairs Ministers of the six Member States decided to create an intergovernmental Committee of qualified technicians whose objective was to find out other economic sectors (mean of transportations and energy sources) that could have been integrated. In the spring of 1956 the Committee proposed to the Foreign Affairs Ministers Congress, gathered in Venice, the possibility to create a European Community for Atomic Energy (EAEC or Euratom) and a European Economic Community (EEC).

Because of the energetic crisis in 1956, the energy sources seemed to be the first emergency to cope with. Economic markets' integration, at that time, was seen as something which could be reached only in the long run.

In Rome in March the 25th 1957, both CEE Treaty and Euratom Treaty were signed.

In the CEE Treaty the main objectives that the Community had agreed to reach were written, but there were no references concerning the methods, the deadlines and the legislative structure which had to be followed by the Member States to reach those objectives. Nevertheless, all the norms concerning the custom union were specifically written. The Treaty foresaw the abolition of tariffs (quotas, duties) and the creation of a common custom management towards countries outside the Community. The incoming economic integration rose the necessity to harmonise the social and economic policies among the member countries, in particular the most differing ones.

The lack of a tangible policy, deadlines and legislative structure of the EEC Treaty was a result of the failure of the EDC Treaty. In order not to damage the sovereignty power of the Member States, the idea of the EEC Treaty was to create an environment in which the negotiations among EEC members could be driven.

The Euratom was instead created to co-ordinate the co-operative development of nuclear power among European countries.

2.3 From EEC to the Euro: the European Community Between Crisis and Expansions

On January the 1st 1958 the EEC and Euratom started their institutional activity.

In addition to the European Parliament Assembly and the Court of Justice, whose authorities were extended to the EEC and the Euratom, the European Economic Community Treaty provided for new particular institutions in order to manage the community. The new institutions were:

- the Council of European Economic Community, which corresponded to the Council of Ministers in the ECSC
- the Commission of European Communities, which corresponded to the High Authority in the ECSC.

By the end of the 1950s' the United Kingdom (UK) asked to join the European Economic Community, as it had finally regained its industrial power. In addition to this, the UK wanted to join the Community in order to take advantage of the growing continental European economies (such as the Italian, French and the German one), perfect markets where the UK's companies could have exported their products, as its own domestic marked was saturated. Moreover, the UK could have regained the economic power it has lost as the ex Commonwealth countries were getting closer the American economic influence (Olivi and Santaniello, 2010).

But the UK application found two difficulties: a political one and an economic one. The first difficulty was represented by France and its President De Gaulle's veto. De Gaulle was worried that if the UK had joined the EEC France would have lost its initiative power inside the Community itself. The economic difficulty referred instead to the common price level on agricultural products, which was one of the first policies discussed by the EEC parliament.

These UK difficulties became a matter of discussion inside the EEC itself. In fact, the French had vetoed the UK application, some details of Common Agricultural Policy (also known as CAP) and other Community decision. This veto position which blocked, at that time, the Community's decision-making process shows the ineffectiveness and the strong policy stability that the European governance embodied.

Only thanks to a domestic political change in France (the 1968 disorder and the voluntary De Gaulle's resignation as President of France) the stationary situation in the EEC changed. The new French President, Georges Pompidou, decided to have a different and more conciliatory attitude towards the foreign and Communitarian affairs. After years of negotiation and arguments between France and the other five Members, thanks to the new political environment, the EEC found a common decision in favour of the application of the UK and concerning the CAP (which was in to force since 1962), finding a new policy that was more fair towards the German and Italian agricultural economy.

In May 1967, Denmark, Ireland, Norway and the United Kingdom applied once again (they all tried to join EEC in 1960, but De Gaulle vetoed their applications) for all of the Community Treaties, and in 1969, when Pompidou was elected president of France, the French veto was lifted. Negotiations between the European Commission and the applying countries began in 1970 and three years later the accession treaties were signed and all but Norway (which rejected membership in a domestic referendum) acceded to the Community in 1973.

In the meanwhile, in July 1967, a Merger Treaty which merged the ECSC and Euratom's institutions into the EEC ones came into force, giving birth to the European Communities, EC.

Even though the Treaty of Rome and the EEC norms provided for a European Parliament elected by the European citizens, this had never been applied as the treaties did not provide a voting system. It was only in 1976 that the Parliament pressured for an agreement on this matter. And, in September 1976, the Council agreed on a voting system, which, still nowadays, is different from country to country. The first European Parliament election call was in June 1979.

In the following years many other countries applied to join the Community. Greece applied in 1975 and joined in 1981. Spain and Portugal applied in 1977 and joined in 1986. The applications from Greece, Spain and Portugal, differently from the previous applications, were not because of economic purposes, but for a political ones. In fact, these countries, at that time, were coming out of dictatorial regimes (in particular Franco's regime in Spain and the "Colonel's regime" in Greece). Joining the European Communities would have meant to reintegrate these countries into the democratic Europe. The "Southern Enlargement" brought to two different kinds of issues, since those countries were underdeveloped compared to the rest of Western Europe: the first issue concerned the high diversity in the development of EC members, which led to converging policies in order to cope this problem; the second issue concerned the possibilities of migration from poorer countries to richer ones, to face this problem a transitory period in which migration between countries was limited was set. These issues are still existing and are part of the current Eurozone crisis. That is why part of the transitory rules have been extended also to the countries of the "Easter Enlargement" (Olivi and Santaniello, 2010).
After the new enlargement of the European Communities, the European sectorial integration and the community policy-making were improving and leading the community Members during expansion periods and helping them during recession periods. Even though the 1980s were a turbulent period for the European economic environment because of expansions and crises, Member countries realised that the free market still had a limit. There were no tariff, no barrier and no limits in trading and exchanging capital, labour and goods among the Members, but there was still something which create inefficiency in the common market idea: the boarders. For this reason in 1985 France, Germany and Benelux signed the Schengen Agreements. The main purpose of this agreement was the abolition of the boarders among the signatories of the agreement. This would have reduced the cost of trading and transportation of goods from a country to another.
But the boarders were not the only obstacle to reach a real, open and free market between the EC members. Other problems were the divergences between countries in matter of legislation, work safety, production standards, consumers right and environmental impact of production of goods. These and many others were the issues that the European Parliament and the European Commission tried to solve and rule in order to harmonise and standardise every national market and production.
These issues brought to an important Act. In February 1986, in Luxembourg and in The Hague the foreign ministers signed the Single European Act, which reformed the institutions and their power, the foreign policy cooperation, and the common market. This Act aimed to set common standards and community goals, which every Member should have reached until 1992. This harmonisation

concerned important matters such as work safety, production standards, environment and consumers rights. The general idea was to set goals in oder to reach a new step of a further integration after the achievement of the Single European Act's goals. This Act was also due to the possibility of a further enlargement of the European Communities, which would have meant an increase in the diversity between the Members and the need of more powerful institutions that would have led new integration policies.

The same desire of the increasing the policy-areas of cooperations led to the agreement of the Maastricht Treaty (1992), which came into force in November the 1st 1993. The European Communities of the 1990s, which had been integrated in most of the economic sectors and which did not have any barriers and in which workers and capitals could freely move inside the community territory, had a limit: currencies.

In a market, such as the European one, where there were twelve different currencies, the hypothetically free and open market still had constraints. In such an economic environment, a company that wanted to export or import goods and services had to be careful to the exchange rate between its currency and the foreign one. A transaction between countries with different currencies is costly and risky, on the goods market, but can also generate instability in the economy, on the capital market. Because of a floating exchange rate, the same transaction made in two different moments could be profitable or not. Since the exchange rates could be arbitrarily changed by a country varying the monetary policy (expansive or restrictive), the appreciation or the depreciation of a currency could lead to a distortion of the trades in the common market. Moreover, an extreme openness to international trade (in goods and financial markets), such as the European common market, could have led from an increasing instability of the exchange rates' market to an unstable economy with effects on inflation, balance of payment and aggregate demand.

Because of these risks, the members of the EC decided to sign a treaty with the aim of creating a common currency, the Euro, and an independent central bank, the European Central Bank (ECB). The Maastricht Treaty provided for numerous macroeconomic goals (concerning inflation, economic growth, public debt and balanced national budget). Each EU country, willing to join the Euro, had to reach the parameters within December the 31st 1998. Moreover, the macroeconomic parameters for those countries who wanted to apply to join the EU, were made more restrictive.

The Maastricht Treaty (formally known as the Treaty on European Union) *"also introduced new forms of co-operation between the Member State governments - for example on defence, and in the area of "justice and home affairs". By adding this inter-governmental co-operation to the existing "Community" system, the Maastricht Treaty created a new structure with three "pillars" which is* *political as well economic."*[2] The Maastricht Treaty marked the birth of the European Union (EU).

2.4 The European Union and the Current Eurozone Crisis

With the birth of the European Union all the previous European Communities were merged under its name. Merging all the Communities under one identity meant the reassessment of the European Institutions and policy-making. Moreover, the birth of a common currency would have meant depriving the National-States of part of their economic decisions: the monetary policies. These changes brought the EU to a stronger position in relation to the National-States' sovereignty, but the Member States of the UE still kept their political power and the power to adapt the EU directives to their national legislation. This situation has given the opportunity to the EU Commission to increase its position among the EU Members, but it has also given the opportunity to the EU Members to soften the Directives' effects in the national policies.

From 1992 to the present days, the EU has encountered many difficulties and many changes.

In 1995 Austria, Finland and Sweden joined the EU, after thirteen months from their application. It has been the fastest process of acceptance by the EU. The fastness of the process was due to the fact that those countries were already matching all the requirement. Moreover, they were part of the EFTA (European Free Trade Agreement) which was a free trade zone established by the countries who had not already joined the Union. This enlargement was set out mainly for economic reasons, such as reducing the trading costs between these countries and the EU Members (Mantovani and Marattin, 2008).

In 1997 the Amsterdam Treaty was signed, which entered into force in 1999. The Amsterdam Treaty focused on citizenship and rights of individuals, trying to increase the democracy in the EU Institutions, giving more power to the European Parliament. This focus led to the improvement of security's and justice's Directives, starting the Common Foreign and Security Policy (CFSP). A foreign policy has been set and with it a new institutional figure: the High Representative for EU Foreign Policy, *"shall assist the Council in matters coming within the scope of the common foreign and security policy, in particular through contributing to the formulation, preparation and implementation of policy decisions, and, when appropriate and acting on behalf of the Council at the request of the Presidency, through conducting political dialogue with third parties".*[3] Moreover, it amended the

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2 http://europa.eu/abc/treaties/index_en.htm

3 Art. 26, TREATY OF AMSTERDAM AMENDING THE TREATY ON EUROPEAN UNION, THE TREATIES ESTABLISHING THE EUROPEAN COMMUNITIES AND RELATED ACTS, Official Journal C 340, 10 November 1997. http://eur-lex.europa.eu/en/treaties/dat/11997D/htm/11997D.html 21/10/2011

EC Treaty, the ECSC Treaty, the Euratom Treaty and the European Single Act concerning the election of the European Parliament, and it modernised the primary sources of communitarian law deleting many obsolete articles. The Treaty incorporated the Schengen Agreement into the EU legal system (Ireland and the UK remained outside the Schengen Agreement).

In 2001, the Nice Treaty has been signed and it entered into force in 2003. The Treaty *"dealt mostly with reforming the institutions so that the Union could function efficiently after its enlargement to 25 Member States. The Treaty of Nice, the former Treaty of the EU and the Treaty of the EC have been merged into one consolidated version."*[4]

In the meanwhile, in 2002, the national currencies have been substituted the Euro, which became the new currency for twelve countries.

Nice Treaty's purpose was to improve the European legislation and institutions in order to better manage the Union after the imminent enlargement of 2004. It was the biggest one: ten countries (Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia) joined the EU. The EU accepted most of these countries because of both a political and an economic reason. The political reason consisted in the fact (as for Spain and Greece) that the ex socialist despotic countries needed a guide for a transition towards democracy and a liberal market economy. Moreover, there was the EU purpose to gather all the European countries under the EU flag. The economic reason was that the Eastern markets could have been useful for the expansion of the Western countries economies with possibilities of profitable investments at lower costs (Mantovani and Marattin, 2008).

The same year in Rome the European Constitution (formally known as the Treaty establishing a Constitution for Europe) was signed, which is not ratified yet in all the EU countries.

In 2007, two other countries, Bulgaria and Romania, joined the EU for the same reasons of the Eastern countries which joined the EU in 2004.

In the same year, the last and most important treaty was signed: the Lisbon Treaty, which came into force on December the 1st 2009. The Lisbon Treaty changed significantly the previous agreements, introducing novelty to the previous political structure. These are the most important changes of the Lisbon Treaty:

- The aim of the Union was set to be the "*economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance.*" (Art. 2.3 Com.1) And moreover "*It shall promote economic, social and territorial*

[4] http://europa.eu/abc/treaties/index_en.htm. 21/10/2011

cohesion, and solidarity among Member States." (Art. 2.3 Com.3)[5] These are the main objectives of the EU policies after the signing of the Treaty.

- The extension of the double majority voting system[6] to most of the policies under the European Council's and the Council of Ministers' control, from 2014 onwards.
- The European Council President has a duration term of two years and half, reducing in this way the rotating Council Presidency's role.
- The power of the Parliament is increased in order to increase the power of citizens' voting decision, as it is the only institution with members directly elected by the citizens.
- The External Relations Commissioner are merged with the CFSP High Representative, in order to have just one external representative.
- The possibility for citizens to make a bill to the Commission, if it is signed by at least one million citizens.

From the Treaty one can infer that the ratio which led the Treaty was the idea of a further integration of the countries in order to make the complete European integration (even fiscal and political) possible. This is shown by the emphasis that the Treaty puts on the increasing power of the European institutions and on the power of citizens, moreover by changing of the EU objective from *"the raising [..] [of] economic and social cohesion and solidarity among Member States"*[7] into "*it shall promote economic, social and territorial cohesion, and solidarity among Member States*."[8]. The territorial cohesion is the new feature underlined by the Treaty which changed also the EU policies from National policies into Regional policies, increasing the efficiency and the effectiveness of its actions on the territorial economic and social improvement.

From 2009 until the current days, the EU has experimented the financial and economic crisis of the period 2009-2010, and the current public debt crisis of 2010-2011. The debt crisis has started for two reasons: on one side, because of a bad management of the National-States' public finances, due to a structural deficit, which has brought to an increasing public debt. On the other side, because the credit rating agencies (which are private independent companies) downgraded the rating of the credit worthiness of sovereign debts. This downgrading has led to an increase in the bond yield

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[5] Art. 2, AMENDMENTS TO THE TREATY ON EUROPEAN UNION AND TO THE TREATY ESTABLISHING THE EUROPEAN COMMUNITY, Official Journal C 306/10, 17 December 2007

[6] A policy to be approved needed to have the approval from more than the 55% of the members which must represent at least the 65% of the EU citizens.

[7] Art. 2, TREATY ON EUROPEAN UNION, Official Journal C 191, 29 July 1992.

[8] Art. 2.3 Com.3, AMENDMENTS TO THE TREATY ON EUROPEAN UNION AND TO THE TREATY ESTABLISHING THE EUROPEAN COMMUNITY, Official Journal C 306/10, 17 December 2007

rates and moreover to a bond yield spread between the downgraded countries and the rest of the Eurozone.[9]

Rather than the causes of the European economy's crisis, which is now becoming a political crisis too, the problem of the lack of fast and effective solutions is analysed in this dissertation.

At first, the Sovereign Debt crises generated a strong national feeling and most of the EU Member States' Governments had a myope sight in the resolution of the crises bounded to national interests. Germany and France, more than others, disagreed on the possibility to solve the problem with European Budget's resources. Thus, the cost of the crisis would have been shared mostly by the bigger economies of the EU. But after a deeper analysis, countries such as Germany and France realised that a default of a country such as Greece would have led their own economies in to a negative scenery. French and German private and national banks, in fact, own many Greek bonds, therefore a default of the Greek debt would have led to a financial crisis in France and Germany (to underline the situation of the French financial system it should be remembered that many French private banks were downgrade because of their bond investment portfolio)[10]. Thus the Greek debt crisis and moreover the Italian debt crisis (which started in June 2011 and is still ongoing) would have led into a systemic Eurozone crisis, if a European decision in favour of a help towards the sovereign debt would not have been taken.

Currently in the Eurozone the Belgian, Greek, Irish, Italian, Portuguese and Spanish sovereign debts are at risk. The EU and the world markets, however, have focused their interest mainly over the Greek and the Italian public debt, since their default would risk on the World's economy. The EU, in particular the Commission and the European Central Bank (ECB), have started facing the debt crisis by asking for the adoption, in Greece and Italy, of restrictive fiscal policies to reach the balanced national budget and a reduction of the public debt. Together with these fiscal policies the European Union Institutions have introduced different financial tools: the European Fiscal Stability Mechanism, the possibility for the ECB to buy Italian and Greek Bonds, and an *ad hoc* financing tool for Greece (they will be taken into account in Chapter 4). These possible solutions of the crisis are not sufficient, as at the moment, rather than an financial aid, there should be a stronger common policy developed with an efficient decision-making process.

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9 For the purpose of the dissertation it is not necessary to give a deep analysis of the crises, for more information about sovereign debt crisis:Rabah Arezki, Bertrand Candelon, Amadou N. R. Sy, Sovereign Rating News and Financial Markets Spillovers: Evidence from the European Debt Crisis, International Monetary Fund, 01/mar/2011

10 For more information: http://www.bbc.co.uk/news/business-13798000, 20/11/2011

2.5 Conclusions

As it has been shown throughout this chapter, the European Integration is the result of long and difficult political decisions. These decisions have been the results of a long process of political bargaining led by European countries. At the beginning, the EU was established to improve the European countries' own international position and economic growth, and, later on, it developed to guarantee the EU economic and political power as a global actor. The European Union was founded because of a political will which has found its objectification through an economic integration act.

Over the years, the European Union has faced many political and economic crises, which have been in a certain way the "*boost factor*" of the integration's radical changes. A clear example of this may be the European Single Act and the Maastricht Treaty which have been important pillars of the European Integration, as they have given a strong acceleration to the integration process. In a period in which the partial integration was creating issues rather than advantages, in fact, the European Single Act was established to cope with the policy divergency among the countries. The Maastricht Treaty was, instead, signed in order to modernised the European Communities and facilitate trades and freedom of movement inside the Community.

Looking back at the European Union history, it is clear how much political decisions and national interests influenced the whole integration process and its effects on the European economy. The relevance of the European Institutions and the weight of the Member States' political power (Chapter 3) will be shown in the following chapters, together with an analysis of the European economic environment (Chapter 4 and 5).

3 The European Union: Institutions and the Decision-making Process

As it has been written in section 2.1, the EU Integration has been accomplished thanks to a sectorial integration. Consequently, a policy and budget integration has been reached. Policy-making is a long process which involves many actors and many steps. Each policy actor and each step can present issues which make the whole policy process long and difficult to accomplish. For these reasons the European policy actors and the European policy models will be described in detail in the following paragraphs.

3.1 Current European Union Institutions

To comprehend the policy-making and therefore the decision-making process it is essential to know how the European Union is currently shaped and managed. This will also be helpful to better understand the decision power distribution among the European actors. The European Institutions could be divided into political, judicial and financial institutions.

3.1.1 Political Institutions

The European political Institutions are the oldest of the Union, since they were originally designed and created for the ECSC and later on changed and adapted in the corse of time to the Community needs. The current political institutions are: the European Parliament, the Council of the European Union, the European Council and the European Commission.

The European Parliament

The European Parliament is the only European Institution voted by European citizens by a direct universal suffrage[11], every five years. It is the democratic expression of the European Union, and because of its democratic meaning, its powers were increased over the years in order to give a stronger decisional power to the citizens' representatives (Mantovani and Marattin, 2008). The main

[11] Art.223.1 Com.1, CONSOLIDATED VERSION OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION, Official Journal of the European Union C 115/149, 9 May 2008

meeting place is in Strasbourg (France), but sometimes this Institution could be gathered in Bruxelles (Belgium). The Parliament shall be convened by the request of either the majority of its members, the Commission or the Council. It shall also hold an annual session once a year, the second Tuesday of March.[12] The European Parliamentary Assembly is made up by 736 Member of the European Parliament (MEP)[13], which represent about 502 million European Citizens (375 million eligible voters in 2009) of 27 different countries.

The Parliament together with the Council could be seen as two chambers in a bicameral legislative branch of the European Union, where the Parliament is the Lower House and the Council is the Senate. The European Parliament does not have all the responsibilities and the rights of a national parliament. Its power is bounded to matters of budget, supervision of EU institutions and the respect of the human rights in the EU, the relationship with the national parliaments and legislative initiative (in limited cases) (Mantovani and Marattin, 2008).

The budgetary power of the Parliament, ruled by the Budgetary Treaties (amended by the Lisbon Treaty), consists in the possibility of the Parliament to approve or deny the EU annual budget drawn up by the Commission. Every year in December the Parliament examines the budget for the next year and approves it by majority vote. In case of deny of the EU budget, the budgetary process has to be repeated.

The democratic control power of the Parliament is expressed in two different ways: controlling and supervising the action of the European institutions (such as the Commission, the Council and the European Council) and guaranteeing the respect of the Human Rights inside and outside the European territories.

The Parliament votes the confidence to the Commission, in each of its components, after the speech of each of its members. It also approves the application of countries to join the EU and the majority of the international agreements. The Parliament can *"set up a temporary Committee of Inquiry to investigate, without prejudice to the powers conferred by the Treaties on other institutions or bodies, alleged contraventions or maladministration in the implementation of Union law, except where the alleged facts are being examined before a court and while the case is still subject to legal proceeding"*[14]. Moreover the Parliament elects the European Ombudsman, which "*shall be empowered*

[12] Art.229 Com.1, CONSOLIDATED VERSION OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION, Official Journal of the European Union C 115/151, 9 May 2008

[13] The Lisbon Treaty foresee 750 MEP with the addition of the President of the parliament, this will be applied on the next parliament elections in 2014.

[14] Art.226 Com.1, CONSOLIDATED VERSION OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION, Official Journal of the European Union C 115/150, 9 May 2008

to receive complaints from any citizen of the Union or any natural or legal person residing or having its registered office in a Member State concerning instances of maladministration in the activities of the Union institutions, bodies, offices or agencies, with the exception of the Court of Justice of the European Union acting in its judicial role."[15]

The Parliament power which has been changed the most over the years is the legislative power. The European legislative power is a Commission's prerogative, but, in order to strengthen the democracy among the European institutions, in the last two decades the European treaties have given the legislative power, under particular requirement, to the Parliament. The Parliament, which has a power of political initiative, can "*request the Commission to submit any appropriate proposal on matters on which it considers that a Union act is required for the purpose of implementing the Treaties. If the Commission does not submit a proposal, it shall inform the European Parliament of the reasons.*"[16] The role of the Parliament in the law-making procedure can change, depending on the matter of the law. There are two legislative procedures: the ordinary one and the special one. The ordinary procedure puts the Parliament at the same level of the Council (Co-Decision), whereas in the special procedure, which is applied only in specific cases, the Parliament has only a consultative role.

The Parliament initiative is an important democratic and political power, which is slowly strengthening the political power of the EU towards a further integration.

The Council of the European Union

The Council of the European Union, also known as the Council, is composed of all the Member States' Ministers. This Institution can change its composition depending on the subjects under discussion, as it gathers all the national Ministers on a particular matter. The Council could be considered the Upper House, the Senate, of the EU. Its meetings are gathered in Brussels (Belgium). "*The Council shall meet when convened by its President on his own initiative or at the request of one of its Members or of the Commission*"[17].

The Council has ten different configurations covering the whole range of the EU policies: General Affairs, Foreign Affairs, Economic and Financial Affairs (EcoFin), Justice and Home Affairs (JHA),

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[15] Art.228, CONSOLIDATED VERSION OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION, Official Journal of the European Union C 115/150, 9 May 2008

[16] Art.225, CONSOLIDATED VERSION OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION, Official Journal of the European Union C 115/150, 9 May 2008

[17] Art.237, CONSOLIDATED VERSION OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION, Official Journal of the European Union C 115/153, 9 May 2008

Employment, Social Policy, Health and Consumer Affairs, Competitiveness (internal market, industry, research and space), Transport, Telecommunications and Energy, Agriculture and Fisheries, Environment, Education, youth, culture and sport. For instance, the "Economic and Financial Affairs" configuration is made up of the Economic and Finance Ministers.

The Council has also a permanent committee, the Permanent Representatives Committee (COREPER), which is made up of permanent representatives of the Member States working in Brussels. "*The work of this Committee is itself prepared by more than 150 committees and working groups consisting of delegates from the Member States.*"[18]

The presidency of the Council is held by a Member State's government, which rotates every six months between the Member States. Since 2007, every three Member States cooperate on a common agenda during their merged eighteen months, even though only one of them formally holds the presidency for the six-month period.

The Council is the decision-maker institution of the Union. It holds the executive power and the power to approve the EU budget, together with the Parliament (Co-decision). It also coordinates the economic policies of the Member States according to the European Council guidelines.

The Council of European Union, representing Ministers of all the Member States, expresses the national interest, of each country, in the European Union Institutions. Because of this, later on, its governance will be discussed.

The European Council

The European Council is the European Institution which gathers the government chiefs of all the Member States (Presidents, Chancellors or Prime Ministers depending from each national political environment), the President of the European Commission and the President of the European Council. The High Representative for Foreign Affairs may join the meeting of the European Council as well. The European Council meets in Brussels (Belgium) since 1961, when it was established as an informal body. It is now officially a formal Institution of the EU since 2009 when the Lisbon Treaty came into force. It shall gather, convented by its President, twice every six months. The main object of the Council is to "*provide the Union with the necessary impetus for its development and shall define the general political directions and priorities thereof. It shall not exercise legislative functions.*"[19] In other words it defines the general political directions and priorities of the European

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[18] http://www.consilium.europa.eu/council/council-configurations?lang=en, 23/11/2011

[19] Art.15.1, CONSOLIDATED VERSION OF THE TREATY ON EUROPEAN UNION, Official Journal of the European Union C 83/23, 30 March 2010

Union.

The European Council elects its President by a qualified majority. The role of the President is to chair and lead the work of the European Council. The President is a sort of supervisor of the Institution (in fact he does not have the right to vote), facilitating the cohesion and the consensus among its members and guarantying the continuity of the work of the European Council. The Presidency lasts for a term of two years and a half and it can be renewed once.

The European Commission

The European Commission is the heart of the European Union; it controls most of the European Funds (such as the European Regional Development Fund) and develops the European policies (such as Common Agricultural Policy). The Commission is the executive body of the Union "*and represents the interests of Europe as a whole (as opposed to the interests of individual countries)*"[20], it is composed of 27 members each from a different country of the Union. Each member of the Commission should work, possibly, aiming for the interest and the development of the Union.

The main roles of the Commission are to set the goals and the priorities of the EU actions, and, as it is the executive body, it is charged to propose legislation to the Parliament and the Council for discussion and approval. The Commission is also charged to manage and implement the EU policies and to draw up the EU budget (which subsequently will be approved by the Parliament and the Council), that is why the Commission controls also the numerous EU funds.

The Commission meets in Brussels (Belgium) once a week (but when the Parliament holds its plenary session, the Commission will meet in Strasbourg, France), there are also offices, "representations", related to this institution in all EU countries. The Commission's meetings follow the "Commission Work Programme" agenda[21].

The President of the Commission is proposed by the Council unanimously and voted by the majority of the Parliament Members. If the candidate nominated by the Council is rejected by the Parliament, the Council shall name another candidate within a month. The elected-President shall choose the Commissioners and their policy area, among the candidates proposed by the EU Member States. The list of the chosen commissioners is sent first to the Council of Ministers and then to the Parliament for approval. If the list is approved by the Parliament, the new Commission is officially nominated by the Council.

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[20] http://ec.europa.eu/about/index_en.htm, 14/10/2011

[21] for further information about Commission Work Programme visit: http://ec.europa.eu/atwork/programmes/index_en.htm

Table 3.1: Organisation Chart of the European Union Political Institutions

European Commission: the heart of the European Union

Composition:

- 27 Commissioners, one from each Member State,
- the President of the Commission (currently, José Manuel Barroso, Spain).

Functions:

- Proposing new laws to the Parliament and the Council,
- Managing the EU budget and allocating funds,
- Enforcing the European Law, together with the European Court of Justice,
- Representing the EU internationally.

European Council: the political guide of the Union

Composition:

- Government chiefs of the 27 Member States,
- President of the Council (currently, Herman Van Rompuy, the Netherlands),
- President of the Commission (currently, José Manuel Barroso, Spain),
- The High Representative for Foreign Affairs.

Functions:

- Proposing, by unanimity voting, the President of the European Commission
- Proposing, together with the elected-President of the Commission, the 27 Commissioners,
- Electing, by qualified majority, the President of the Council,
- Electing the Governor of the ECB,
- Providing general directions and priorities for the European Union,
- Taking decision about the European Integration.

Council of European Union: the decision-maker of the Union

Composition:

- Ministers of the 27 Member States.

Functions:

- Adopting legislative acts, in Co-decision with the Parliament,
- Adopting the EU budget, in Co-decision with the Parliament,
- Making laws, together with the Parliament, proposed by the Commission,
- Helping coordinate Member States' policies,
- Concluding international agreements on behalf of the Union.

European Parliament: the citizens' representative

Composition:

- 736 Member of European Parliament,
- President of the European Parliament (currently, Martin Schulz, Germany).

Functions:

- Adopting legislative acts, in Co-decision with the Council,
- Adopting the EU budget, in Co-decision with the Council,
- Supervising the European Union Institutions and their actions,
- Approving the election of the President of the EU Commission and its Commissioners,
- Guaranteeing the respect of human rights within the EU.

As it can be seen, the administration of the European Union is not strictly political. In fact, the executive body, the institution which handles the law and policy-making process, is made up of technicians which set goals and policies taking care of the evolution of the EU integration process. The Parliament and the two Councils are instead political institutions, where their members are politicians elected, directly or indirectly, by the EU citizens. In this framework the political and democratic institutions intervene only after the Commission has set a decision.
The EU decision-making process is described in paragraph 3.3.

3.1.2 Judicial Institutions

Since Montesquieu, the classical theory of the separation of the State's powers states that, in order to have a balanced governance of the State, its powers should be dividend into legislative, executive and judicial power. As it was shown before, the EU has an ambiguous division of the powers among the political and administrative institutions, which gathers both the legislative and the executive power.
The judicial power is instead clearly and neatly set in the hands of the judicial institutions: the court of Justice of the European Union , the General Court and the Civil Service Tribunal.

The Court of Justice of the European Union

The court of Justice has been one of the first institutions established since the signing of the ECSC Treaty in 1952. It is based in Luxembourg and it is the highest court in the EU, concerning the European law. It is composed of one Judge from each Member State and from eight Advocates-General, which stay in charge for six re-eligible years. The members of the Court of Justice "*shall be chosen from persons whose independence is beyond doubt and who possess the qualifications required for appointment to the highest judicial offices in their respective countries or who are jurisconsults of recognised competence; they shall be appointed by common accord of the governments of the Member States*"[22]. The Court of Justice is administrated by the Registrar, which helps the Court, the Chambers, the President and the Judges in all of their official functions.
The Court shall pronounce upon appeals between EU Members or recourses of single European citizens against decisions taken by communitarian institutions. Moreover "*the Court of Justice of the European Union shall have jurisdiction to give preliminary rulings concerning: (a) the interpre-*

[22] Art. 253, CONSOLIDATED VERSION OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION, Official Journal of the European Union C 115/158, 9 May 2008

tation of the Treaties; (b) the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union."[23]

The General Court

The General Court was establish in 1988 after the request of the Court of Justice to lighten its work and to introduce two levels of jurisdiction. In a two-level judicial system, all cases are heard in first instance by the General Court and when it may "*considers that the case requires a decision of principle likely to affect the unity or consistency of Union law, it may refer the case to the Court of Justice for a ruling.*"[24]

The General Court is composed of 27 Judges, one from each country, and one Registrar, which stays in charge for six years.

As the number of cases brought before the Court was increasing, a "judicial panel" in certain specific areas has been created, in order to filter the caseload of cases directed to the Court.

The European Union Civil Service Tribunal

The Civil Service Tribunal is one of the most recent judicial institutions. Established in 2004, when the Nice Treaty came into force, it was a "*judicial panel*" which the Lisbon treaty codified into a "*specialised court*", with the Consolidate Version of the Treaty on the Functioning of the European Union art. 257, which states:

> *"The European Parliament and the Council, acting in accordance with the ordinary legislative procedure, may establish specialised courts attached to the General Court to hear and determine at first instance certain classes of action or proceeding brought in specific areas. The European Parliament and the Council shall act by means of regulations either on a proposal from the Commission after consultation of the Court of Justice or at the request of the Court of Justice after consultation of the Commission."*

The Civil Service Tribunal takes decisions on disputes between public servants and the European Institutions or it shall take decisions on the European Institutions charged of maladministration.

[23] Art. 267, CONSOLIDATED VERSION OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION, Official Journal of the European Union C 115/164, 9 May 2008

[24] Art. 258.3, CONSOLIDATED VERSION OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION, Official Journal of the European Union C 115/160, 9 May 2008

3.1.3 Financial Institutions

The decision to establish financial institutions in the European Communities was taken by the end of the 1980's. Jacques Delors, the President of the European Communities Commission, at that time, gathered a committee, the *Delors Committee*, of twelve Member States' Central-Bank Governors in order to find a way to drive the European Communities towards an Economic and Monetary Union (EMU). In 1989, Delors published a report, the *Delors Report*, which summed the Committee ideas concerning a monetary union. The Delors Report proposed to introduce in the European system three stages which would have led to the creation of a common currency and of common financial institutions.

The first stage started in 1990 when capital movements were completely liberalised and exchange controls were abolished. Two years later, with the Maastricht Treaty, the EMU became a formal objective of the European Commission and a number of economic convergence criteria were set.

The second stage took action from January the 1st 1994 until December the 31st 1998. During this period the forerunner of the European Central Bank, the European Monetary Institute, was established. The EMI task was to increase the monetary cooperation between Member States of the Community and their National Central Banks. The transitory nature of the European Monetary Institute underlined the progress of the integration process of the European Communities. In 1997, by signing the Amsterdam Treaty, the Member States, which decided to join the new common currency, subscribed the Stability and Growth Pact, which give a shape to the budgetary rigour after the creation of the unique currency. In 1998, all the eleven countries, which joined the Euro, were selected to participate to the third stage (even though countries such as Italy and Belgium did not match all the criteria set in the Maastricht Treaty). On June the 1st 1998, the European Central Bank was created and on December the 31st 1998 the fixed conversion rates between the Member States' currencies and the Euro were established (Mantovani and Marattin, 2008).

The third stage began on January the 1st 1999 and it is still taking action. In 1999 the Euro became a real currency and in the following three years all the national currencies were progressively converted into the Euro banknotes and coins, which were officially introduced in January 2002.

The starting eleven countries which joined the EMU over the years became seventeen, the last one was Estonia that joined the EMU system in January 2011.

The short history of the monetary union shows how recent the european common financial system, with its institutions, is.

The European Central Bank

The European Central Bank (ECB) in based in Frankfurt (Germany), it is the tangible manifestation of the third stage of the EMU. Its Governing Council is made up of the executive board of the ECB and of the Governors of the National Central Banks of the Eurozone. The Executive Board is composed of six members (President, Vice-president and four other members), which "*shall be appointed by the European Council, acting by a qualified majority, from among persons of recognised standing and professional experience in monetary or banking matters, on a recommendation from the Council, after it has consulted the European Parliament and the Governing Council of the European Central Bank*."[25] The ECB together with the National Central Banks (NCBs) composes the European System of Central Banks (ESCB), which main objective is to "*support the general economic policies in the Union in order to contribute to the achievement of the latter's objectives*".[26]

The ECB is the decision-making body of the ESCB. It makes decisions concerning the monetary policy for the European Union, which can create difficulties to some countries in achieving the common goals. This happens because the decisions made by the ECB, such as decisions over base borrowing rates, on one side, can help some regional economies on the other side, they may not. In order to help the financial stability of the European economy, in 2010, the Member States of the EU agreed to introduce the European Financial Stability Facility (EFSF), which is an Institution whose objective is to "*safeguard financial stability in the Euro Zone by raising funds in capital markets to finance loans for euro area Member States*"[27]. In other words the EFSF provides loans to countries in financial difficulty or finances the recapitalization of financial institutions through loans to the governments. In order to accomplish its mandate "*ESFS issue bonds or other debt instruments on capital markets*".[28] Other Member States' financing methods are described in paragraph 4.7.

The European Investment Bank

The European Investment Bank (EIB) prescinds from the existence of the EMU: it was established in 1957, headquartered in Luxembourg, it had legal status since 2004. It was created to finance the Union long-term investments, which were important for the sustainability of the integration process

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[25] Art. 283.2, CONSOLIDATED VERSION OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION, Official Journal of the European Union C 115/168, 9 May 2008

[26] Art. 282.2, CONSOLIDATED VERSION OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION, Official Journal of the European Union C 115/167, 9 May 2008

[27] http://www.efsf.europa.eu/about/index.htm, 3/12/2011

[28] Ibid

and all the political objectives of the Union. The executive board of the EIB is made of the Governors of the 27 EU Members States and its shareholders are the Member States themselves. The EIB invests in the EU Member States in order to help the achievement of the of EU policies, such as the EU policy objectives in the following areas: stimulating investments to small businesses, favouring cohesion and convergence among EU Regions, financing environmental projects in order to face the climate change and to support the creation of sustainable communities, investing in projects whose object is to achieve a sustainable, competitive and secure energy (producing alternative energy and reducing dependence on imports), promoting the knowledge of economy and constructing trans-European networks.

The EIB also invests outside the EU boarders "*in over 150 countries [...], working to implement the financial pillar of EU external cooperation and development policies (private sector development, infrastructure development, security of energy supply, and environmental sustainability)*." [29]

In 2010, the EIB invested EUR 83 billions in new approved projects, of in which the 86% were projects set in the European Union.[30]

The European Investment Fund

The European Investment Fund (EIF) was establish in 2004, it has legal status and its shareholders are the EIB (61,9%), the European Commission (30%) and 25 other private institutions (8,1%)[31]. It was created to support the creation, growth and development of the small and medium enterprises (SMEs). The Fund guarantees loans and invests venture capital of SMEs. The EIF is one of the Funds that move their action following the "*Cohesion and competitiveness for growth and employment*" policies[32]. It acts on official mandate of the EIB and it shall also operate in countries which are candidate to join the Union, in this way it fastens the convergency process.

In 2010, the EIF invested EUR 2,8 billions in 22 Guarantees' operations and 39 venture capital funds.[33]

As the European institutional framework shows, the European Governance is a complex body of institutions which works and decides following formal rules, agreed after a long process of political

[29] http://www.eib.org/about/index.htm, 2/12/2011

[30] http://www.eib.org/about/key_figures/index.htm, 1/12/2011

[31] http://www.eif.org/who_we_are/shareholder/index.htm 20/11/2011

[32] "Cohesion and competitiveness for growth" policy was 45,5% of the EU budget in 2011. http://ec.europa.eu/budget/figures/2011/2011_en.cfm

[33] http://www.eib.org/about/key_figures/index.htm, 1/12/2011

bargaining, and informal behaviours shaped by the European actors' power. The following paragraphs will analyse how formal and informal roles influence the European governance, starting from the power division in the decision-making environment and continuing by showing how this division of powers influences the policy-making in the European Union.

3.2 The Decision-Making Environment

The EU policies are the result of a long decision-making process, carried out by the Political (Commission, Parliament, Council) and Financial (Central Bank) Institutions. In order to better understand the way in which the policies are made and the decision-making process is conducted, it could be useful to have a quick broad look at the EU literature which, since the end of the sixties, has questioned itself about a definition of the EU Political System. At the beginning two different positions were the main streams upon EU scholars' researches, on one side, federalist writers, such as Pinder (1968) and Friedrich (1969), saw the EU as a federal or confederal system, such as the German, Swiss or American one; on the other side, there were writers like Lindberg and Scheingold (1970), who described the EU system as a political process characterised by political demands (input), governmental actors and public policies (outputs). After the Maastricht Treaty and the change in the political power distribution, due to the directives ruled by the treaty, the EU scholars have changed their focus and they tried to find a way to describe "*the EU as a political system using the theoretical tools developed in the study of domestic policies*" (Pollack, 2010). One of the scholars who better accomplished in explaining the EU political system in this way was Simon Hix. He stated that the EU could be studied using "*the tools, methods and cross-systemic theories from the general study of government, politics, and policy-making*" (Hix, 1999). With these words he underlined that the EU is not a *sui generis* system of governance, but just a variation on the theme of an existing political system.

Synthesising the general thoughts on the EU political system, in order to study the decision-making process, it can be said that the separation of the EU powers could be clustered into two dimensions: a vertical and a horizontal separation of the powers (Pollack, 2010).

3.2.1 The Vertical Distribution of the Powers

The vertical separation of the powers is the division of the decision-making between the EU and the Member States' level. Pollack (2010) underlined how this separation between the European level and the National level constitutes a federal system, as it has its three characterising elements: the public authority is divided between States' government and a central government; each level of government makes the final decision on different issues; and a high court with federal jurisdiction judges disputes concerning federalism (Kelemen, 2003). Nevertheless, it should be said that the distribution of the powers between the two levels, in many occasions, results to be ambiguous and *de facto* the European and Member States' governments often act as if they had, in most issues, a concurrent jurisdiction rather an exclusive one. Moreover, the division of power between national and federal governments should be guaranteed by a constitution. In the European situation, this is shaped by the EU treaties (signed over the years) that give a broad and flexible definition of the power of the Union. The Union, in fact, in order to reach its fundamental aims, has the power to regulate or adopt any "necessary or proper" legislation (Pollack, 2010).

Another big difference between a federal state and the EU is detected in the lack of a substantial federal fiscal transfer across state boundaries. The EU, indeed, spends almost 1.1% of the EU GDP (1,13% in 2011, it will be 1,12% in 2012)[34] in agricultural an cohesion spendings. The redistribution or the macroeconomic stabilisation is mainly managed by the national fiscal policies.

Even though there are differences between the EU and a strict definition of federal state, Pollack states that "*the struggle over European integration [...], is not a sui generis process, but is a constitutionally structured process of oscillation between states and central governments familiar from other federal systems.*" (Pollack, 2010)

3.2.2 The Horizontal Distribution of the Powers

The horizontal separation of the powers, thus the three fundamental functions of the government (legislative, executive, judicial), in the EU follows the American model: the three functions are taken by three different branches of the government. As it has been already shown previously, the EU Institutions can lead more than one function and, vice versa, one function can be governed by more than one institution. For instance, the legislative power is shared by the European Parliament and the Council of European Union. Many scholar studies have shown how voting behaviour, which directly influences the decision-making, in the Parliament is not driven by a nationality-based decision but by a *party-group* decision. It has been demonstrated that there is more cohesion among party group decisions rather than in nationality ones in roll-call votes (Tsebelis and Garrett, 2000; Kreppel, 2001; Hix, Noury, and Roland, 2007). On the contrary, an opposite behaviour has been

[34] Commitment Appropriations/EU GDP ratio, source: EU Budget. http://ec.europa.eu/budget/ (15/01/2012)

noticed among the members of the Council: they follow a Member State coalition pattern. This coalition seems to be based on a geographical distribution, North-South (see Mattila, 2004; Hayes-Renshaw and Wallace, 2006; and Naurin and Wallace, 2008). These different patterns of voting behaviour reflect the way the members of the two institutions are elected: the Members of the European Parliament are directly elected in order to represent a party/ideal at European level, on the contrary, the Members of the Council represent their country/region's interests.

The European Parliament, in the last twenty years, has increased its political role and influence in the decision-making, thanks to the changes brought by the Maastricht and Amsterdam Treaties. In addition to this, the equilibrium between the Parliament and the Council has moved towards a stronger bicameralism.

The executive power is shared between the Commission, the Member States and independent regulatory agencies (which are numerous agencies created in order to better manage specific EU policies). The structure of the executive power can be laid out into a principal-agent scheme, where the principals are the Member States, which hold the sovereignty and the executive power inside their boarders; and the agents are the supranational institutions and agencies, which are delegate to perform the executive power on certain issues. Some scholars have proved that the principals delegate part of their powers to the agents, in order to reduce the transition-cost of policy-making. Moreover, this delegation ensures the Member States' Governments to engage their credibility to the international agreements and, thus, to enjoy the policy-relevant expertise provided by the supranational actors (Pollack, 1997, 2003; Moravcsik, 1998; Majone, 2000; Franchino, 2004, 2007).

The jurisdictional function and the relations between the national and supranational institutions have been theorised only by few scholars, in comparison with to the more studied legislative and executive powers. An interesting position is the one taken by Geoffrey Garrett (1992), who claimed that the European Court of Justice (ECJ) is a mean for the Member States to solve the disputes created by the Treaties' framework, as it is an incomplete contracts system. Under this view, the Member States accept the ECJ jurisprudence, even if ruling goes against them, as they have a long-run interest in the strengthening of the EU law. Not many scholars agreed with Garrett's point of view, some of them argued that the position of the ECJ is more autonomous than Garrett suggests, as it can be also inferred from European legislation (Article 267, Consolidated Version of the Treaty on The Functioning of the European Union) (Weiler, 1994; Mattli and Sluaghter, 1995, 1998; Alter, 2001).

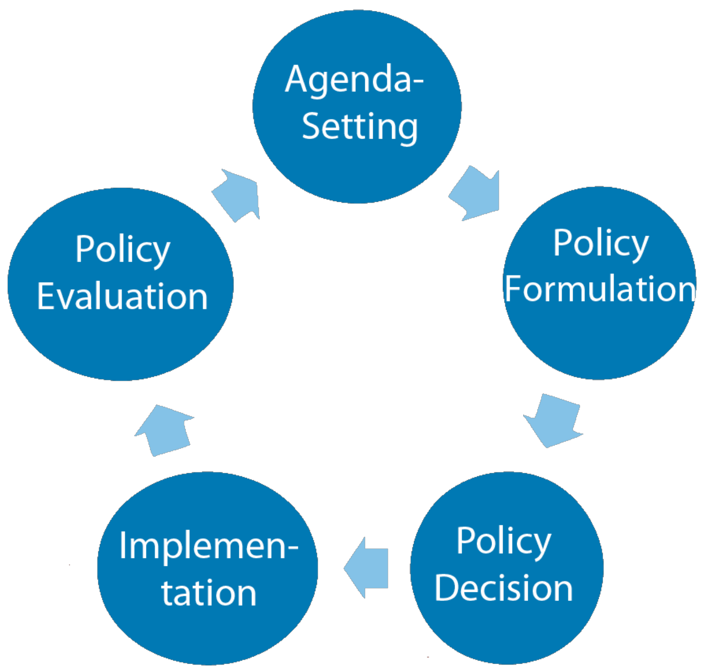
The most recent researches have focused on the relationship between the ECJ and the national courts, and between the ECJ and individual litigants. Recently, national courts have brought many disputes before the European court. The number of individuals that use the EU law to reach their objectives within the national system has significantly increased (Mattli and Slaughter, 1998; Alter, 2001; Conant, 2002). This tendency shows "*the complex and ambivalent relationship between the ECJ and the national courts*" (Pollack, 2010).

3.3 Policy-Cycle in the EU

After a broad view of the environment where European decisions are taken, now it is time to see the process used to make decisions. An important tool, which could be helpful to understand a complex process such as the policy-making, is the notion of *policy-cycle* (A.R. Young, 2010).

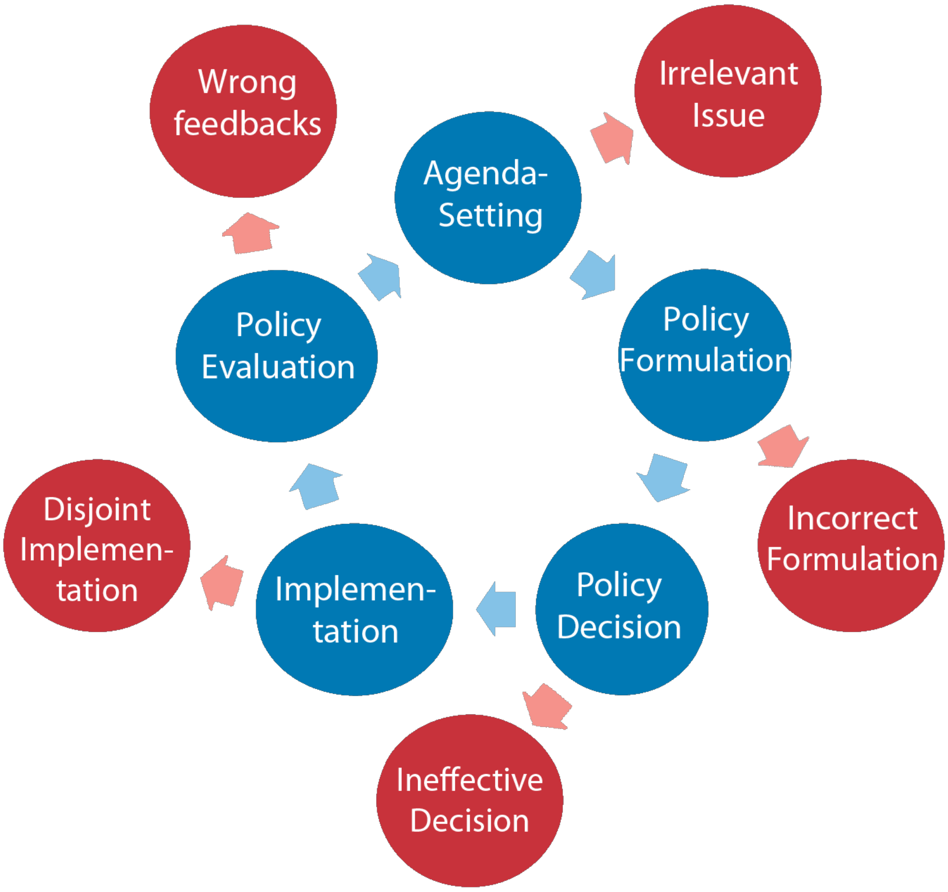
The policy-cycle it a rational sequence of actions taken to solve an issue. Thus, the policy-cycle is laid out as follows: first step, an issue, after becoming a matter of concern, is put on a political agenda (agenda-setting); second step, after the issue is defined, a number of actions that could be done in order to solve the issue are proposed (policy formulating); third step, after the discussion and the formulation of the proposed actions, it is time to decide which one of them to undertake (policy decision); fourth step, if a policy is taken it must be implemented (implementation); fifth step, the results and consequences of the the implementation should be evaluated and discussed, in order to understand the effects of the policy (evaluation), this feed-back evaluation leads to the beginning of the cycle once again. The feed-back evaluation should improve the effectiveness of the subsequent policies turning the policy-cycle into a policy-virtuous-spiral (Fig. 3.1).

Fig. 3.1 Policy-Cycle



This is how a policy-cycle should be, however the process is not that obvious and automatic. The real policy-making process is, in fact, more complex and often more than one policy-decision is taken to solve an issue, and these multiple policy-decisions could have an effect on different levels of governance (Streeck and Thelen, 2005; Carbone, 2008). Moreover, the policy-cycle implies the applying of rational decisions but often in each policy step it is possible to choose wrong or incoherent decisions, which could be ineffective or, even worse, they could lead to negative effects (Cohen et al., 1972; Richardson, 2006) (Fig.3.2).

Fig. 3.2 Ineffective Policy-Cycle



Even though the policy-cycle is a theoretical model with its limits in the applicability, it is possible to apply different analytical approaches to each stage (Peterson and Bomber, 1999; Sabatier, 1999; Richardson, 2006), in order to make easier to understand the EU policy and decision-making process.

Before the stage-by-stage analysis, the actors of the policy process will be shown. The main players of the decision process of liberal democracies, and indeed of the European Union, are: politicians, bureaucrats, and interests groups.

Politicians are generally highly responsive to societal pressure (constituents' opinion) and/or interest group lobbying, which means that they are very influenceable by these categories (Derthick and

Quirk, 1986; Putnam, 1988; Atkinson and Coleman, 1989; Evans, 1993). The influence of politicians in the process depends on the distribution of political power among the institutions (Baumgartner and Leech, 1998; Grossman and Helpman, 2001).

Bureaucrats interests could be purposive, hence they are determined to achieve policy goals, or reflexive, thus their main objective is to enhance the power and the importance of their specific branch of bureaucracy (Peters, 1992; Dunleavy, 1997).

Interest Groups are define as "*non-profit, non-violent associations of individuals or other organisations that are independent of governments that aggregate interests and inject them into the policy process*" (A.R.Young: 49, 2010). Since an action led by many individuals with direct interest in the matter of the policy is more effective, it is often easier for producers, rather than for consumers or environmentalists, to organise an effective action which is converted into a policy (G. Jordan, 1998; A.R. Young, 1998).

Generally the inputs of interest groups in the policy process is welcomed by politicians and bureaucrats, since interest groups are usually very informed about the issue they want to tackle and their knowledge is useful for those who have to set the policy (politicians and bureaucrats). Moreover, a policy is more effective if the affected actors are part of the process (Lindblom, 1977; Beer,1982)

These actors in the EU process play a different role compared to role they perform in the national level. For instance, in the EU, the Commissioners are bureaucrats, who, compared to the national level pattern, have a more important position on agenda-setting and policy formulation and a lesser one in the policy implementation. In the Parliament and the Council there are two different kinds of politicians. The Members of the European Parliament are directly elected by the European citizens, therefore their interests are driven by societal pressure like in a national parliament (even though they refer to a European society instead of a national one), but their role is less strong than the one of national parliamentarians. The members of the Council are instead National Ministers, which embody an important role adopting European legislations, but their decisions are driven by their own or their national constituents' interests (A.R. Young, 2010). European interest groups are usually associations of national associations, such as sectorial associations or national lobbies, even though there is a growing number of European groups with direct membership (Greenwood and Young, 2005).

The actors of the policy process may intervene with different authorities and follow different interests depending on the process stage they are acting, which is why it is important to know the institutional environment in which a policy decision is taken.

3.3.1 Agenda-Setting

The first stage of the policy process is the agenda-setting. This is very important since without a start the policy process cannot be accomplished and issues cannot be tackled. The "agenda-setting" can be defined as the stage where actors have to decide what to decide, which is crucial since the decision is soaked in a "*context where there is a great deal of uncertainty*" (A.R. Young, 2010: 52). In this context of uncertainly it is important for the entrepreneurs, in order to have a successful policy, to frame an issue which is linked with a wide interest.

In the European Union, the European Commission is the actor who has the power of initiative, thus of suggesting the issues to be discussed. Therefore the Commission is the Institution to be persuaded in order to put forward an issue. The European Parliament, the Councils or European citizens (with a collective action signed by at least one million of citizens) can suggest to the Commission to advance a policy initiative.

Despite the fact that the Commission is the policy entrepreneur of the EU, it needs an external support from other EU institutional actors, in order to have tangible chance for its policies to be adopted.

3.3.2 Policy Formulation

Before decisions may be taken, it is important to screen and assess all the alternatives. This process of assessment and reduction of all possible options is not necessarily performed after the "agenda-setting". It could happen that it could be accomplished during the agenda-setting, since it is usually carried on by a different set of actors from those who participate to the "agenda-setting". The policy formulation is frequently represented as the result of "policy networks" (A. R. Young, 2010).

Policy networks are "*the patterns of interaction among actors working a particular policy system or decision-making process, in reference to a particular type of relationship such as information exchange or political coordination"* (A.D. Henry, 2011: 364). Another important element of the policy networks is the common interest, among actors, in policy decision and implementation (R. Rhodes, 2006).

The EU policy-making does not correspond to the policy networks idea, since, on one side, the different value systems and, more generally, a different vision in problem-solving underline the cultural diversity among the twenty-seven European Member States. Furthermore, on the other side, the diversity between the actors which make the policy decision (the Commission and other European institutions), and the ones who implement the policy (the Member States), makes the policy network idea inapplicable to the EU system. For these reasons the EU policy formulation is an open process (Richardson, 2000). In many policy areas the Commission is the principal or the sole actor in policy formulation, this allows the Commission to have a central role in both agenda-setting and policy formulation, even though its role in the decision-making is rangebound (Hix, 2005).

3.3.3 Policy Decision

The decision-making is the most controversial stage in the EU policy process since, as it will be describe later (Section 3.4.3), there are different decision-making modes depending on the different policy areas. Even though there are different modes in the EU policy decision, it is possible to gathered them into macro-groups which differ in the way the decision is approached: executive or legislative politics.

3.3.3.1 Executive Politics

Executive politics are the policy-actions run by the executive authorities which receive the delegation of decision-making responsibilities. The benefits coming from the delegation of decision-making are strictly linked to the complexity of the policy area. The more a policy is complex the higher is the advantage in delegating the decision making to a policy-relevant expertise. A typical example of this situation can be found in the policies on healthcare area where specialised agencies, such as European Medicines Evaluation Agency, have the responsibility to provide expert advice for the Commission, which – under certain circumstances – officially takes the decision (Krapohl, 2004; Eberlein and Grande, 2005). Another situation in which delegations could be helpful is when politicians' commitment to a policy can undermine its effectiveness. Problems of commitment can rise when there is a gap between short-term costs and long-term advantages (time inconsistency), or when the provided benefits are widely diffuse, but the costs are not equally allocated and thus this situation generates a strong political pressure which would lead politicians to abandon the policy (A.R. Young, 2010).

The delegation is a useful tool as it gives a higher institutional authority to the policy, since it is developed by expertise in the policy area.

Analysing this instrument of decision-making under the principal-agent approach, however, presents limits for the actions of the bureaucratic agents, whose freedom is subjected to the principals' wills. "*In this view, any analysis of Commission decision-making must consider what authority has been delegated to it and how its preferences relate to those of the member states on the issue in question*" (A.R. Young: 57, 2010).

3.3.3.2 Legislative Politics

Legislative politics are the policy-decisions made by the legislative authorities of the EU. In this set of institutions, the decision-making in the European Parliament should be distinguished by the Council's one. As written before, the two institutions have a different political composition and a different voting system which deeply influences their decision-making process.

Normally in a bicameral system, formed by Parliament and Senate, both Chambers act following the *minimum-winning coalitions theory* (Riker, 1962), which is based on the idea that a coalition gathering the minimum number of votes necessary to secure victory is needed. The minimum-winning coalition "*means that there are fewer interests to accommodate and gives the members of the coalition, particularly those decisive in creating a winning majority, greater influence over policy*" (A.R. Young 2010: 58). In the European Parliament the minimum-winning coalitions' pattern has been adopted only recently (Kreppel and Hix, 2003; Hix and Noury, 2009), thanks to the increasing power of the Parliament in the decision-making process. In the past, the Parliament has had the tendency to gather oversized voting coalitions, in order to strengthen the relative influence of the European Parliament on the Council (A.R. Young, 2010). The increasing power of the Parliament, together with its voting electoral system (by direct election of the European citizens), has made the European Parliament's behaviour closer to the national one: its members follow the minimum-winning coalitions pattern and group themselves in coalitions based on "party group" orientations (left-centre-right).

Unlike the European Parliament, the Members of the Council of the European Union behave more like actors within an international negotiation, rather than like members of a legislative institution. Thus, under these circumstances the minimum-winning coalition theory does not hold. In the Council poll each government's member's preference is relevant, for this reason "*preferences close to the centre of the range of preferences on a given issue are more likely to be in a winning majority*" , on the other side other government preferences "*are likely to be isolated in the EU decision-making*" (A.R. Young, 2010). Studies on the Council's voting have shown that in the majority of the cases, independently from the voting method applied, the Council tends to look for consensus whenever it is possible (Hayes-Rental and Wallace, 2006; Schneider et al, 2006). Thus, since the composition of the Council (member state governments) and the vote preferences of its members (nationality based), the best tool, in order to understand the Council behaviour, is the bargaining approach (Schneider et al, 2006).

Bargaining is defined as the method in which decisions are put forward when all the actors agree. This agreement is reached, after a process where an outcome, which makes none of the actors worse off (lowest common denominator outcome), or through the use of issue linkage (actor A agreed to decision 1 if actor B agreed to decision 2), inducements (incentives to agreed to the decision), threats (if actor A veto decision 1, then actor B veto decision 2) (Putnam, 1988) is identified. Bargaining outcomes reflect the weighted voting power of the actors, the most powerful actor (or group of actors) is the one that has the best alternative to an agreement, since he has the power to realise objectives unilaterally or cooperating with an alternative set of actors: *best alternative to negotiated agreement* (BATNA) (Garrett and Tsebelis, 1996; Moravcsik, 1998; Keohane and Nye, 2001). An interesting variant of the bargaining analysis is Fritz Scharpf's "joint-decision trap". This different approach is very useful to understand the current situation of the EU politics. The "joint decision trap" (Scharpf, 1988, 2006) is a bargaining model where there is no solution which all veto players prefer to the *status quo* (keep the situation unchanged). Scharps's opinion is that the "joint-decision trap" is not a typical scene in the European decision-making, but it is relevant when institutions create an "extreme variant of a multiple-veto player system" and where the Commission does not have the right of initiative, hence the transaction costs between parts is high. In a twenty-seven-member-states-EU the possibility to come upon a "joint-decision trap" is even higher than in the past (Scharpf, 2006).

One of the reasons why bargaining models better predict the decision-making in the EU than procedural models, is due to the fact that, in the Council, policy-making is important to be capable of satisfying different interests at the same time (Schneider et al., 2006).

In the decision-making process there are differences according to the number of institutions that take part. Previously, the process in which a sole decision-maker acts has been shown, now it is time to see what the dynamics under an inter-institutional decision are, which is when the decision-making process is carried out by different EU Institutions. Among the European Institutions, the one that holds the decision power is the Council, because it is the Institution where most of the actors which can block a decision (veto players) are, therefore it is harder to reach an agreement in the Council than in other EU Institutions (Tsebelis, 1995). Among the EU Institutions, however, there are many other veto players which can block a decision during the policy-making process: the Commission can deny to put forward a proposal; under co-decision voting system, both the Parliament and the Council can block legislations; under unanimity, each Member State can block the policy process; and under Qualified Majority Voting (QMV) a minority of states, which represent a majority of EU citizens, can block a decision (since the Council should reach at least 67% of the EU Member States which represent at least 62% of the EU population, and 77% of the voting weight to approve a decision). Because of this large numbers of veto players in order to adopt a policy, Simon Hix (2008) has referred to the EU as a "*hyper-consensus system of government*". This high consensus voting requires, in order to secure an agreement, a coalition across two levels of governance (EU Institutions and Member States), but the creation of such coalitions is difficult and costly (A.R. Young, 2010).

3.3.4 Implementation

After the decision has been taken, the next stage is to implement the decision. Usually, because of the compromises behind the decisions and/or the vagueness of its language, Member States adopt the decision in very different ways (Treib, 2008). Thus, it is clear that the implementation is a key phase in the EU policy-making, since there is the risk that a policy is put into effect in a meaningless way. In the EU policy-making process the decision could take effect in order to influence the behaviour of different targets, depending on the policy area. There are some policies (setting interest rates or ruling anti-competitive behaviour) in which the decision-making and the implementation are essentially the same thing, thus there are no further stages after the EU decision has been taken. Some other policies are directed to influence national governments' action, such as the budgetary policies or the fiscal discipline for the Stability and Growth Pact. Most of the policies, however, are aimed to affect the Member States' individuals and firms' behaviour.

There are different ways to take policies into effect depending on the different target of the policy itself. They can take effect via "directives" or via "regulations". The directives are decisions taken by the EU institutions (or in general, by international organisations) which must be transposed into national law in order to became effective. This legal paradigm underlines the international agreement characteristic of the European decisions. When a directive is transposed into law into a national legislative system there could be some changes in the national law in compliance with the EU decision. "*Whether and how implementation occurs depends on the preferences of the key societal actors bad the government regarding the new obligation relative to the status quo*" (A.R. Young: 62, 2010). The possible political impact (the possibility that the government could loose constituents if the directive is applied) of a directive in a State could deeply affect the implementation itself (Treib, 2008).

Analysing the policy implementation in the EU, some scholars infer that there are three critical characters which could affect the effectiveness of a decision: first, the effects of the EU decisions varies among the Member States, concerning the cost of implementation and the political and administrative likeliness to comply the decision; second, the Member States adopt different national policies in order to undertake a common policy (this is due to differences in both executive and legislative politics); third, the Member States sometimes do not conform to EU rules (Héritier et al., 2001; Börzel and Rises, 2007; Young, 2010).

In order to guarantee a certain respect for the EU legislations, the implementation process is supervised by the Commission, which is aided by many subjects of adjudication before national and European courts (Tallberg, 2003).

3.3.5 Evaluation

After the implementation, the policy process has to continue because, in order to improve the impact of the future policies or the improvement of the current ones, it is important to close the policy cycle with a feedback on the results of the process. There are two different ways to feedback the policy-cycle, evaluations its effectiveness: political feedback loops, and split-overs.

The most immediate way to evaluate a policy's effectiveness is the feedback loop. This procedure simply testifies that, if a policy has not solved an issue it was address to tackle, something in the policy process did not work as it should have. If a policy is ineffective, this could not be directly connected to the efficiency of the implementation. The policy, in fact, could be ineffective because it was not sufficiently ambitious or because a wrong approach was decided (Raustiala and Slaughter, 2002). In the EU process, the policy feedback is not so clear and direct as it is in the application of a national policies. In the EU, the link between the society and the government is weak and the responses of a policy are not easy to be defined. This means that the Commission cannot gather the same amount of information (feedbacks) that a democratic national government can reach.

Political feedback loops can be identified as "positive" or "negative" in the impact of a policy. A "positive" political feedback loop occurs when the actors ,which benefit from the effects of the policy, strive to maintain the policy itself (Pierson 1993, 2000). The relevant number of veto players in the European Union strengthens the resistance of a policy, and this strictness in the decision-making makes the policies laborious to be modified. Therefore, decisions which are taken earlier will prevail on those which will be taken thereafter. The rigidness in policy changing could lead in the long-run into a sub-optimal policy system, in this case the concept of "policy stability" assumes a nega-

tive meaning. That is why frequently, after a long period of policy stability, as soon as the policies become either obsolete or because of an external shock, the policy system experiences an sudden and deep change (Pierson 2000). It was studied by Hall and Thelen (2009) that if on one side there could be a “positive” feedback supporting the policy stability, on the other side there are actors, which do not agree with the policy, that try to change it, creating a “negative” feedback.
The second possible feedback, after the implementation, is the “spill-over”. The spill-over is a non-related feedback to the same policy process, but it provides impulses for a further policy development. In a certain way, the spill-over is like an externality of a policy, which could be positive or negative. A positive spill-over is, for instance, what happened with the introduction of the common currency, which improved also the European single markets. A negative spill-over could be instead when the elimination of boarders, which increases cooperations between countries, but also creates migrations and security problems, was introduced (A.R. Young 2010). The collateral policies that could be developed requires an action of the policy actors who should put them into the policy agenda, but this action requires a good cohesion among the institutions.

3.4 Decision-Making in the EU: the Five Modes

It has been shown that in the policy-cycle, in particular in the decision making, the decision could be accomplished through different procedures, according to the different policy areas. Analysing the policy-making in the EU, Helen Wallace (2010) has found five different modes in driving the “day-to-day” decision-making:

- The classical Community method;
- The EU regulatory mode;
- The EU distributional mode;
- Policy co-ordination;
- Intensive trans-governmentlism.

This distinction in the way of conducting the decision process is due, not only to the continuos dihcotomic balance between National and European powers on policy development, but also to the differences between the changing views on how to improve the European governance.
In the real action of the European decision making, in most of the cases, the distinction of the method is not so neat, indeed, the decision is taken following different methods, in a sort of hybridisation of the suggested methods.

3.4.1 The Classical Community Mode

The classical Community mode refers to the one used to develop the Common Agricultural Policy (CAP) in the 1960s, which set the guidelines to the way of proceeding for the following policies in the EEC Institutions. The key rules of the main actors of this mode were:

- a strong role of the European Commission which was delegated to policy design, policy brokering, policy execution and the management of the results;
- the European Council of Ministers empowerd its role through strategic bargaining and package deals;
- an occasional intervention of the ECJ to strengthen the legal authority of the Community decision;
- a limited opportunity for the European Parliament and for elected representatives at national level to influence the decision of the Commission;
- "*a locking-in stakeholders by their co-option into a European process which offered them a better reward than the national politics*" (H. Wallace, 2010);
- national agencies were part of the process as operating arms of the common decision maker;
- the resources of the policy were gathered on a collective basis.

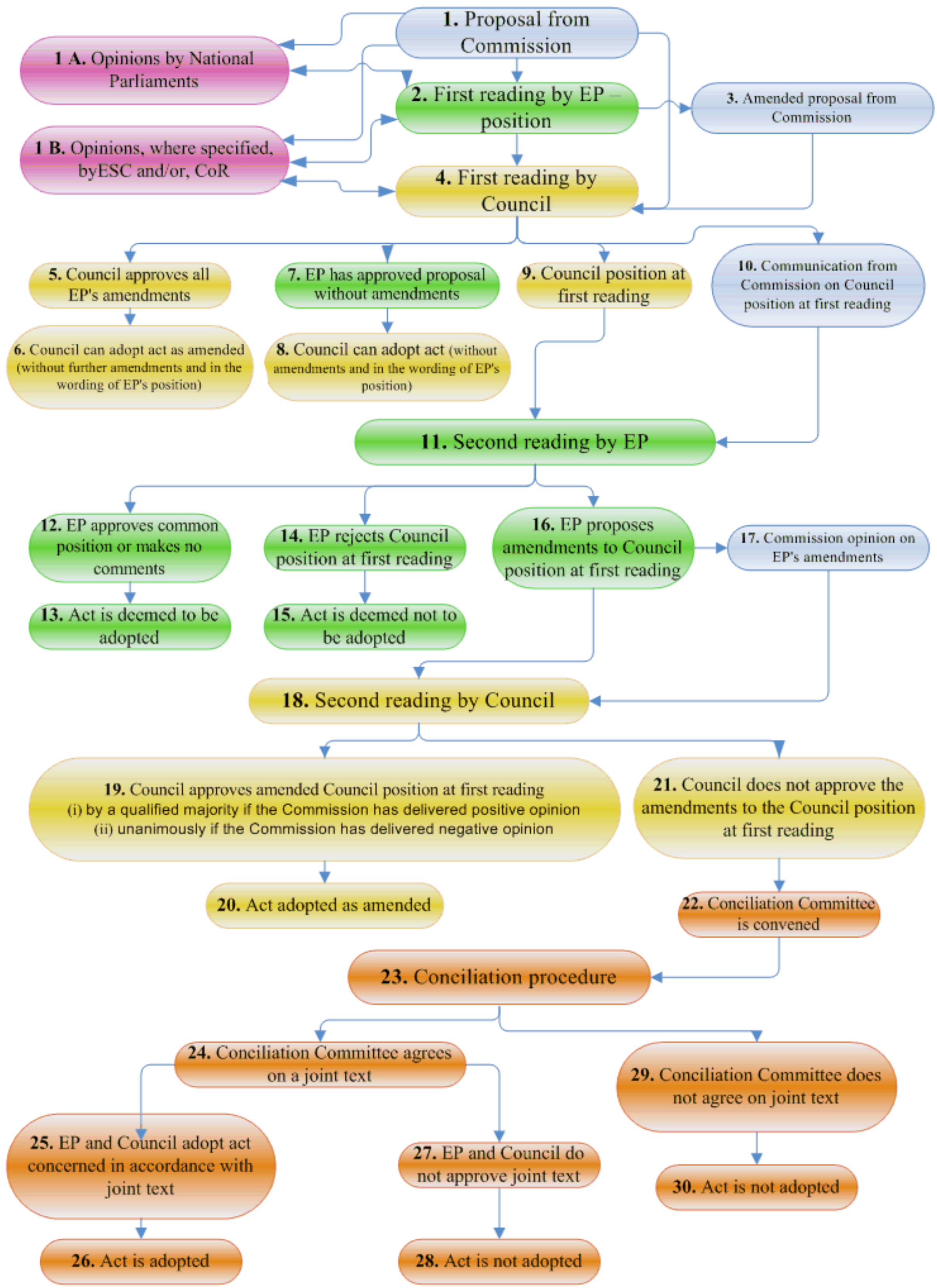
The template set by the CAP emphasised the shifting power from the national to the European level, where a particular policy sector built a cross-national fidelities, and this allegiance was mediated by "*a form of politics in which political and economical elites colluded to further their*" (H. Wallace 2010) different interests. Under this decisional structure, Scharpf (1988) identified a "joint-decision trap" within the operation of the European Council. He underlined how the power of veto-players created high obstacles to the revision of the common policy once it was agreed.

The classical Community mode was used mainly on trade matter policies, but it was also adopted in the procedure which brought the birth of the common currency, even though in this occasion the central delegated institution was the ECB rather than the Commission.

3.4.2 The EU Regulatory Mode

The EU Regulatory mode was set up under the Treaty of Rome in order to achieve its main objective in establishing the single European market. In order to reach such results it was essential to introduce a new form of regulation (Majone, 1996), which helped national policy-makers to escape from the constrains of politics and the rigidities of the national level policy-making. For this reasons, a European Regulatory mode, which could have combined transnational standards with the

Figure 3.3: Regulatory mode flow chart



Source: http://ec.europa.eu/codecision/stepbystep/diagram_en.htm 03/03/2012 national differences, was introduced.

This regulatory regime is characterised by:

- The European Commission is the architect and the defender of regulatory objectives and rules, setting economic criteria and often working with stakeholders and communities of experts;
- The European Council, as the Institution which gathers the national governments, is the place where minimum standards and the directions of harmonisation are decided;
- The European Court of Justice and the Court of First Instance are the Institutions which ensure the application of the rules by the Member States and give the opportunities to individual entrepreneurs to be compensated in case of discrimination or non-application;
- The European Parliament: with an increased strength, is the representative institution for the non-economic aspects (such as environmental, regional, social);
- The regulatory agencies: both European and National, solve an important role of cooperation and mediation;
- The stakeholders have the extensive opportunities to influence the shape and the content of the European markets' rules. (H. Wallace, 2010)

This mode has been used for many policy areas, such as: employment policy, industrial policy (in particular about competition regime and environmental impact), biotechnology and food safety and recently it was also adopted to reform the CAP. This mode took the place of the previous classic Community mode, as it made the possibility to reform a policy, due to the large number of veto-players, difficult. This sectorial regulatory mode has given the birth to many new quasi-independent regulatory agencies, such as the European Food Safety Authority (H. Wallace 2010), which rule and audit a particular sector under the supervision of the Commission.

The regulatory mode, after two decades of experience, has proved itself as successful with goods and competition regulations. But it also appears less efficient in dealing with process standards and in other policies, where there is a discrepancy between the common policy decision and the national level implementation (which can vary from country to country) (H. Wallace 2010). Another limit of this way of developing policies has been shown by Coen and Richardson (2009) which emphasise the increasing role of interest groups, lobbying and corporate actors who have become strong veto-players in the competition regulation[35].

3.4.3 The EU Distributional Mode

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[35] For more information about Agricultural Lobby impact on the acton of EU policy read "*Growth Coalitions and Rural Development Policy in the EU and the US*" Warner, Mildred; Shortall, Sally; EuroChoices, 2008, v. 7, iss. 3, pp. 34-37.

Over the years, the European Union strove for a redistribution and reallocation of resources to different groups, sectors, regions and countries, initially because of “financial solidarity” and lately, from the mid-1980s, because of a need for “cohesion” among European countries. Due to the enlargement of the European boarders, the number of marginalised countries, regions and social groups, which needed to be protected and helped to face the challenges of the global markets, increased creating an unbalanced effect within the European economy. This distributional issues brought to a peculiar policy mode whose effort was, for instance, to transfer resources from both taxpayers and consumers to particular groups of interest, sectors, regions or countries. The increasing “*arguments over the distributional of budgetary burdens and benefits of participation in the EU meant that distributional policy-making was often highly politicised*” (H. Wallace, 2010).

The Distributional mode is characterised by:

- The European Commission tries to conceive programmes, according to the needs of local and regional authorities or sectorial stakeholders and agencies, and to adopt financial incentives to acquire consideration and clients;
- The European Council: governments' members in the Council, under the pressure of local and regional agencies or lobbies and other stakeholders, bargane over budget with redistributive factors;
- The European Parliament: the Members of the European Parliament, increasing their pressure in the decision-making, strengthen the requests of the regional and local stakeholders;
- The local and regional authorities: “*benefiting from some policy empowerment as a result of engaging in the European area*” (H. Wallace, 2010);
- The stakeholders are a pivotal component of the policy making process, since each actor refers to their interests during the decision-making;

This mode shifted the initiative from the Commission-based to a more local and stakeholder-oriented one. The stakeholders in this process play a strong and essential role, since they are the interest holders. But, together with the stakeholders, the Council – with its bargaining between governments– and the Parliament – holding the non-economic interests of the European citizens – play the real role of decision-makers in the policy process, that is why the decisions taken under the distributional mode are defined as “multi-level governance” decisions (Marks, 1993).

3.4.4 Policy Coordination Mode

Policy coordination is a mode drawn by the Organisation for Economic Cooperation and Development (OECD). It has been used by the EU Commission since 1960s to develop light forms of cooperation and coordination in the matters of core EU economic competences. "*Policy coordination was intended as a mechanism of transition from nationally rooted policy-making to an EU collective regime*" (H. Wallace: 99, 2010). This mode is characterised by:

- The European Commission: it is the developer of networks of experts or epistemic communities, gathering technical evidences which give support to a shared method to encourage modernisation and innovation;
- The European Council: it brainstorms or proposes ideas together with national experts rather than bargain solutions;
- The European Parliament: it institutes committees of specialists advocated to specific approaches;
- New actors, such as independent experts, which are promoters of ideas and techniques, develop systematic policy comparisons and benchmarks in order to promote policy learning;
- The output of such decisions is a "soft law" and "declaratory commitments" directed to a gradual change in behaviour and policy-making within the Member States (H. Wallace, 2010).

This mode of policy-making is largely used in the EU in order to reach the growth and cohesion objectives stated in the Lisbon Treaty, through projects funded by the EU institutions, such as the European Regional Development Fund. The funds are specifically allocated by the EU Commission on issues that the applicants of the funds have to tackle. The applicants have to set a network of expertise and find a solution to the specific issue and, after that, they have to implement the decision taken (Sapir et al. 2004; Kok 2004). Thus, it is evident that this mode, which is identified as the "open method of coordination" (OMC), is not aimed to establish a single common framework which must be applied in each Member States. Its objective is to share experiences and spread the know-how of the best practice. This mode shows also some limits which, sometimes, makes its outputs ineffective. In particular, the heterogeneity of the actions among the numerous Member States makes it difficult to set comparable indicators between the different actions. Moreover, the relevant number of actors create a disperse political responsibility, which makes it harder to exercise political accountability (H. Wallace, 2010).

3.4.5 Intensive Trans-Governamentalism

Across its history, the EU has faced issues and, consequently, decisions which have been beyond the market-making and market-regulating competences, and, in such occasions, the role of the Member States' Governments were pivotal for the decision making. For this reason, such European cooperation, is called "trans-governamentalism" (H. Wallace, 2010). It is commonly used in the EU institutional system when the EU institutional framework, as it is, is not appropriate to face a particular issue. It is characterised by an intensive intergovernmental dialog among some Members States' Governments that, separately from the EU institutional framework, decide to adopt a particular policy, which could be lately adopted in the EU legislation. An example of the application of this mode was the Schengen Agreement. This, in fact, was a policy (liberalisation of internal boarders) developed outside the EU framework, and lately introduced in the EU legislations. This intensive trans-governamentalism is characterised by:

- The European Commission has a limited or marginal role;
- The European Council is the entrepreneur actor, in particular the EU Council of Ministers, which sets the direction of the policy;
- The European Parliament and the European Court of Justice are excluded from the policy cycle;
- The National Policy-Makers are involved by the Member State' Governments (thus the EU Council of Ministers) in order to shape the national interests;
- The output of the cooperation is a joint policy.

The European trans-governamentalism has sometimes been the first step which has led to a treaty foundation, even tough the decision and the discussion of a policy have been set outside the main EU institutions. Throughout the European history, the sudden changes, which were underlined by the signing of a treaty, began thanks to a Member States' dialog outside the EEC/EU Institutions. In a certain way, nowadays, a similar situation with the Member States' public finance crisis is happening: in fact, the intense dialog between the European Governments is deciding the future path of the EU more than the European Institutions themselves.

As it is shown, the EU operates through various methods and institutional patterns which have constantly changed over the years. This constant change is a response to the evolution of the internal and external factors, which are economic, political, functional and procedural. The codification of this five policy modes could better help to understand the action of the EU in the decision-making process.

3.5 Conclusions

The European Union framework and its governance are one of the most important factors which influence the European Integration and the future of the EU itself. As it has been said, the distribution of the powers alongside the decisional process is crucial to efficiently conduct a policy from the agenda-setting towards the feedback evaluation in a proper and rational way. Unfortunately, the distribution of the powers, in each step of the European policy-making process, is not efficient yet. There are, in fact, numerous occasions in which one of the policy players has the power to deny or to stop a decision, as it has happened for CAP (Common Agricultural Policy) reform, which has been stopped for many years because of the veto of one of the Member States (Roederer-Rynning, 2003). The CAP is just one of the numerous examples in which national interests, empowered by voting and/or veto powers, have stuck the European modernisation process. Other examples of this kind will be shown later.

For this reason, many scholars (Kirman and Widgren, 1995; Faini, 1995; Pokrivcak, Crombez, and Swinnen, 2006; Widgren, 2008; Bârsan-Pipu and Tache, 2009; Widgren 2009) have studied the influence of the voting system on the decision-making process and the possible alternatives in order to decrease power inequities in the voting process. In Chapter 6 alternative voting systems and their effects on the European decision-making will be discussed.

4 The European Union: the Budget

One of the most important factors which influences and guarantees the evolution of the modern States is the budget. The budget is how the resources of a country or of a supranational infrastructure are managed. In this section, the characteristics of budgetary politics and of policy-making are unveiled, to show the institutional bargaining for the allocation of the resources. It is important to remark that "*budgets matter politically, because money*[36] *represents the commitment of resources to the provision of the public goods and involves political choices across sectors and regions. The politics of making and managing budgets has had considerable salience in the evolution of the EU because budgets involve both distributive and redistributive politics*" (Laffan and Lindner 2010)[37].

The existence of the EU Budget is due to and guaranteed by its distinct functions (Laffan and Lindner 2010):

- a means of side-payments, which are essential to secure the consensus and the political stability on further economic integration;
- the source for funding European public goods which benefit all European citizens;
- the basis for wealth redistribution from richer to poorer regions of the EU, which promotes the economic convergence towards higher standards of living throughout the Union;
- a means of endowing the EU role in the World.

Therefore it is important, as many authors did, to start the Budget analysis taking a look at its evolution over the years, showing the political and economic reasons which changed the budgetary framework. Consequently, the current EU Budget and its framework will be shown.

4.1 Birth and Development of the Early Financial System (1951-1975)

Since the establishment of the European Coal and Steal Community (ECSC) in 1951, with the Paris Treaty, the Community started to have a financial autonomy managed through different budgets (administrative and operating budgets). In its first twenty-four years (1951-1975) the Community Financial System has experienced numerous changes.

The fist endeavour concerning the budgets was to merge all of the budgetary instruments: from 1957, step by step, the administrative budget of the ECSC and the EurAtom were merged into the

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[36] ndr. here, the word money has a broad meaning referring to the more general idea of financial resources.

[37] More about politics influence on budgetary decision see Linder, J. (2006), *Conflict and Change in EU Budgetary Politics* (London: Routledge)

EEC General Budget (thanks to the EEC Treat in 1957, the Merger Treaty in 1965, and Luxembourg Treaty 1970), which eased the budget management and reduced the waste of resources.
Another important decision concerning the European budgets was taken towards the financial autonomy of the Community. Originally the ECSC had to "*procure the funds it requires to carry out its tasks*" (Art. 49, Paris Treaty) imposing levies on the production of coal and steel and contracting loans. In the further Treaties, between 1958 and 1970, a system of Member States' contributions was introduced (with the following proportion: 28% for Germany, France and Italy, 7.9% for Belgium and the Netherlands and 0.2% for Luxembourg, unanimity was required to modify these proportions). In 1971, a new system of own resources to finance the General Budget was introduced. The self-financing system, approved in 1970, foresaw that the European Institutions should have fund their budget through:
- custom duties,
- agricultural levies,
- VAT-based revenue (initially limited to the 1% rate in every Member States).

In the period between 1971 and 1975, the Member States continued to contribute to the European budget in order to guarantee its balance. Since 1975, the Communities should have been entirely financed by own sources, even though until 1981 the Member States should have contributed to the Communities' Budget in a constantly decreasing way. "*This own resources decision, which could not be changed unless unanimity was reached in the Council, thus created a stable basis for financing the Union*" (Commission, 2008).
The first budgets where devoted to the development and the accomplishment of the earlier common policies, such as the creation of the European Agricultural Guidance and Guarantee Fund (EAGGF) (1962), the research policy (initially based on the Euratom Treaty but then extended to many other fields), the reform of the European Social Fund (ESF) (1971), the establishment of the European Regional Development Fund (ERDF) (1975).
Due to the increasing number of institutions and policies, the equity between the institutions in the exercise of powers over the budget was changed. Initially, in the ECSC Budget the High Authority and the auditors were the only actors taking control. But, in the subsequent Treaties, the actors who were in charge on the management of the budget increased. In 1957, the Rome Treaty ratified that the Commission (which drafts the budget and implements it) and the Council (which adopts the budged and has the possibility to discharge it) were the new actors of the EEC Financing System. In 1970, thanks to the Luxembourg Treaty, the distinction between compulsory and non-compulsory expenditure was introduced. Moreover, after its introduction, the European Parliament received the

power to adopt the non-compulsory expenditure of the budget (but not the power to decide on the compulsory expenditure, which was prerogative of the Council). Furthermore, the budgetary discharge power was given to the joint Council/Parliament decision. In 1975, the Brussels Treaty ratified that the powers of decision on the budgetary matters are shared between the Council and the Parliament, which became the European budgetary authorities; while the Commission is in charge of drafting the budget and the Court of Auditor (which replace the Auditor Board in 1976) controls the budget. All of these provisions are still in force today.

4.2 The Crisis of the Community's Finance and the Budgetary Battle (1975 - 1987)

In the first twenty years of the European Communities' history, a big change was given by the first enlargement of the Communities. In fact, in 1973 the United Kingdom, Denmark and Ireland joined the EEC, which was starting the gradual implementation of the own resources, thus the new Member States had to respect its provisions.

In the period between 1975 and 1987, the political and institutional balance within the Communities's financial framework experienced in the previous years was gradually unsettling. During this period the decision-making process on budgetary matters was extremely difficult and the conflict among the actors was so harsh that in 1980, 1985, 1986 and 1988 the budgets were adopted only when the financial year was ongoing, hence, it would have been applied for a period of only five or six months (Commission 2008).

The main reasons which caused such situation were: the conflicts between the institutions, the budgetary imbalance, and the deficiency of sources to cover the needs of the growing Community.

The institutional changes adopted from 1975, the power-sharing between the Council and the Parliament, resulted difficult to be implemented due to the vagueness of the provisions stated in the Brussels Treaty (also known as EC Treaty). Moreover, the establishment of the direct elections for the European Parliament created a climate of conflict between the Parliament and the Council. This conflict was in particular underlined by the new power of the European Parliament concerning the Communities Budget, in particular on the decision on the compulsory and non-compulsory expenditures. "*The Council [had] the final say over compulsory expenditure, the amount of which is fixed at its second reading, while Parliament [had] the last word on the volume of non-compulsory expenditure at its final reading of the draft budget*" (Commission; 25, 2008). Dividing the responsibility between the two branches of the budgetary decision-making process created many problems, since anytime the two institutions were in variance the whole process was stuck. Moreover, the EC Treaty did not provide any provisions concerning conciliation mechanisms or imposing solutions to solve the possible conflict between the two institutions.

The relevant change in the Parliament power on the matter of budget was even more emphasised by the clashing between the legislative power and the budgetary power. Until 1974, the legislative power and the budgetary power were held by the sole European Council, thus any decision taken on the legislative side would have been approved on the budgetary, side since they ware taken by the same institution. This situation changed radically when Council have started to share the power concerning the budget with the Parliament. Thus from 1975 onwards, the Parliament started to "*inserted many new budget lines and entered appropriations which could sometimes be used to start up new actions; the amounts increased over the years*" (Commission: 27, 2008). On the other side, the Council, using its legislative power, started to impose maximum amounts to relevant expenditures. This action was seen by the Parliament as an encroachment of its budgetary power over non-compulsory expenditure by the Council.

In 1982, the Commission, the Council, and the Parliament signed a joint declaration which set up constrains on budgetary matter for the Council and the Parliament, defining in details all the responsibilities of the two branches of the budgetary authorities. The declaration gave a better definition of compulsory and non-compulsory expenditures, it laid down the "*maximum-rate of increase for such expenditure in relation to expenditure of the same type to be incurred during the current year*" (Art. 272 (9) EC Treaty, 1976). Moreover, the declaration specified a procedure for the approval of the annual budget, it also stated that "*maximum amount by regulation must be avoid*" and that there should have been a separation from a legal basis for the utilisation of appropriations for any "significant action". The joint declaration lasted until 1986, when Spain and Portugal joined the EC. The joining of new actors within the Institutions created a new disagreement between the budgetary authority, which were brought by the Council before the Court of Justice, which annulled the budget for the 1986 financial year.

The second reason which caused a harsh conflict within the Communities debate, raised by the two bigger net contributors to the EC budget, the United Kingdom (UK) and Germany, was the budgetary imbalance.

The UK, at the time of its accession, was, on one side, one of the biggest contributors to the EC budget, since the contribution was VAT-based and the UK had one of the highest GNP of the Community. On the other side, the UK, having a small agricultural sector, which was (and still is) the highest spending of the EC Budget, availed very little of this Community's spending. This structural imbalance was underlined and strongly opposed by the UK since 1974, threatening to leave with a national referendum in 1975. From 1975 onwards, the Community tried to find a solution to this imbalance that could have also occurred to other countries in the future. In 1975 the European Council agreed on a compensation from the Community Budget to all the Member States which were bearing an unacceptable financial burden, with a partial rebate on the VAT-based contribution. The rebate would have been triggered if certain conditions had occurred at the same time[38], the conditions never took place and the rebate and the mechanism were never applied. In 1979, another compensation mechanism was agreed, but only in 1984 (taking effect from 7 May 1985) a stable decision on the UK rebate was taken. Initially, the compensation should have been accomplished reducing a fixed amount of resources from the VAT-based contribution. Subsequently, it was decided that the reductions should have been two-thirds of the difference between the UK share in VAT-based contribution and its share of total allocated expenditures. The UK rebate was financed by all the of other Member States, in accordance with their percentage share of VAT endowment.

As a consequence of the rebate to the UK VAT-based contribution, Germany, as it was the first net contributor of the EC budget, complained about the compensation to the UK and, in particular, about the fact that it should have paid the largest part of the rebate. Because of this imbalance highlighted by Germany, its share enjoyed a one-third reduction.

The third important reason which caused a conflicting period on budgetary matters, was the inadequacy of the resources to cover the growing needs of the Community. This inadequacy was mainly caused, on one side, by an insufficiency of the revenue, and, on the other side, because of a rise in expenditures. The revenues of the Community in this period experienced a reduction as:

- its own resources diminished their yield,
- custom duties affected the reduction of the tariff due to the GATT negotiations (whose aim was to abolish any tariff barrier),
- the agricultural levies affected the reduction of importation of agricultural goods, due to the increasing production within the EC boarders.

In addition to these reasons, the VAT-based revenue faced a period of relative stagnation, due to a slowing down of consumers' expenditures in the Member States' economies.

The imbalance between revenue and expenditures of the Community was even more emphasised by the enlargement of the Community in size and actions. Many existing policies were boosted, such as the European Social Fund and the European Regional Development Fund. New policies were started, like the common fisheries market policies, the first framework for Community research and

[38] "*per capita GDP below 85 % of the Community average; rate of growth less than 120 % of the Community average and share of own resources payments exceeding by 10 % the share of total Community GDP*" (Commission: 29, 2008)

a Community system of authorised quotas. Another cause of increasing expenditure was the inability to manage the agricultural policies, which increased by 16% per year[39] and systematically exceeded the estimates made in the preliminary draft of the budget. The last important new source of expenditure was brought by the new Member States which joined the EC, Greece (1981), Spain and Portugal (1986), which were net beneficiaries from the Community Budget.

In order to find a solution to the inadequacy between revenue and expenditures, in 1984 (taking effects from 1 January 1986) the European Council found a political agreement, which raised the VAT ceiling to 1,4%, and, in the transitional period 1984-1985, stated that the Member States should have advanced payments in order to balance the budget (the advances were repayable in 1984 and non-repayable in 1985). In 1987 the new VAT ceiling was not enough to balance the budget and ECU 4 billion had to be deferred.

On the expenditure side, a budgetary discipline was taken to help in this difficult situation of the Community's finance. As written previously, in 1979, the Council agreed on an internal code of conduct for a reduction of the growth of non-compulsory expenditures, setting a maximum rate of increase. In 1984, the European Council extended the budgetary discipline to the agricultural expenditures, which should not have grown faster that its own resource base. These first attempts toward a budgetary stability had to face the growing disputes between the Parliament and the Council and the fragmentation of the decision-making process.

4.3 The Delors I Package (1988-1992)

With the new enlargement and the signing of the Single Act, in 1986, it was evident that the Community needed a financial system reform. In 1987, the Commission, presided by Jacques Delors, presented a reform proposal, also known as *Delors I package*. This proposal was important for three key decisions:

- increase the resources for the Community, in order to operate properly in the period 1988-1992;
- improve the proportion of the expenditures, in particular giving more emphasis to cohesion policies, policy discipline and a effective reduction in agricultural expenditure;
- provide a new equitable system to finance the Community, this new system should have linked the Member States' contributions closely to their level of relative prosperity.

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[39] Commission (2008), European Union Public Finance (Luxembourg; Office for Official Publications of the European Communities); p.31.

In 1988, with the Council Decision 88/376/EEC, the European Council agreed to the Commission view, designing a new system which improved the stability and balance of revenue and expenditures.

According to the first key decision, the own resources of the Community were increased. A new category of revenue based on Member States' GNP (as it is a good indicator of ability to pay of a Member State), which automatically provided the necessary financing for the Community budget, was also introduced. The contribution of each country was computed by applying to a base, formed by the sum of the Member States' GNP at market prices, a rate to be determined during the budgetary procedure knowing the amount of resources needed to balance the expenditures. Other changes were set for the UK compensation in order to neutralise the effects created by the new features of the own resources system (see Commission: 38, 2008).

Together with the new resources, in order to increase the Community revenue, the Delors I package foresaw a new expenditure framework. The new budgetary discipline was stated in the Council Decision of 1988 and in the Interinstitutional Agreement, signed the same year by the Commission, the Council and the Parliament. The "financial perspective 1988-1992", incorporated as part of the Interinstitutional Agreement, was the key step of the new expenditure framework. This was conceived to provide a consilient and controlled growth in the numerous budgetary expenditures, and, in the meanwhile, setting up a new equilibrium in the distribution of expenditures, in order to ensure the right development of policies coupled with the structural policies stated in the Single Act. The "financial perspective", for the first time in the Community's history, has bound the budgetary authorities, giving expenditure ceilings for the Community and reducing their manoeuvre during the annual budgetary operations.

Another important operation on the expenditure side was the reform of the spending on agricultural matters. The Council had developed a guideline in order to better control the agricultural expenditures, which were (and still are) the largest budgetary cost of the Community.

An important decision was taken to tackle the harsh conflict between the Parliament and the Council about the non-compulsory expenditures. The Parliament could have raised each year non-compulsory expenditures up to the limit congruent with the ceilings in the "financial perspective". The budgetary authorities also agreed that any revision about the compulsory expenditures would not have affected the non-compulsory expenditures. The Interinstitutional Agreement added also other undertakings which both the budgetary institutions would have had to follow: the Council and the Parliament should have implemented as many of the preliminary budget drafts, made by the Commission, as possible; and the allocation of the commitment appropriations for the European funds should have been respected. In 1988, thanks to the Regulation No 2049/88, the Financial Regulation was reformed to have a better and more effective impact in the new enlarged Community.

The last part of the Delors I package has reformed the Structural Funds (EAGGF Guidance Section, Social Fund and Regional Fund), making their action more coordinated, rationalising their objectives and coupling them with the Single Act purposes.

"*For the purposes of rationalisation, the European Council also decided that Community action through the Funds would be targeted at the following five general objectives:*

- *objective 1: promoting development and structural adjustment in less-developed regions;*
- *objective 2: converting the regions, frontier regions or parts of regions (including employment areas and urban communities) seriously affected by industrial decline;*
- *objective 3: combating long-term unemployment;*
- *objective 4: facilitating the occupational integration of young people;*
- *objectives 5a and 5b: with a view to reform of the common agricultural policy, speeding up the adjustment of agricultural structures and promoting the development of rural areas.*" (Commission: 43, 2008)

To have the proper impact achieving the established goals, it was explicitly specified which Funds should have achieved each of the five objectives set by the European Council:

- objective 1: ERDF, ESF and EAGGF Guidance Section;
- objective 2: ERDF and ESF;
- objective 3: ESF;
- objective 4: ESF;
- objective 5a: EAGGF Guidance Section;
- objective 5b: EAGGF Guidance Section, ESF and ERDF.

The Delors I package framed, for the first time, a coordinated action of the Funds with a corresponding link to the purposes of the Treaty.

In 1992, the Commission assessed the action of the Delors I package and its analysis was presented to the Parliament and the Council in two reports (COM(92) 82 about the application of the Interinstitutional Agreement and COM(92) 81 about the results concerning the own resources).

The reports' conclusions described positive results, as the Delors I package achieved many of the objectives it had set. The reports underlined the achievements in the management of the public expenditures and the improvement in the decision-making process which have guaranteed a more coordinated work by the EC institutions. Moreover, the reports focused their analysis on the effects of the new regime concerning the own resources of the Community.

In the period between 1988 and 1992, the European Budget has closely followed the "financial perspective", which was revised and adjusted a limited number of times. The modifications brought to the "financial perspective" were due to important changes in the international environment, such as the end of the Cold War, the independence of the former URSS republics, the unification of Germany, the Gulf crisis, the war in the former Yugoslavia. European Communities have financed many humanitarian projects and allocated numerous funds to help populations and countries under economic difficulties. Moreover, the adjustments made to the "financial perspective" were addressed to strengthen the Community's policies, such as internal policies and cooperation activities in developing countries behalf. An important indication regarding the expenditures was the relative reduction of the agricultural expenditures, whereas, other expenditures have raised more than what had been foreseen by the "financial perspective", in fact the actual ceiling on expenditure was 5,5% per year on average, while the financial framework had planned the 3,9% per year (Table 4.1). The discrepancy between the "perspective" and the actual action of the Community was due to a differ-

Table 4.1: Actual Application of the Financial Perspective 1988-92

	Rate of increase (%) in real terms 1992/88		Distribution (%) of the total appropriations for commitments		
	Original financial perspective	Actual financial perspective	Original financial perspective		Actual financial perspective
			1988	1992	1992
EAGGF Guarantee Section	7.6	6.8	60.7	56.1	52.5
Structural operations	72.7	94.8	17.2	25.5	27.1
Multiannual policies	98.3	101.1	2.7	4.5	4.3
Other policies	33.1	136.5	4.6	5.3	8.9
Repayments and administration	-37.8	-42.8	12.6	6.7	5.8
Monetary reserve	–	-16.2	2.2	1.9	1.5
Total appropriations for commitments	16.5	23.7	100	100	100
Total appropriations for payments	14.4	22.6	96.6	94.9	95.8

Source: Commission: 46, 2008.

ent allocation of the resources compared with what had been planned and because of a sudden increase of expenditures in external policies to help the difficult international environment.

Together with a better management of the expenditures, the budgetary authorities, during the Delors I package period, improved their budgetary procedures and their budget managements. The Council and the Parliament had followed properly the Interinstitutional Agreement so that there had not been particular conflicts and the budgets had been agreed, approved and implemented on time. The debate concerning the adjustments of the budget has shown the different approaches of the two arms of the budgetary decision-making. On one side, the Parliament has advocated for an increase of expenditures, using the gap under the ceiling of the own resources, on the other side, the Council has claimed for a redistribution of expenditures under each heading.

The budget process was coupled with a more rigorous budget management. During the decision-making process, the Council and the Parliament have followed the principle of annuality and the principle of specification which led to a consequent reduction in waste of resources. Moreover, the Commission has started to assess the impact of the implementation of the budgetary actions, in order to have a more transparent cost-effectiveness view of the process, which increased the performance of the budgetary actions.

Another important issue which was tackled by the Delors I package was the budgetary imbalance. In fact, the expenditures for the whole period remained under the ceiling of the available resources, even though the expenditures averagely increased more than what the "financial perspective" had forecast. The budget balance was possible thanks to a moderate increase in the agricultural expenditures and to a faster economic growth of the Community, which had significantly increased the volume of the available resources, in comparison to what had been expected during the development of the "financial perspective". Analysing the revenues it must be added that the "traditional" own resources (custom duties and custom tariff) have decreased during that period and that the VAT-based resources have remained the largest revenue of the Community.

4.4 The Delors II Package (1993-1999)

After the successful results of the Delors I package, in 1992, the Commission decided to consolidate its general framework and to improve it, because of the changes brought by the Maastricht Treaty. The proposal of the Commission, for the so called Delors II package, was to improve the achievements reached in the previous period on the agricultural expenditures and on the Structural Funds management. Moreover, to implement new policies and actions in order to help the birth of the future common currency and to set the basis to meet the new international responsibilities brought by the new-born European Union.

The Maastricht Treaty in 1992 set important goals for the Union, which needed new policies to be developed and implemented. The first instrument, established by the Treaty, was the Cohesion Fund to finance infrastructures, environment projects and transports in the Member States with a per capita GNP under the 90% of the Union average. The first objective of the Fund was to favour economic convergences, which were essential in the circumstances of the economic and monetary union.

The key priorities set by the Commission in order to reach the purpose of the Treaty were: economic and social cohesion; external action to take account of changes in the international environment; fortifying the competitiveness of the European Industry through researches and financing the trans-European networks.

During the European Council, in Edinburgh in 1992, the financial package was set out. The Council decided the provisions for own resources and expenditures. It agreed to increase the own resources ceiling of the Union GNP; the overall ceiling on appropriations for commitments was fixed at 1.335% of GNP; the VAT-based own resourcing of the Union was reduced in equal steps in the period 1995-1999 (Commission, 2008).

On the expenditure side, the new package agreed by the Council foresaw an increase in every heading, except for the agricultural expenditure. The financial framework for the period 1993-1999 was set as pictured in the table 4.2.

Together with the decision of the European Council to adopt the financial framework, there was the renewal of the Interinstitutional Agreement in order to keep onwards the institutional stability which characterised the Delors I package. After the debate regarding the Interinstitutional Agreement, new ideas were adopted to improve it concerning the budgetary discipline and the budgetary procedure. One of the most relevant changes in the budgetary discipline concerned the possibility to introduce additional appropriations under the ceiling for the various headings, which were possible without revising the financial perspective first. Despite the small changes in the budgetary discipline, the budgetary procedure was subjected to a stronger revision.

Under the new procedure's framework, the Parliament gained more power on budgetary decisions, having the possibility to discuss with the Council budget priorities and compulsory expenditures. The Parliament would have also had the possibility to discuss the volume of compulsory expenditures to be booked in the budget, even though the Council would have still had the last word.

The last major innovation of the Agreement was the introduction of a 'negative co-decision' proce-

Table 4.2: Financial perspective 1993-99							
Appropriations for commitments							
							(million ECU at 1992 prices)
	1993	1994	1995	1996	1997	1998	1999
1. Agricultural guideline	35 230	35 095	35 722	36 364	37 023	37 697	38 389
2. Structural operations	21 277	21 885	23 480	24 990	26 526	28 240	30 000
— Cohesion Fund	1 500	1 750	2 000	2 250	2 500	2 550	2 600
— Structural Funds and other operations	19 777	20 135	21 480	22 740	24 026	25 690	27 400
3. Internal policies	3 940	4 084	4 323	4 520	4 710	4 910	5 100
4. External action	3 950	4 000	4 280	4 560	4 830	5 180	5 600
5. Administrative expenditure	3 280	3 380	3 580	3 690	3 800	3 850	3 900
6. Reserves	1 500	1 500	1 100	1 100	1 100	1 100	1 100
— Monetary reserve	1 000	1 000	500	500	500	500	500
— External action							
• emergency aid	200	200	300	300	300	300	300
• loan guarantees	300	300	300	300	300	300	300
Total appropriations for commitments	69 177	69 944	72 485	75 224	77 989	80 977	84 089
Appropriations for payments required	65 908	67 036	69 150	71 290	74 491	77 249	80 114
Appropriations for payments (% GNP)	1.20	1.19	1.20	1.21	1.23	1.25	1.26
Margin for unforeseen expenditure (% GNP)		0.01	0.01	0.01	0.01	0.01	0.01
Own resources ceiling (% GNP)	1.20	1.20	1.21	1.22	1.24	1.26	1.27
Pro memoria: total external expenditure	4 450	4 500	4 880	5 160	5 430	5 780	6 200
Pro memoria: the inflation rate applicable for the 1993 budget is 4.3 %.							

(Source: Commission: 56, 2008)

dure which was used to mobilise the reserves. If the Commission's proposal had not achieved the agreement between the two arms of the budgetary authority, and if they had not agreed on a common decision, the proposal would have been considered approved.

The implementation and the consequent results of the action of the Delors II package have been influenced by many events which occurred in the European Union during the 1990s, such as the difficult economic recession which has affected the international environment and the enlargement of the Union.

Due to the recessive international economic environment[40], the financial perspective has been revised since the beginning of its action in 1993. The real GNP of the Union was subjected to a reduction until the second half of 1994. The contraction of the EU real GNP influenced all the Union Budget, since the GNP was the base to compute most of the revenue and expenditure indicators. In particular, the reduction on the GNP had a direct impact on the agricultural expenditures. The ceiling on own resources was affected as well, the weakening of the GNP led to the reduction of the ceiling own sources, which in 1995 were insufficient to cover all the expenditures forecast by the financial framework, moreover the margin for unforeseen expenditure of 0,01% of the GNP became too small to be effective. Another important element influenced by the GNP reduction was the own resources themselves, in fact, due to the recession, the traditional own resources and the VAT-based resources were significantly below the level forecast on the financial perspective. The shortfall of the own resources created negative balance which, in conformity with the Financial Regulation, had to be registered in the budget of the following year as expenditure, therefore weakening in principle the amounts of expenditure foreseen in the financial framework (Commission 2008). Because of these effects of shortfall of resources, the Parliament asked that the negative balance, resulting from revenue shortfalls, would not decrease the volume available within the expenditure ceilings.

During the implementation of the Delors II package, together with the economic recession, the European Union had experienced the new enlargement from twelve to fifteen Member States. In 1993 Norway, Austria, Finland and Sweden started their negotiation to join the EU (successively Norway did not join the EU because the Norwegians vote against entry in a national referendum). The joining of the Scandinavian counties and Austria would have helped the budget of the Union, since their relative prosperity would have made them net contributors of the EU Budget. The negotiation between the applicant countries and the Union ended with the decision for a budgetary compensation in favour of the applicants, in particular to ease their entering in the Union Budget. These facilitations were carried out in two ways: the loss of earnings occurred during the first year in the agriculture sector would have been compensated on the account of the non-payment of direct per hectare aid; and, in order to support the falling in prices of the agricultural sector of the applicant countries, a degressive compensation in the next four years (depreciation of stocks and direct compensatory aid) would have been applied.

The Act of Accession, which gathered all the provisions decided during the negotiation, also foresaw appropriations which the new Member States could have demanded within the Structural Funds, such as the possibility for Burgenland region of Austria to be eligible for "objective 1"

[40] For further reading on the subject see: Malinvaud E. (1994) and Von Hagen, J., & Lutz, S. (1996)

(promoting development and structural adjustment in less-developed regions). A new objective ("objective 6") which directed the allocation of the budget also in favour of regions with a population density not exceeding eight inhabitants per squared kilometre (useful for the development of some Scandinavian regions) was also added.

The accession of new Member States imposed a revision to the financial perspective, which was adjusted to the EU-15 with the financial framework 1995-1999, the process was so fast that it could be already adopted in 1995. The new financial perspective provided for a higher ceiling for headings, in order to cover the increasing expenditures due to the enlargement of the Union. The enlargement affected all the expenditure sectors: the agricultural guidelines were raised since the Union GNP increased; the structural operations were influenced by the new allocation of Structural Funds ratified by the Act of Accession; the internal policies rose, matching to the relative volume of the GNP of the new Member States; the external policies rose due to the higher ability to contribute of the European Union; the administrative expenditures rose during the period 1995-99; moreover, the margin for unforeseen expenditures also rose (Commission: 65, 2008). Table 4.3 shows the revised financial framework 1995-99.

The results of the Delors II package shown that the financial perspective, except for the modification in 1995 due to the enlargement to 15 Member States, were substantially unchanged even though the economic environment during the 1990s was particularly difficult for the European Union.

On a deeper analysis of the budget it can be seen that, on the side of expenditures in the period 1993-96, the expenses of the Union were very close to the ceiling of the financial framework and in 1994 and 1995 the spending was particularly under the expectations foreseen by the financial perspective. This reduction in spending under the expectation was due to an under-utilisation of the agricultural and structural operations, in favour of a priority allocation of the resources towards the other Union policies. From 1997, thanks to a higher amount of resources, due to the enlargement and to a better economic environment, the annual budget was adopted following the financial perspective and keeping a substantial gap under the own resources ceiling.

Another important aspect that has to be analysed about the Delors II package implementation, was the evolution of the budgetary debate between the Parliament and the Council during the financial framework period. The debate at the beginning of the period, in 1993, showed the will of the Parliament to increase its budgetary power with the attempt to embody the same budgetary power of the Council. After this conflictual start the two budgetary authorities worked in order to find an agreement which would have improved the budgetary procedure, in particular after the enlargement

Table 4.3: Financial perspective for the enlarged Community 1995-99

Appropriations for commitment

(million ECU at 1995 prices)

	1995	1996	1997	1998	1999
1. Common agricultural policy	37 944	39 546	40 267	41 006	41 764
2. Structural operations	26 329	27 710	29 375	31 164	32 956
Structural Funds (1)	24 069	25 206	26 604	28 340	30 187
Cohesion Fund	2 152	2 396	2 663	2 716	2 769
EEA financial mechanism (2) (3)	108	108	108	108	0
3. Internal policies	5 060	5 233	5 449	5 677	5 894
4. External action	4 895	5 162	5 468	5 865	6 340
5. Administrative expenditure	4 022	4 110	4 232	4 295	4 359
6. Reserves	1 146	1 140	1 140	1 140	1 140
Monetary reserve (2)	500	500	500	500	500
Guarantee reserve	323	320	320	320	320
Emergency aid reserve	323	320	320	320	320
7. Compensation (2)	1 547	701	212	99	0
8. Total appropriations for commitments	80 943	83 602	86 143	89 246	92 453
9. Total appropriations for payments	77 229	79 248	82 227	85 073	88 007
Appropriations for payments as % of GNP	1.20	1.21	1.22	1.23	1.24
Margin as % of GNP	0.01	0.01	0.02	0.03	0.03
Own resources ceiling as % of GNP	1.21	1.22	1.24	1.26	1.27

(1) Between 1996 and 1999 the annual technical adjustment for the amounts intended for the new Member States, fixed at 1995 prices in the Act of Accession, were based on 1995 prices.
(2) Current prices.
(3) The ceiling for this subheading could be changed, if necessary, under the technical adjustment procedure provided for in paragraph 9 of the Interinstitutional Agreement in line with the actual payments in the course of each financial year.

Source: Commission: 66, 2008.

to fifteen members. After numerous agreements reached by the two institutions, a new legislative procedure was introduced: the co-decision, which has given the same power to the Parliament and the Council over particular budgetary decisions. Together with the "co-decision", a new decisional framework was developed. The multi-annual programmes would be approved under co-decision. Other agreements were taken over procedural decisions of specific policies such as fisheries, agriculture, and common foreign and security policy. The Parliament and the Council, in 1998, agreed also on the principle that to use appropriations added to the budget previously requires the adoption of a basic instrument, except for pilot projects, preparatory measures and one-off actions.

4.5 A Stable Budgetary Base for a Larger Europe: Agenda 2000 (2000-2006)

The work which led to the financial framework of the period 2000-2006, started in 1997 and after two years of negotiation the Union institutions approved the financial perspective, also known as the Agenda 2000. Differently from the previous financial frameworks, the Agenda 2000 was characterised by a long and intensive negotiation between the Member States. The key point of the debate regarded: the reform of the Common Agricultural Policy and structural operations, which should have been reformed in order to have a better impact in the issues affecting also the new Member States; the budgetary discipline and the raising of own resources ceiling, since the EU would have established the common currency in 2002; a better distribution of the expenditures, as many budget's net contributors had complained about the imbalance between contributions and benefits.

The negotiation led to the financial framework 2000-2006 which underlined the main concern expressed by Member States during the budgetary debate: stabilisation and consolidation of expenditures, which also gave the certainty of a non increasing deficit in absolute terms for the net contributors. The new provisions of the budget foresaw to keep constant the own resources ceiling, a reduction of total expenditure, whereas the margins on unforeseeable expenditures were increased. The reduction of the total expenditures was a result of the new framework of the European policies which where reduced in their number but focused in their action.

The agricultural expenditures (Heading 1) were no longer managed by the agricultural guidelines, but they resulted as expenditures of the reformed CAP. Under the Heading 1 the expenses for pre-accession aid, concerning agricultural components, and the agricultural spending for the forthcoming enlargement were also added. The CAP expenditure were reduced, since the reform of this policy brought to a reduction in the intervention price (15% less for arable crops and 20% for beef) and in the compensation, in form of aid, to producers.

The structural expenditures (Heading 2) were substantially kept constant, but their composition and allocation radically changed. Most of the expenditures were allocated on the cohesion policy, which included the expenses devoted to the pre-accession aid for the forthcoming members. The expenditures on Heading 2 were reorganised following the Commission's proposal to make them more rational and focused, in order to decrease the wastes. For this reason there was a concentration of the resources, reducing the objectives of the Structural Funds from seven to three:

- Objective 1: promoting development and structural adjustments in least well-off regions (with a per capita GDP less than 75% of the Union average).
- Objective 2: converting rural areas in decline, areas affected by change in industry, services or fisheries, and urban areas in difficulty.
- Objective 3: to support the adaptation and modernisation of education, training and employment systems.

Together with a concentration of resources there was also a geographical concentration, reducing the maximum eligibility for the Objective 1 and the volume of population eligible for the Objective 2.

The provisions concerning the other expenditures (internal policies, external actions and administrative expenditures) were aligned with the reduction and stabilisation of Heading 1 and Heading 2. Noteworthy are the decisions to introduce pre-accession aids to help the Member States-to-be, in order to ease their accession to the Common Market's economy and decrease their gap with the other European Member States, and to set the administrative expenditures at a reasonable level, keeping the staff number and the pensions constant over the period of Agenda 2000.

On the revenuer side, the European Council decided to decrease the VAT-based resource, and, in order to balance this reduction, the percentage of the traditional own sources was increased. The UK compensation mechanism was retained and, in order to balanced the position of other net contributors, the share paid by Germany, the Netherlands, Austria and Sweden was reduced.

With the Agenda 2000, a new Interinstitutional Agreement, which was substantially unchanged on its key provisions (in comparison with the previous one), but in which new key provisions were added to make it more flexible on the possibility of budgetary negative outturn, were introduced. The new provisions mainly concern:

- The possibility to transfer to successive years the part of the allocations which could not be committed in a given year.
- There could be no transfers between the 'pre-accession' heading and the recourses left available for future enlargement, nor between these headings and the ceilings for the other headings set for the EU-15.
- A "flexibility instrument" was introduced, which allowed financing, for a given financial year, of specific expenditures which could not be financed within the ceilings available.

Together with new provisions, the European institutions agreed on few new rules in the matter of budgetary procedures:

- To extend the conciliation procedure to cover all expenditures (compulsory and non-compulsory),

- to lay down guidelines, by broad categories, in order to classify the expenditure.

The Agenda 2000 has been applied as it was set out in the Interinstitutional Agreement, even though its implementations have been made difficult by two important issues: the annual budget debate and the enlargement of the Union.

The main concerns of the debate over the budget were on the external action expenditure allocated to finance regions afflicted by war conflicts (such as Kosovo in 2000 and Iraq from 2004 to 2006) or internal policies expenditure (fisheries programme for the conversion of fishing vessels). The debate between the institutions was related to the way in which the extraordinary expenditure should have been budgeted. The Commission, in those occasions, proposed a revision of the financial framework with the consequent raising of the ceiling of expenditures of the related headings. The proposal of the Commission, which was supported by the Parliament, was opposed by the Council. The solution agreed for the Kosovo's humanity aid was to apply the new flexibility instrument, which was later on used to finance all of the other unforeseeable events that the European Union has faced during the Agenda 2000 period.

Budgetary issues were also raised when, in 2001, at the Laeken European Council the decision to shift the joining of the ten candidate nations was taken. The joining was shifted from 2002 (decided in Berlin, 1999, Table 4.4) to 2004-06. This changes had an impact on the foreseen pre-accession aid expenditures that were planned to be reduced in 2002, after the joining of six new members to the Union. Thus the annual spendings prearranged for the period 2004-06, originally intended to cover the requirements coupled to the third, fourth and fifth year of the accession of six new Member States, would have then been usable for the first three years of the accession of Ten new Member States (Table 4.5).

In the period between 2001-03, the Commission, the EU leaders and the candidate countries presented different adjustments to the original Berlin decisions, in order to face the impact that the later accession date and the higher number of the candidate countries would have had on the EU budget.

The Commission's proposal, made in the beginning of 2002, can be summarised in the following key points:

- to phase in the direct aids over a period of ten years, thus going well beyond the 2000-06 financial framework,
- to make the transition to the EU rural development policy better adapted to the needs of the new Member States, such as increasing the EU co-financing rate up to 80 % for the rural development measures financed by the EAGGF Guarantee Section,

Table 4.4: Financial perspective (EU-15)

(million EUR at 1999 prices)

Appropriations for commitments	2000	2001	2002	2003	2004	2005	2006
1. Agriculture	40 920	42 800	43 900	43 770	42 760	41 930	41 660
CAP (not including rural development)	36 620	38 480	39 570	39 430	38 410	37 570	37 290
Rural development and accompanying measures	4 300	4 320	4 330	4 340	4 350	4 360	4 370
2. Structural operations	32 045	31 455	30 865	30 285	29 595	29 595	29 170
Structural Funds	29 430	28 840	28 250	27 670	27 080	27 080	26 660
Cohesion Fund	2 615	2 615	2 615	2 615	2 515	2 515	2 510
3. Internal policies (1)	5 930	6 040	6 150	6 260	6 370	6 480	6 600
4. External action	4 550	4 560	4 570	4 580	4 590	4 600	4 610
5. Administration (2)	4 560	4 600	4 700	4 800	4 900	5 000	5 100
6. Reserves	900	900	650	400	400	400	400
Monetary reserve	500	500	250				
Emergency aid reserve	200	200	200	200	200	200	200
Guarantee reserve	200	200	200	200	200	200	200
7. Pre-accession aid	3 120	3 120	3 120	3 120	3 120	3 120	3 120
Agriculture	520	520	520	520	520	520	520
Pre-accession structural instrument	1 040	1 040	1 040	1 040	1 040	1 040	1 040
Phare (applicant countries)	1 560	1 560	1 560	1 560	1 560	1 560	1 560
Total appropriations for commitments	92 025	93 475	93 955	93 215	91 735	91 125	90 660
Total appropriations for payments	89 600	91 110	94 220	94 880	91 910	90 160	89 620
Appropriations for payments as % of GNP	1.13 %	1.12 %	1.13 %	1.11 %	1.05 %	1.01 %	0.97 %
Available for accession (appropriations for payments)			4 140	6 710	8 890	11 440	14 220
Agriculture			1 600	2 030	2 450	2 930	3 400
Other expenditure			2 540	4 680	6 440	8 510	10 820
Ceiling, appropriations for payments	89 600	91 110	98 360	101 590	100 800	101 600	103 840
Ceiling, payments as % of GNP	1.13 %	1.12 %	1.18 %	1.19 %	1.15 %	1.13 %	1.13 %
Margin for unforeseen expenditure	0.14 %	0.15 %	0.09 %	0.08 %	0.12 %	0.14 %	0.14 %
Own resources ceiling	1.27 %	1.27 %	1.27 %	1.27 %	1.27 %	1.27 %	1.27 %

(1) In accordance with Article 2 of Decision No 182/1999/EC of the European Parliament and of the Council and Article 2 of Council Decision 1999/64/Euratom (OJ L 26, 1.2.1999, p. 1 and p. 34), EUR 11 510 million at current prices is available for research over the period 2000-02.

(2) The expenditure on pensions included under the ceiling for this heading is calculated net of staff contributions to the pension scheme, up to a maximum of EUR 1 100 million at 1999 prices for the period 2000-06.

Source: Commission: 81, 2008.

Table 4.5: Financial framework (EU-21)

(million EUR at 1999 prices)

Appropriations for commitments	2000	2001	2002	2003	2004	2005	2006
1. Agriculture	40 920	42 800	43 900	43 770	42 760	41 930	41 660
CAP (not including rural development)	36 620	38 480	39 570	39 430	38 410	37 570	37 290
Rural development and accompanying measures	4 300	4 320	4 330	4 340	4 350	4 360	4 370
2. Structural operations	32 045	31 455	30 865	30 285	29 595	29 595	29 170
Structural Funds	29 430	28 840	28 250	27 670	27 080	27 080	26 660
Cohesion Fund	2 615	2 615	2 615	2 615	2 515	2 515	2 510
3. Internal policies ([1])	5 930	6 040	6 150	6 260	6 370	6 480	6 600
4. External action	4 550	4 560	4 570	4 580	4 590	4 600	4 610
5. Administration ([2])	4 560	4 600	4 700	4 800	4 900	5 000	5 100
6. Reserves	900	900	650	400	400	400	400
Monetary reserve	500	500	250				
Emergency aid reserve	200	200	200	200	200	200	200
Guarantee reserve	200	200	200	200	200	200	200
7. Pre-accession aid	3 120	3 120	3 120	3 120	3 120	3 120	3 120
Agriculture	520	520	520	520	520	520	520
Pre-accession structural instrument	1 040	1 040	1 040	1 040	1 040	1 040	1 040
Phare (applicant countries)	1 560	1 560	1 560	1 560	1 560	1 560	1 560
8. Enlargement			6 450	9 030	11 610	14 200	16 780
Agriculture			1 600	2 030	2 450	2 930	3 400
Structural operations			3 750	5 830	7 920	10 000	12 080
Internal policies			730	760	790	820	850
Administration			370	410	450	450	450
Total approps for commitments	92 025	93 475	100 405	102 245	103 345	105 325	107 440
Total appropriations for payments	89 600	91 110	98 360	101 590	100 800	101 600	103 840
of which: enlargement			*4 140*	*6 710*	*8 890*	*11 440*	*14 220*
Appropriations for payments as % of GNP	1.13 %	1.12 %	1.14 %	1.15 %	1.11 %	1.09 %	1.09 %
Margin for unforeseen expenditure	0.14 %	0.15 %	0.13 %	0.12 %	0.16 %	0.18 %	0.18 %
Own resources ceiling	1.27 %	1.27 %	1.27 %	1.27 %	1.27 %	1.27 %	1.27 %

([1]) In accordance with Article 2 of Decision No 182/1999/EC of the European Parliament and of the Council and Article 2 of Council Decision 1999/64/Euratom (OJ L 26, 1.2.1999, p. 1 and p. 34), EUR 11 510 million at current prices is available for research over the period 2000-02.

([2]) The expenditure on pensions included under the ceiling for this heading is calculated net of staff contributions to the pension scheme, up to a maximum of EUR 1 100 million at 1999 prices for the period 2000-06.

Source: Commission: 82, 2008.

- Cohesion Fund expenditure boosted to 33 % of total structural actions, compared to 18 % for the other beneficiary Member States,
- additional allocations would be made for nuclear safety,
- no new Member State should find itself in a net budgetary position vis-à-vis the EU budget, which was worse than the year before enlargement .

The EU leaders, gathered in Brussels in 2002, proposed a common position on the matter of the effect of the enlargement on the EU budget which can be outlined:

- direct agricultural payments were to be introduced following a 10-year phasing-in schedule, expressed as a percentage of the level of such payments in the Union,
- a ceiling for common agricultural policy (Heading 1a) for the EU-25 increased by 1 % per year in nominal terms,
- the total allocation for structural operations was reduced,
- the own resources *acquis* was to apply to the new Member States as from accession,
- temporary budgetary compensations, offsetting any deterioration of the *ex ante* estimated net budgetary position of the new Member States in comparison with their situation in the year before accession, would be offered in the form of lump-sum, temporary payments on the expenditure side of the EU budget.

By the end of 2002, in Copenaghen, the Presidents or the Prime Ministers from the EU and ten candidate countries signed an Agreement which starting from the Brussels common position added some new features concerning a lump-sum cash-flow facility, an extra package consisting of the Schengen facility.

All these measures, both increased the expenditures and reduced the temporary budgetary compensation.

As foreseen by the 1999 Interinstitutional Agreement, the European Parliament and Council had to adjust the financial framework, in order to consider the expenditure needs arising from the enlargement. The new financial framework changed as follow (Commission, 2008):

- the appropriations for the Ten new Member States which had been earmarked in enlargement (former Heading 8) were transferred to the regular headings (agriculture, structural operations, internal policies and administration). Thus this shift of resources allowed an increased of annual ceiling for the commitments,
- the appropriation for pre-accession aid were kept unchanged but they started to cover the pre-accession assistance for Turkey, while amounts allocated for Romania and Bulgaria pre-accession were increased,

- a new Compensation heading (new Heading 8) was introduced, under the Compensation expenditure there were all the amounts in favour of the Ten new members, such as the ‘temporary budgetary compensation’ and ‘special lump-sum cash-flow facility’.

Other changes agreed in the Interinstitutional Agreement were the reduction of the overall ceiling for commitment appropriations and the own resources ceiling for EU-25 remain unchanged in percentage value and it was kept at 1,24% of EU-25 GNI (the GNI of the 25 Member States’ European Union). Successively to the appropriations’ revision the financial framework was adjusted to 2004 prices in order to be coupled with the GNI and the European prices at the time of its ratification (Table 4.6 and .4.7 show the adjusted financial framework respectively at 1999 prices and at 2004 prices).

After the long and intense negotiation for the accession of the Ten new Member States and the consequent debate on the budget adjustments, the 2004 accession gave to the European Institutions a proper feedback concerning a good practice to follow on the matter of new accession of candidates countries. In fact, the budgetary package agreed by Bulgaria and Romania, which joined the EU in 2007, with the Commission for their upcoming access to the EU was similar to the one proposed by the Commission for the accession of the “Ten”. There was also no need to adjust the financial framework for the enlargement, since the negotiation for the new financial framework and for the accession coincided.

Table 4.6: Financial framework (EU-25) adjusted for enlargement (at 1999 prices)

(million EUR at 1999 prices)

Commitment appropriations	2000	2001	2002	2003	2004	2005	2006
1. Agriculture	40 920	42 800	43 900	43 770	44 657	45 677	45 807
1a Common agricultural policy	36 620	38 480	39 570	39 430	38 737	39 602	39 612
1b Rural development	4 300	4 320	4 330	4 340	5 920	6 075	6 195
2. Structural actions	32 045	31 455	30 865	30 285	35 665	36 502	37 940
Structural Funds	29 430	28 840	28 250	27 670	30 533	31 835	32 608
Cohesion Fund	2 615	2 615	2 615	2 615	5 132	4 667	5 332
3. Internal policies	5 930	6 040	6 150	6 260	7 877	8 098	8 212
4. External actions	4 550	4 560	4 570	4 580	4 590	4 600	4 610
5. Administration (1)	4 560	4 600	4 700	4 800	5 403	5 558	5 712
6. Reserves	900	900	650	400	400	400	400
Monetary reserve	500	500	250	0	0	0	0
Emergency aid reserve	200	200	200	200	200	200	200
Guarantee reserve	200	200	200	200	200	200	200
7. Pre-accession strategy	3 120	3 120	3 120	3 120	3 120	3 120	3 120
Agriculture	520	520	520	520			
Pre-accession structural instrument	1 040	1 040	1 040	1 040			
Phare (applicant countries)	1 560	1 560	1 560	1 560			
8. Compensation					1 273	1 173	940
Total appropriations for commitments	92 025	93 475	93 955	93 215	102 985	105 128	106 741
Total appropriations for payments	89 600	91 110	94 220	94 880	100 800	101 600	103 840
Ceiling, approps for payments as % of GNI (ESA 95)	1.07 %	1.08 %	1.11 %	1.10 %	1.08 %	1.06 %	1.06 %
Margin for unforeseen expenditure	0.17 %	0.16 %	0.13 %	0.14 %	0.16 %	0.18 %	0.18 %
Own resources ceiling	1.24 %	1.24 %	1.24 %	1.24 %	1.24 %	1.24 %	1.24 %

(1) The expenditure on pensions included under the ceiling for this heading is calculated net of staff contributions to the pension scheme, up to a maximum of EUR 1 100 million euros at 1999 prices for the period 2000-06.

Commission: 95, 2008.

Table 4.7: Financial framework (EU-25)adjusted for enlargement (at 2004 prices)

(million EUR at 2004 prices)

	Current prices					2004 prices	
Commitment appropriations	2000	2001	2002	2003	2004	2005	2006
1. Agriculture	41 738	44 530	46 587	47 378	49 305	50 431	50 575
1a Common agricultural policy	37 352	40 035	41 992	42 680	42 769	43 724	43 735
1b Rural development	4 386	4 495	4 595	4 698	6 536	6 707	6 840
2. Structural actions	32 678	32 720	33 638	33 968	41 035	41 685	42 932
Structural Funds	30 019	30 005	30 849	31 129	35 353	36 517	37 028
Cohesion Fund	2 659	2 715	2 789	2 839	5 682	5 168	5 904
3. Internal policies	6 031	6 272	6 558	6 796	8 722	8 967	9 093
4. External actions	4 627	4 735	4 873	4 972	5 082	5 093	5 104
5. Administration ([1])	4 638	4 776	5 012	5 211	5 983	6 154	6 325
6. Reserves	906	916	676	434	442	442	442
Monetary reserve	500	500	250	0	0	0	0
Emergency aid reserve	203	208	213	217	221	221	221
Guarantee reserve	203	208	213	217	221	221	221
7. Pre-accession strategy	3 174	3 240	3 328	3 386	3 455	3 455	3 455
Agriculture	529	540	555	564			
Pre-accession structural instrument	1 058	1 080	1 109	1 129			
Phare (applicant countries)	1 587	1 620	1 664	1 693			
8. Compensation					1 410	1 299	1 041
Total appropriations for commitments	93 792	97 189	100 672	102 145	115 434	117 526	118 967
Total appropriations for payments	91 322	94 730	100 078	102 767	111 380	112 260	114 740
Ceiling, approps for payments as % of GNI (ESA 95)	1.07 %	1.08 %	1.11 %	1.09 %	1.08 %	1.06 %	1.06 %
Margin for unforeseen expenditure	0.17 %	0.16 %	0.13 %	0.15 %	0.16 %	0.18 %	0.18 %
Own resources ceiling	1.24 %	1.24 %	1.24 %	1.24 %	1.24 %	1.24 %	1.24 %

([1]) The expenditure on pensions included under the ceiling for this heading is calculated net of staff contributions to the pension scheme, up to a maximum of EUR 1 100 million at 1999 prices for the period 2000-06.

Source: Commission: 96, 2008.

4.6 Policy Challenges and Budgetary Means of the EU27: Financial Framework 2007-2013 and the Current Situation

In 2007 the implementation of the current financial framework started, but behind the results of 2007 there was a 3-year-long negotiation period which found its difficulties inside and outside the European debate. The negotiation for the latest financial framework started in 2004 together with the accession to the "Ten" and immediately after the debate concerning the adjustments of Agenda 2000's Budget. The major objectives which the EU wanted to achieve with the financial framework 2007-2013 were to increase (Commission, 2008):

- cohesion and cooperation in order to reach a higher European growth and a labour market which could offers more and better jobs,
- the citizenship of the European citizen guaranteeing concrete rights and duties, especially concerning freedom, justice and security,
- the impact of Europe in the world economy and polity.

But the EU Commission's prospective had to face the Member States' positions which led to periodical political instabilities within the European Institutions, in particular within the European Council, especially concerning two issues: the adoption of a European Constitution (rejected by France and the Netherlands in 2005) and the divergent positions upon military intervention (in particular war in Iraq 2003, and in Libya 2011).

To increase the political instability and the divergences on the budgetary decision, there was the fact that the latest enlargement of the EU increased the Union's GDP by only the 5%, compared to the 30% growth of the population, thus it meant a drastic increase of the expenditure compared to the revenue. This unbalance was not seen with favour by the EU Budget net contributors – Germany, France, the Netherlands, Austria, Sweden and the United Kingdom. So, in order to match the will of the net contributor, the CAP expenditure (which with the enlargement would have increased of the 50%) were phased-in for a 10-years period as suggested by France and Germany, moreover the six net contributors asked for a reduction of the expenditure of the EU to the 1% of the EU GNI.

Because of this background, the negotiation for the financial framework 2007-2013 needed a deep discussion.

Table 4.8: Shift in the allocation of resources between budget headings 2006-13 according to the Commission's original proposal from February 2004

(million EUR at constant 2004 prices)

Commitment appropriations	2006 ([1])	2007	2013	Difference 2006-2013
1. Sustainable growth	47 582	59 675	76 785	+ 61.4 %
1a Competitiveness for growth and employment	8 791	12 105	25 825	+ 193.8 %
1b Cohesion for growth and employment ([2])	38 791	47 570	50 960	+ 31.4 %
2. Preservation and management of natural resources	56 015	57 180	57 805	+ 3.2 %
of which market related expenditure and direct payments	43 735	43 500	42 293	- 3.3 %
3. Citizenship, freedom, security and justice	1 381	1 630	3 620	+ 162.1 %
4. The EU as a global partner ([3])	11 232	11 400	15 740	+ 40.1 %
5. Administration ([4])	3 436	3 675	4 500	+ 31.0 %
6. Compensations	1 041			
Total appropriations for commitments	120 688	133 560	158 450	+ 31.3 %
Total appropriations for payments ([b]) ([c])	114 740	124 600	143 100	+ 24.7 %
% of GNI	*1.09 %*	*1.15 %*	*1.15 %*	
Margin	*0.15 %*	*0.09 %*	*0.09 %*	
Own resources ceiling	*1.24 %*	*1.24 %*	*1.24 %*	

([1]) 2006 expenditure under the MAFF 2000-06 has been broken down according to the proposed new nomenclature to facilitate comparisons.

([2]) Includes expenditure for the Solidarity Fund (EUR 1 billion in 2004 at current prices) as from 2006. However, corresponding payments are calculated only as from 2007.

([3]) Integration of the EDF into the EU budget is assumed to take effect in 2008. EDF commitments for 2006 and 2007 are included only for comparison purposes. Payments on commitments before 2008 are not taken into account in the payment figures.

([4]) Includes administrative expenditure for salaries, pensions, European Schools, and institutions other than the Commission. Other administrative expenditures are included in the first four expenditure headings.

Source: Figures based on COM(2004) 101 final, 10.2.2004, p. 29.

Source: Commission: 101, 2008

4.6.1 The Commission's Proposals

In 2004, the Commission published its proposal which presented many changes compared to the previous financial frameworks. The headings of expenditures were completely changes and rearranged in order to better accomplish the objective set by the Lisbon Agenda (Table 4.8):

1. sustainable growth,

2. preservation and management of natural resources of which market related expenditure and direct payments,
3. citizenship, freedom, security and justice,
4. the EU as a global partner.

The Commission proposed to keep the ceiling of the own resources at 1,24% of the EU GNI (1,27% of the EU GNP) and an average yearly appropriations for payments of 1.14 % of GNI, in order to anticipate the objection of the Member States, which were reluctant to increase the budget in a period characterised by a difficult economic growth.

Not only quantitative allocations and goals were added to the Commission proposals, in fact also qualitative goals that the European Union should reach by 2013 were introduced.

A deep examination of the Commission's proposals is essential to understand what the ambitious idea of the European executive authority was.

1a. Competitiveness for Growth and Employment

The first heading foresaw a new approach for the EU Budget, which, in order to increases the competitiveness of the Member States, should have financed a new common market for research and technology, with a significant increase in the direct funds for research and students mobility (such as Life Learning Program). The efforts asked were also to increase and improve the trans-European networks between Member States, which should have been led financing new infrastructure and transports (such as new motorways and high-speed railways).

The Growth Adjustment Fund (whose funds were available from heading 1a and 1b) was also introduced, in order to improve the accomplishment of the growth and cohesion objectives by establishing flexibility margins in the Budget. This should have made the EU able to react quickly to the economic changes.

1b. Cohesion for Growth and Employment

Under this sub-heading, a further allocation of resources on national and regional development, towards the improvement of the physical and human capital, in order to exert an increasing impact on competitiveness and growth, were asked. The amounts coming from this heading would have financed national and regional projects which should have improved the know-how of the EU citizens, increasing the education and knowledge of the European labor force, and rose the competitiveness of the European industry, as the Lisbon Agenda claimed.

2. Preservation and Management of Natural Resources of which Market Related Expenditure and Direct Payments

This heading of the budget gathered the proposals for the environmental policies set by the Lisbon and Göteborg Agenda and for the new Common Agricultural Policy. The CAP reform can be summarised in three key points: decoupling direct payments to farmers from production, simplifying them; shifting funds from market support to rural development, thanks to decreases in direct payments to farms of bigger dimension; reducing ceiling on expenditures on market support and direct aid.

On the side of environmental policies, the Commission proposed the introduction of new projects concerning the research on environmental technology and the creation of a network in the area of biodiversity. Unfortunately this policies, due to the critical economic crisis, were largely reduced in favour of the priority headings such as growth, CAP, and internal policies.

3. Citizenship, Freedom, Security and Justice

Due to the considerable enlargement of the EU, issues such as security, immigration and justice became more important and relevant. For this reasons the Commission decided to allocated amounts specifically for the development of new asylums and immigration policies, nevertheless the creation of a new legislation to prevent and fight terrorism.

4. The EU as a Global Player

Under this heading the Commission set all the actions and policies that increase the position of the European Union in the economic and political environment. These actions were taken under the concerns of war and poverty, in particular, in the countries close to EU borders.

Together with these main headings and their policies, the Commission proposed a new own resourcing system. The reasons why the Commission claimed for a new own resourcing concerned issues regarding the rebate of the UK, as it has been a provision concerning only one Member State. This provision goes against the principle stated in 1984 Fontainebleau European Council: any Member State should contribute to the Community budget in relation to its relative prosperity. The proposals to solve the UK rebate were either to set a mechanism, which should have been applied to all the Member States, that would have reduced the VAT-based contribution of the net contributor or to eliminate the correction on the UK contribution. This issues was raised also by the other net contributors which argued that the UK rebate represents an imbalance in the Member Stater contribu-

tion to the EU budget, moreover the UK across the years has become the smallest net contributor.
In addition to this, the Commission proposed three new possible resourcing methods based on energy consumption, national VAT bases, and corporate income. The idea of the Commission was to introduced a "*genuine tax-based own resource by 2014*" (COM(2004) 505 final, vol. I). On the evaluation of the possible new own resources the Commission stated that an energy- or VAT-based resource would be attainable over the medium term, a common fiscal resource based on corporate income would have instead been feasible in a long-term period. This proposals are interesting because the Commission has already thought about an eventual partial fiscal integration to finance the Union Budget. Unfortunately, the debate on the own resources was not set as a priority during the Luxembourg and the UK Presidencies, which shifted the focus of the debate far from the Commission's proposals. This situation "*was symptomatic of the difficulties and complexity of the broad political agreement achieved*" (Commission:107; 2008).
The last proposal of the Commission's package regarded the renewal of the Interinstitutional Agreement (IIA). After a deep analysis of the Agenda 2000 IIA implementation's effects, the Commission stated that the Agreement should be unchanged, since the results brought by the previous IIA were successful. Moreover, the Commission underlined the importance of the application of the "flexibility instrument" (Commission, 2008) and asked to increase the flexibility in the allocation of the budget resources, since the budget covers a period of seven years (in which many economic changes can occur). The flexibility instrument is divided into numerous specific headings with small margins which give little possibility of manoeuvre. In the latest analysis, the Commission decided to stop the usage of the agricultural guidelines, since those expenditures were already allocated under the ceiling agreed until 2013.

4.6.2 The Negotiation Results

After three years of negotiations, in 2006, the European policy actors decided the financial framework to implement in the period 2007-2013. The proposal of the some Member States, in particular the net contributors, was to decrease the ceiling of the average expenditure to 1% of the EU GNI, while the new Member States were interested in securing an agreement that would have grant them the possibility to receive a substantial part of the heading 1 and 2 funds.
Also, the budgetary authorities claimed for requests: the European Parliament asked for a limited shifts of expenditures among headings; the Council suggested a reduction of the overall expenditure for commitment appropriations.

The final decision led to a reduction in spending, the "*global ceiling for commitment appropriations will fall from 1.10 % of EU GNI in 2007 to 1.01 % in 2013, [...and the] global multi-annual commitments would decrease compared to the average level of 1.05 % of EU GNI foreseen for 2007-13*" (Commission: 110, 2008). This reduction in the ceilings would have faced the increasing cost of the CAP due to the phasing-in of the numerous policies linked with the EU enlargement. The allocation of the resources experienced a change compared to the Commission's proposal, with an increase of funds for the CAP and for the cohesion policies and with a reduction of the competitiveness and the security policy. This reallocation was caused mainly by the difficulty to translate the policy-requests of the Commission, such as policies involving the research or the environment, into monetary terms, thus cohesion and agricultural policies were seen as the main budgetary priority.

On the side of the revenue, there were many changes compared to the previous financial framework. Except for the ceiling on own resources, which was left to 1,24% of the EU GNI, the distinction between agricultural duties and customs duties was eliminated. Moreover, the VAT-based own resource was drastically reduced to 0,30%, and for the net contributors it was even lower: 0.225% for Austria, 0.15% for Germany and 0.10% for the Netherlands and Sweden. This reduction of the financing of the net contributors permitted to the UK rebate to remain unchanged.

The provisions were set to come into force the 1st January 2007; in case of changes to the provisions after that date, the effects would have been retroactive.

The latest agreement reached among the European Institutions was the IIA in May 2006. To the Commission's suggestions to increase the flexibility of the decision-making process, provisions in order to increase the simplification of the agreement were added. The Agreement foresaw: the establishment of a new fund, the European Union Solidarity Fund (EUSF), whose expenditures were introduced in the Budget over the relevant headings of the financial framework; a technical adjustment, which extended the predetermined 2% annual inflation rate to al the budgetary headings, was introduced. In order to face the drastic reduction in the expenditure ceiling, a new flexibility instrument, which would have given the possibility to the budgetary authorities to depart, from the so-called 'reference amounts', up to 5% of multi-annual programmes, was established. The instrument agreed with the Co-Decision procedure. Furthermore, a new European Globalisation Adjustment Fund was created in order to tackle the unemployment caused by the major structural changes led by the globalisation. This fund financed the reintegration of workers in the labour market avoiding additional expenditures on the budget headings. Summarising, all the other instruments introduced by the latest IIA to increase the budgetary flexibility were: the European Union Solidarity Fund and the Emergency Aid Reserve (to respond to emergency situations in third countries).

4.6.3 Financial Framework 2007-13: Updates

As the Financial Framework 2007-2013 is currently in use, it is not possible to conduct a proper analysis of its implementation and therefore it is even more difficult to evaluate its feedbacks. Since its adoption in 2007, the European Budget has been adjusted and revised many times, due to the implementation of new investments (such as, the GALILEO project in 2008), or because of the implementation of new funds and plans to face the economic and the sovereign debt crisis (such as, the European Economic Recovery Plan in 2009).

Table 4.9 : Financial Framework 2007-2013 adjusted - current prices

Commitment appropriations	2007	2008	2009	2010	2011	2012	2013	Total 2007- 2013
1. Sustainable Growth	**53.979**	**57.653**	**61.696**	**63.555**	**63.974**	**66.964**	**69.957**	**437.778**
1a. Competitiveness for Growth and Employment	8.918	10.386	13.269	14.167	12.987	14.203	15.433	89.363
1b. Cohesion for Growth and Employment	45.061	47.267	48.427	49.388	50.987	52.761	54.524	348.415
2. Preservation and Management of Natural Resources	**55.143**	**59.193**	**56.333**	**59.955**	**60.338**	**60.810**	**61.289**	**413.061**
of which: market related expenditure and direct payments	45.759	46.217	46.679	47.146	47.617	48.093	48.574	330.085
3. Citizenship, freedom, security and justice	**1.273**	**1.362**	**1.518**	**1.693**	**1.889**	**2.105**	**2.376**	**12.216**
3a. Freedom, Security and Justice	637	747	867	1.025	1.206	1.406	1.661	7.549
3b. Citizenship	636	615	651	668	683	699	715	4.667
4. EU as a global player	**6.578**	**7.002**	**7.440**	**7.893**	**8.430**	**8.997**	**9.595**	**55.935**
5. Administration [1]	**7.039**	**7.380**	**7.525**	**7.882**	**8.334**	**8.670**	**9.095**	**55.925**
6. Compensations	**445**	**207**	**210**					**862**
Total commitment appropriations	**124.457**	**132.797**	**134.722**	**140.978**	**142.965**	**147.546**	**152.312**	**975.777**
as a percentage of GNI	1,02%	1,08%	1,16%	1,18%	1,16%	1,13%	1,12%	1,12%

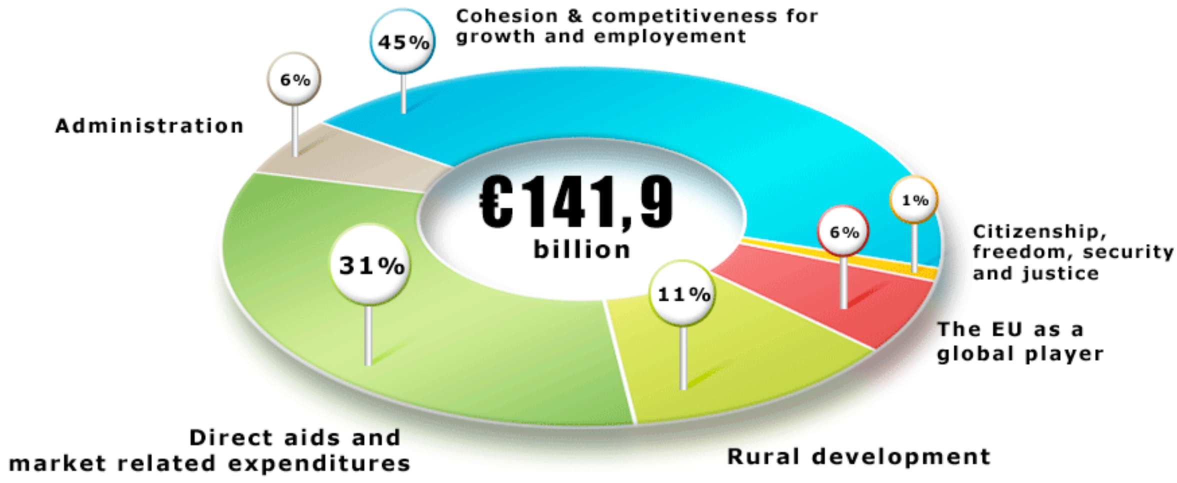
[1]The expenditure on pensions included under the ceiling for this heading is calculated net of the staff contributions to the relevant scheme, within the limit of € 500 million at 2004 prices for the period 2007-2013.

Payment appropriations	2007	2008	2009	2010	2011	2012	2013	Total 2007- 2013
Total payment appropriations	122.190	129.681	120.445	134.289	134.280	141.360	143.331	925.576
as a percentage of GNI	1,00%	1,05%	1,04%	1,12%	1,09%	1,08%	1,05%	1,06%
Margin available	0,24%	0,19%	0,20%	0,11%	0,14%	0,18%	0,18%	0,17%
Own Resources Ceiling as a percentage of GNI	1,24%	1,24%	1,24%	1,23%	1,23%	1,23%	1,23%	1,23%

Source: http://ec.europa.eu/budget/figures/fin_fwk0713/fwk0713_en.cfm, 03/01/2012

As it can be seen in the Financial Framework 2007-13 adjusted to 2012 (Table: 4.9), the highest share of the EU budget is devoted to the European growth (Heading 1), which represent the European Union support towards technological research and entrepreneurship, and to the agricultural policy (Heading 2), which still represents a core policy in the EU Budget. Heading 1 and 2 are so relevant that they represent the 87% of the whole European Budget. Their weight on the European Budget is even more relevant in the expenditure distribution for the year 2012, looking at Figure: 4.1 it possible to see a clearer distribution of the European expenditure.

Figure 4.1 : European Budget 2012



Source: http://ec.europa.eu/budget/figures/2012/2012_en.cfm 04/12/2011

4.7 The Sovereign Debt Crisis and the European Stabilization Mechanism (ESM)

Since 2009, the European Union, due to the Irish and Portuguese sovereign debt crisis, has faced a new period of economic and political instability. The traditional regional financing mechanism was not able to help the Member States to reduce the negative effects of the crisis, therefore a new way to help countries should have been developed. As "*a stabilization policy is always more efficient at global level an at the level of each decentralised federated entity*" (Menguy, 2010), after a long debate among the Member States, the development of a centralised mechanism to financially assist Member States was decided. This mechanism should have been out of the EU budget, as the EU resources cannot be use to directly help a Member State. Thus, out of the budgetary financial framework, in 2010, two new financial tools were developed to safeguard the EU financial stability and to cope with sovereign debt crisis.

Due to a second stronger sovereign debt crisis affecting Greece, the EuroZone State Members decided to adopt a stronger and permanent mechanism to tackle the sovereign debt issue and to prevent other financial instabilities. But, since the process to develop this new method and the process to reach an agreement among the Euro-Area Member States was taking to much time, another temporary facility was adopted to assist the Greek financial difficulties.

4.7.1 The European Fiscal Stability Facility (EFSF) and the European Financial Stabilization Mechanism (EFSM)

After the Ecofin Council's decision taken on 9 May 2010, in June 2010 the European Financial Stability Facility (EFSF) and the European Financial Stabilization Mechanism (EFSM) were established (as already written in Paragraph 3.1) and they will be operative until June 2013. They are currently financing Portugal and Ireland sovereign debts.

These two European financial facilities are a temporary mechanism developed by the European Union in order to bailout the Euro-Area Member States which face financial difficulties.

These facilities establish that, in case of financial instability, such as sovereign debt crisis, a Euro-Zone Member State could ask, under determined conditions described in the ESFM legislation[41], a financial assistance to the EU, which is allowed to borrow National Bonds in financial markets on behalf of the Member States. The EU, represented by the Commission, lends the returns to the beneficiary Member State. The beneficiary Member State must consequently repay all interests and the loan principal via the Commission. The EU Commission, together with the ECB and the IMF, guarantees the repayment of the bonds, the multiple guarantors are needed to safeguard the EU Budget and the economy stability. The Commission, after the 27 European Union Member States consensus, has the authority to raise up the funds to EUR 60 billion, from the ESFM, and to borrow up to EUR 440 billion, from the ESFS (Commission, 2011).

4.7.2 The European Stabilization Mechanism (ESM)

The Heads of the States of the 17 EuroZone countries have recently signed (in February the 2nd 2012) an important treaty establishing a new permanent stabilisation tool: the European Stabilization Mechanism (ESM)[42]. This financial tool will take the place of the current ESFS and ESFM. It might be adopted by every Euro Area Member States which incur into financial difficulties. The upcoming mechanism will follow the main features of the current ESFS, but, despite it, it will be permanent and legally recognised by the European institutional framework as it has been ratified by an European Treaty. The ESM will "*stronger focus on debt sustainability and more effective en-*

41 COUNCIL REGULATION (EU) No 407/2010 of 11 May 2010

42 TREATY ESTABLISHING THE EUROPEAN STABILITY MECHANISM, Bruxelles 02/02/2012

forcement measures, focuses on prevention and will substantially reduce the probability of a crisis emerging in the future"[43].

4.7.3 The Greek Loan Facility

Due to the difficult situation of the Greek financial conditions, the EuroZone Member States agreed, since 2 May 2010, to provide a three-year program bilateral loan to Greece for an amount of EUR 80 billions, together with an additional financing of the International Monetary Fund amounting EUR 30 billions, under a stand-by agreement (SBA). On 14 March 2012, the eligible amount to help the difficult financial conditions of Greece has been increase up to EUR 130 billion until 2014. The Greek loan facility works differently form the ESFS and the EFSM. In fact, the amount received by Greece does not come from loans traded in the financial market, but from bilateral loans signed with other EuroZone countries and gathered by the European Commission. The European Commission, under the facility programme, does not act as the borrower, but as the coordinator and administrator of the shared bilateral loans, entrusted by the Euro-Area countries. The programme, moreover, aims to reduce the debt/GDP ratio under 117% by 2020, in order to built "*the basis for sustainable growth and jobs in Greece*"[44]. The European Commission has the duty to monitor the implementation of Greek reforms which will guarantee the achievement of a debt stability.

4.8 Conclusions

Over the years, the European Budget has faced many crises and constant changes, according to the political and economic evolution of the EU. From its first adoption, significant changes have been made on the decision power of each budget authority. It was in fact clear that one of the most important causes of disagreement among the authorities and therefore cause of budget instability, was the unbalanced division of the decision-making powers among the European Institutions. Thanks to the Inter-Institutional Agreement (IIA) many disputes and sources of disagreement, which had stuck the budget's development and implementation, have been solved.
The multi-annual financial frameworks developed by the Delors Commission represents another important improvement. Evidences from the past financial frameworks have shown a constant im-

[43] http://ec.europa.eu/economy_finance/eu_borrower/european_stabilisation_actions/index_en.htm, 23/03/2012

[44] http://ec.europa.eu/economy_finance/eu_borrower/greek_loan_facility/index_en.htm 23/03/2012

provement in the allocation of the resources and in an inter-institutional relationship evolution, in particular due to a decisional power redistribution.

The budgetary issues, however, are not all solved yet. There still are conflicts between the Member States concerning the Union resources' allocation and the Union sourcing methods, particularly during an economic crisis period. As shown by the sovereign debt crisis, the European Budget is still not effective to boost or at least help the European economic growth. In fact most of the actions taken to solve Member States' financial difficulties have been enhanced with financial tools that are out of the European Budget. These actions are still not efficient and consistent with each other because they are not taken under the IIA rules, hence they are the outcome of unstable bargaining processes.

Part II:
The European Union
Member States

5 The European Member States: Modern Capitalism Diversity

In the previous part the European politics, its policy-making, and its budget and how the EU resources are managed have been shown. Now, it is time to shift the focus of the analysis from the European level to the National level, in order to have an exhaustive view of the whole European environment. As it has been said before, the Member States' decisions, in certain occasions, strongly influence the decisions of all European Institutions, thus it is important to analyse the different Member States' economies and what their key features, which influence their decisions at the European level, are. This analysis is also very important to better understand how the Member States behave as decision-makers within the EU Institutions.

5.1 What is the Variety of Capitalism Approach?

As anyone can experience, each developed country is different. The differentiation can either partially or totally concern aspects of institutional, economic, legislative and social framework. For instance, the German policies on employment are more protective and rigid than the American policies on the same matter, which instead favour a flexible market-based employment regulation. This is just an elementary example to capture the meaning of diversity in modern capitalism, introduced by the *varieties of capitalism* approach developed by Hall and Soskice (2001). This approach is actor-based and analyses the different capitalistic environments and underlines their peculiarity. The study carried out by Hall and Soskice demonstrates what elements influence the economics environment and what are the reasons why it is possible to find different capitalistic approaches to the economy. In first instance, Hall and Soskice analyse the differences between the American and the German economic environment, taking these countries as a sample, respectively for the liberal market economies (LMEs) and the coordinated market economies (CMEs) (Hall and Soskice, 2001). This distinction, however, does not give a realistic picture of the current variety in capitalistic models, but their study was still a good starting point for a new political economy approach. Other scholars have lately implemented their studies and made a deeper research on this matter, in particular looking at the European environment. Bruno Amable (2009) focuses its study on the relationship between the capitalistic models and the institutional intervention in the economy, in particular in the European one. Amable (2009) identifies mainly five different capitalistic patterns: the market-based model; the social-democratic model; the Continental European model; the Mediterranean model; the Asian model. But, before the description of the differences between these models, it is important to study what the element which characterise the *variety of capitalism* approach are (Amable, 2009).

5.1.1 The Core-Actor: the Firms

Many actors play a role in the political economy: individuals, firms, producers groups or government. Among these actors, the variety of capitalism approach focuses its studies on the firm point of view, as it is the core of all the capitalistic economies. Firms are the key agents which lead the technological change and the competitiveness of the markets. They are actors which are in constant relationship with the other actors (internal and external) of the economic environment, these relationships are problematic and unstable, as shown by studies on transaction costs and principal-agent relationships. Firms, indeed, constantly face problems of moral hazard, adverse selection and the shirking of their interactions with the other numerous players, such as: employees, suppliers, clients, collaborators, stakeholders, trade unions, business associations and governments. For these reasons, Hall and Soskice (6; 2001) describe the firm as a relational player whose "*success depends substantially on the ability to coordinate effectively with a wide range of actors*". They also underline how the actions of firms effect the whole economy, in the attempt to solve their coordination problems, in particular the problems concerning their core competencies:

- "*industrial relations*", where firms bargain over wages and working conditions with their employees, trade union and other employers, the firms decisions do not affect only the productivity of the firms themselves but also the rest of the economy concerning unemployment rate or inflation;
- "*vocational training and education*", where firms encounter the necessity to train their workforce with fitting skills, which effect the whole economy improving the overall skill levels and the competitiveness;
- "*corporate governance*", in which firms look for access to finance and where shareholders seek for returns on their investments, as a global result this increase the "*availability of finance*";
- "*inter-firm relations*" (relationships that companies have with other enterprises), this core competency of the firm gathers all the endeavours which could imply "*standard-setting, technology transfer, and collaborative research and development*", thus firms should focus on technological progress and competitiveness, in order to avoid the risk of a loss of the competitive advantage due to the sharing of patented information, which effects into a global competitive and technological progress;
- "*employees*": an effort of the firms is to coordinate the work of its workers in order to achieve the objectives of the firm itself, under this circumstances problems of moral hazard and adverse selec-

tion, due to information-sharing that creates a reserve of specialised information, may arise. The specialised information, on one side, can be an added value for the management (information about firm's operations), but, on the other side, it could give to the workers the possibility to hold back information and efforts.

From the Hall and Soskice's analysis how the firm is the core actor of the whole economy and the starting point of the entire approach is evident.

5.1.2 The Differentiation Factors: the Role of Institutions/Organisations, Culture and History

The capitalistic economies are characterised by different environments in which firms play, this differentiation is due to the different role exerted by institutions and cultures, which influence how firms coordinate their core competencies, and thus their activities and their impact in the whole economy.

5.1.2.1 Institutions and Organisations

What are institutions? And what are theirs role in the society? Institutions were devised "*by human beings to create order and reduce uncertainty in exchange*" (North, 1991), and they can be defined as "*the rules of the game in society or, more formally, are the humanly devised constraints that shape human interaction*" (North 3; 1990), those constrains are both formal rules (such as law, constitutions, property rights) and informal behaviours (such as sanctions, customs, traditions, and codes of conduct). In other words, institutions are a set of rules which actors generally follows. Following North's definition, it is possible to describe organisations as a particular type of institution which establishes boundaries and distinguishes their members from non-members, in which there are principles of leadership concerning who is in charge and where a division of responsibilities is made (Hodgson: 8; 2006).[45]

The institutions which affect the most the economy are the ones that have an impact on the firms' decisions, in particular the institutions which help the exchange of information, monitor actors' behaviour, and sanction those actors who do not follow the rules (Ostrom, 1990; Hall and Soskice, 2001). Examples of this kind of institutions are strong trade unions, business or employer associations, and extensive networks of cross-shareholding which help firms to coordinate on strategies that firms cannot achieved by themselves. As the action of such institutions affect the interaction

[45] From now on the terms "institution" and "organization" will be generally used with the same acceptation, since their differentiation is not essential by the meaning of this dissertation.

and the strategies of firms, it is, therefore, important to focus on the difference of institutions' behaviour when national economies are compared.

In the analysis of the institutions which play an important role in the economy, it could be interesting to add another kind of institution. As underlined by Hall and Soskice (2001), there are other institutions which help the coordination firms and are "*crucial to the formation of credible commitments*", these institutions are those which encourage the relevant players to engage in collective discussion and reach agreements with each other (see Elster, 1998). These institutions are called *deliberative institutions*. The action of the deliberative institutions has been stressed by the study of many game-theory scholars (such as: Sharpf, 1987; Knight, 1992; Sabel, 1992, 1994; Eichengreen, 1997; Elster 1998), which have analysed that when multiple equilibria are available, the presence of a thicker common knowledge is essential in order to reach a solution to the problem. Deliberative institutions aim to thicken the actors' common knowledge. This role is also important to increase the capacity of actors to find strategic solution in the political economy, when they have to tackle new unfamiliar challenges, this solution is essential in the modern economy which is constantly affect by exogenous shocks.

In short, the analysis of the institutional framework and the institutions' behaviour represents the basis for a cross-national economy comparison.

Each national economy is made up by many players which create multi-person games with multi interactions that lead, most of the times, to the creation of multiple equilibria. These multiple equilibria could be chosen by the actors, even in the presence of institutions that favour the creation of credible commitments (Fudenberg and Maskin, 1986). As it has been said before, in a situation of multiple equilibria, actors decide the equilibrium to be chosen referring to a set of shared understandings, concerning what other actors are likely to do, often rooted in a sense of what it is appropriate to do in such circumstances (March and Olsen, 1989). In other words, the "*common knowledge*" leads to coordinate actors towards one outcome. From this point of view, it is clear how an institutional framework could affect the coordination's action of the firms, but also the fact that another element which affects the decision-making result of firms exists: informal rules and knowledge.

5.1.2.2 Culture, Informal Rules, and History

Actors follow informal rules and knowledge as they have learned them over the years from their experiences: living and acting within a certain familiar set of actors and a certain shared understanding. This experience leads into something that can be called "*common culture*", which can be also defined as a set of available "*strategies for actions*" that develop from experiences operating in a particular environment (Swindler, 1986; Di Maggio and Powell 1991).

The institutions and the history of a nation's political economy are strictly connected with each other. On one hand, the institutions are created by formal actions, statutory or less, which set up formal institutions and their operating procedures. On the other hand, the historical experience creates an informal set of common expectations that increase the actors' efficient coordination towards a problem to be solved. Thus, the actions of institutions, therefore how they affect the economy, are bound to the historical experience that has built them up. In other words, as Hall and Soskice (14, 2001) says, "*the operative force of many institutions cannot be taken for granted but must be reinforced by the active endeavours of the participants*".

Since the capitalistic economies may be seen as multiple-player games where institutions are the rules, it is important to mention the importance of the institutions in the choice of the game equilibrium. As said before, the common knowledge is a common way to find a solution to a multiple-player game in which all players have a shared understanding of the problem, thus they can reach a shared solution. This fact is even more emphasised in a situation such as an "etiquette game" (H. Young, 1998): a man and a woman are in front of a door, they can both want to walk through the door, but since they cannot pass at the same time, no one receives any pay-off (0,0); conversely, they can both yield the other one to walk through the door and they will be stuck in front of the door and again no one gains any pay-off (0,0); the only solution which will gives a pay-off will be if one of the two players will yield the door to the other one, in this case the one who yields will receive 1 and the other one will have a pay-off of √2. The game has two equilibria solutions which give the same social value in terms of aggregate welfare, but opposite welfare values for each players (Fig. 5.1).

Fig 5.1: Etiquette Game

		Women	
		Not Yield	Yield
Men	Yield	$1, \sqrt{2}$	$0, 0$
	Not Yield	$0, 0$	$\sqrt{2}, 1$

Source: H. Young, 1998

Under this circumstances, the mere coordination cannot reduce the possible incompatibilities between strategies, the choice of the equilibrium will be decided referring to informal rules, such as a collective custom or a decentralised individual choice. In Fig.5.1, the solution of the game could be different depending on the custom shared by the two players.

5.1.2.4 Institutions and Conflict of Interests

Amable (2009) rewrote the etiquette game using two different institutions in conflict of interests as players. He emphasise that, in this situation, the motive which makes the players decide an equilibrium instead of the other one is due to the political weight[46] of the two players: "*the more resistant group, defined as the group that losses less than the other group should an equilibrium not to be reached, is more likely to impose its preferred outcome*" (Amable: 44; 2009). Thus the stronger group can transform an informal rule into a social convention. The strength of this rule is due to the size of the community which shares the rule, in fact the sanction, directly or indirectly, linked to the non-compliance of the rule (for instance, a social sanction such as the title of "impolite person") is more effective when the size of the community is small and when the information of a non-compliance of a player can be easily shared. Thus, the stronger groups of interest may formalise the custom through an explicit enunciation of the common behaviour, in order to ensure that the rule will be complied, avoiding the risk of voluntary and involuntary disobedience.

The formalisation of the rule, however, implies both the clustering within groups of interest and the intervention of a third agent in the game, which will enforce the decisions taken by the group of interest. In a common democratic society, the third agent is the States (which looks for political support) and the etiquette game players are the Parties (which gather citizens' interests) (Palombarini, 1999). The State is an external source of legitimacy for those groups of interest which look for institutional support, in exchange of political support. The State, as legitimate point of conflicts' resolution, become a new source of conflict itself. Consequently, the political conflict will be regulated by rules ,which govern the political competition, that are institutions themselves. Hence, the decisions taken by a State on conflictual disputations among interests are deeply influenced by the rules that structure the political competition, which are endogenous rules of the game that can bias the final institutional equilibrium (Amable, 2009).

Under this pattern of institutions' and actors' interactions, the event of institutional change can be the result of a change in the pay-off distribution or, for a change, in bargaining power among the groups of interest. In case of formal rules, a change in bargaining power may derive from the different way of a group to influence the process of decision-taking, or from the weakening of the net benefit of a group, which leads to a decreasing or to the disappearance of a specific group of inter-

[46] for a more exhaustive demonstration of this statement see, Amable (Chaper 2, pp.41-46; 2009)

est. In case of informal rules, a variation in the pay-off may change the equilibrium's behaviour, which could lead to a change in conventions, whereas a change in bargaining power may lead to a turnover of strategies of both players. On the contrary, a lack of institutional change could be the result of a failure of some groups to organise themselves in a way to push effectively their interests into the political representation system, or the result of a strong enough coalition to oppose the current institutional set of rules (Amable, 2009).

Expanding the size of the discussion to the EU environment, it is possible to loosely couple[47] the etiquette game with the EU political system, where the European Union itself is the third agent and the EU Member States are the game players.

5.1.2.5 Institutional Complementaries

As it has been shown, institutions are the changing agents among the different capitalistic models, and a strong element of differentiation among the models is the presence of "institutional complementaries" within the modern economy. Similarly to "complementary goods", complementarity among the operations of a firm may exist: "*marketing arrangements that offer customised products, for instance, may offer higher returns when coupled to the use of flexible machine tools on the shop floor*" (Hall and Soskice: 17; 2001). This idea, following Aoki (1994), could be extended to the institutions of the political economy: two institutions may be said complementary when the presence (or increase of efficiency) of one affects positively the returns of the other.

An example of institutional complementarity can be seen in the relationship between the labour and the financial market. Aoki (1994) shows that long-term employment is more feasible when the financial system provides capitals on terms that are not sensitive to current profitability, vice versa, in the presence of a financial market which rapidly transfers resources among commitments, a flexible labour market may be more reasonable (Caballero and Hamour 1998; Fehn 1998).

Nations with a certain level of coordination in one sphere of the economy may develop a complementary practice in other spheres as well. Moreover, it could be possible that firms pressure the government, in order to encourage the enhancement of institutional complementary to guarantee the efficiency gain provided by the institutional complementary itself (Hall and Soskice, 2001).

[47] "loosely couple" since, as it has been discussed before, the European Union framework is quite complex to be compared to a national state system, even though national government interests could be seen as groups of interest which impose their political power in the EU policy making decisions.

5.2 The Five Models of Modern Capitalism and the European Economy Clustering

Institutional framework, rules that structure the political competition, complementarity of institutions, culture, and history explicate the possible existence of different capitalistic models. "*International comparisons have indeed emphasised the differences between national institutions*" (Amable: 13, 2009). It can be argued that a national division of the models may be problematic, since within the same Nation there could be more than one model of capitalism (for instance, in Italy it is possible to identify three different capitalistic models, Amable 2009), and also because, analysing many specific institutional frameworks would make it difficult to derive generalisations from the obtained results. Thus, a good way to run a comparative analysis of different models is to adopt a common theoretical framework, as is has been already adopted by Albert (1991), Hall and Soskice (2001) and Amable (2009).

In 2001, Hall and Soskice proposed a division of the models based on the different coordinations of the economy's players, identifying two macro-groups of models: Liberal Market Economy (LME), based on the liberal market mechanisms, in which investments are preferably in transferrable assets, and Coordinated Market Economy (CME), based on strategic coordination in which investments are allocated in specific assets. In their description of the two different models, Hall and Soskice analysed the American case as an example of LME and the German case as a example of CME. Hall and Soskice emphasise their work on the coordination between institutions and firms and among institutions.

The result is interesting, but still too general to understand the heterogeneity and variety of the European capitalistic environment, thus, Amable (2009) in his analysis, starting from the work of Hall and Soskice and deepening their studies, enlightens the presence of five different models: market-based model (MBM), social-democratic model (SDM), Continental European model (CEM), Mediterranean model (MeM) and Asian model (AsM)[48]. He also compares the diversities between the different models focusing on five different institutional areas: product-market competition, labour market and wages-labour nexus, financial intermediation and corporate governance, social protection and Welfare State, and education sector.

The European models are described in the following paragraphs under the five different institutional areas, as it is the best way to lighten the differences among them.

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[48] The Asian Model is represented as a model highly dependent on the business strategies of large corporations that are highly influenced by the State and the centralised financial system. This structure allows the development of long-term strategies. Workers are protected by a de facto protection of employment and possibilities of retraining and career-making within the corporation. This framework underline a fragile rigidity, which, together with a lack of social protection, may lead to an instability of the model that is carried on by the strength of the large corporations.

5.2.1 Market-Based Model

The Market-Based Model (also called the Anglo-Saxon Model) is characterised by a high level of market competition: firms are sensitive to negative shocks that cannot be fully absorbed by price adjustments. Competitiveness is based on an high flexibility of the labour market, since it is very sensitive to quantity adjustments. This high flexibility in production and labour markets enhance a fast reaction of firms to the changing condition of the market. The financial markets are more deregulated and, on one side, they increase the availability to credit, moreover they supply individuals with a large range of risk-diversification instruments (Amable, 2009), but, on the opposite side, they strengthen the possibility to come across a financial crisis. In the European adoption, the Market-Based Model presents different features compared to the global model.

Product-Market Competition

In the MBM, the product-market focuses on the price competition, which also leads the coordination of the market itself. The market is open to the foreign competition and investments, it is slightly regulated and the involvement of the State is substantially absent.

Wage-Labour Nexus

The labour market is characterised by a low protection of the employment and by a high flexibility. The market legislation favours easy hiring and firing, increasing the spread of temporary work. Under this model any active employment policy is foreseen, moreover the unions play a defensive strategy and they are not strong as in the other capitalistic models and, also because of this, the wage-bargaining is decentralised and individual contracts are preferred to the collective contract.

Financial Sector

The MBM has one of the most developed and sophisticated financial market, it is characterised by a low ownership concentration and a high importance of institutional investors. The financial system is also open to foreign investment and, in particular in the UK, there is a higher participation of foreign private banks in the system and a higher share of institutional investors. The legislation focuses its protection in the minority of shareholders, which are the strongest players in the market.

Social Protection

Social protection is one of the institutional areas where the UK defers more from the other Market-Based Model countries. The UK has a relatively high public expenditure on social policies, which are highly devoted towards disability. On the contrary, other Market-Based countries are characterised by a weak intervention of the State in the economy, resulted also in a very weak intervention in the social policy, which are mainly devoted to poverty alleviation. All of the other social issues are left to the private initiative, such as the pension system which is private-funded.

Education

The MBM education system is again divided between the European Market-Based Model and the global one, because of public expenditure share and level of standardisation. The UK education system enjoys higher public intervention which deal to a higher public expenditure, towards tertiary education, financial aids, and a higher degree of standardisation among primary and secondary school system. More generally, the education system is highly focused in the higher-education level, which is greatly competitive. The system is also characterised by a weak vocational education and training which denotes a focus on general skills rather than specific ones. Lifelong learning, even though strictly related to vocational training, is developed and usually carried on by companies or private educational institutions, in order to keep a high level of technological knowledge.

5.2.2 Social-Democratic Model

It is characterised by a higher employment protection, a high level of social protection and an easy access to retraining, This is due to the active labour market policies, all of which increase the protection of specific investments of employees. The intervention enhancing the labour protection decreases the flexibility of the labour market, but it gives workers and employees guarantees. Innovation and productivity are guaranteed by a solidarity wage setting which is allowed by a coordinated wage bargaining.

Product-Market Competition

The SDM, differently from the Market-Based Model, is strongly focused on quality competition and it is characterised by a strong State intervention in the product market coordinating market's actors. Like the MDM, the Social-Democratic Model is open to foreign competition and investments.

Wage-Labour Nexus

As in the market competition, the SDM uses an opposite pattern compared to the Market-Based Model. It is in fact characterised by a moderate market protection and the wages are the result of coordinated or central bargaining between group of interest, thus the role of the unions is strong and strictly correlated with the work of companies, this affects the flexibility of the labour market which is low. To face the low flexibility of the market, the Social-Democratic Model foresees an active employment policy which helps unemployed people through unemployment wages and training formation and specialisation in order to increase their possibility to find a job.

Financial Sector

The financial market, differently from the Market-Based Model, is characterised by a high concentration of ownership and of banks. The intervention of the State results in a high share of institutional investors and in a regulated non-sophisticated financial markets. There is no existence of a market for corporate control, which enhances and reduces the cost of takeovers, mergers and acquisition, as they are controlled by the State.

Social Protection

The Social-Democratic Model is the model with the highest social protection. In fact, the high involvement of the State guarantees a great importance of the Welfare State in public policies, which are the biggest expense of the State in order to assure high quality of public and social services.

Education

The high level of public intervention of the Social-Democratic Model reflects also in the field of education, where public and private education institutions are financed or co-financed by the central State. The education represents a big part of the public expenditure since it is seen as a core area in which invest. In fact, the education system is stressed on quality, specific skills and vocational training. Another important aspect, in which the SDM focuses, is the importance of retraining and lifelong learning.

5.2.3 Continental-European Model

Like the Social-Democratic Model, it is characterised by a high protection of the labour market. Long-term corporate strategies are facilitated by a centralised financial system and a solidarity wage bargaining policy is developed. It stands out from the Social-Democratic Model by a less developed Welfare State and a difficult workforce retraining which "l*imits the possibilities for an 'offensive' flexibility in the labour market*" (Amable; 15, 2009).

Product-Market Competition

Product-market competition in the Central-European Model is a middle ground between the Market-Based Model and the Social-Democratic Model, in fact the competition is based on a moderate price competition and a relatively high quality competition. The State intervenes in the market through public authorities' actions, and permits a low protection against foreign firms and investments.

Wage-Labour Nexus

The Central European Model's policies concerning the labour market guarantee a high employment protection and a job stability, but, on the opposite side, a low flexibility. This high protection together and the active employment policies are favoured by the strong bargaining power of the unions which guarantee the coordination of collective wages and benefits. The State, together with high protection policies, guarantees the industrial rehabilitation of unemployed workers through active employment policies, like in the Social-Democratic Model.

Financial Sector

Financial markets, like in the SDM, are characterised by a high ownership concentration and also by a high concentration of private banking systems. Differently from SDM, the Central European Model shows a slightly higher sophistication of the financial markets, with a moderate development of venture capital and the presence of a market for corporate control, such as takeovers, mergers, and acquisitions. In the CEM financial sector, moreover, private and central banks are deeply involved in firms' investment funding.

Social Protection

The high intervention of the State in the economy affect also the social protection, which is high and employment-based. The social policies that are adopted are contribution-financed social insurance and pay-as-you-go pension systems.

Education

The education system, like in the SDM, is characterised by high level of public expenditure, a high enrolment rate (in particular in the secondary school), a developed vocational education and a strong emphasis on the teaching of specific skills. Differently from the SDM, in the Central European model there is a focus on the secondary-education homogeneity.

5.2.4 Mediterranean Model

It is close to the Continental Model but, unlike it, the Mediterranean Model presents a higher employment protection and a lower social protection (Amable: 107, 2009). This pattern is possible thanks to a low level of product-market competition and the absence of short-term profits due to a centralised financial system. Moreover, the low skills and education level of the workforce restrains from the possibility of high wages and high skills industrial strategy.

Product-Market Competition

The product-market framework is characterised, differently from the other models, by a predominance of small firms and few big companies, which compete more on a price-based competition rather than a quality-based one. The State, like in the Central European Model, is involved in the market decisions and guarantees a moderate protection from foreign firms and investments.

Wage-Labour Nexus

The labour market protection is differentiated in two ways: size of the firm, and type of contract. For large firm employers, the system foresees a higher protection, rather than for small firm employers, as much as long term contracts have a higher protection compared to temporary or part-time works. Thus the labour market is more rigid in large firms and long term contract and more flexible in small firms and temporary contracts, that is also why small firms are preferred and represent a large proportion of the economy (Amable, 2009). This dual distribution of the protection, together with a strong centralised wage bargaining, is guaranteed by the high bargaining power of the unions. The State intervenes in the protection of the employment but does not provide any active policy to reduce frictional and long term unemployment, unlike the Central European Model.

Financial Sector

The Mediterranean Model's financial sector is close to the Central-European Model's one: the ownership is highly concentrated, there is no active market for corporate control, financial markets are slightly sophisticated and are characterised by a high banking concentration. The strong role of private banks influences the action of firms corporate governance in the financial sector.

Social Protection

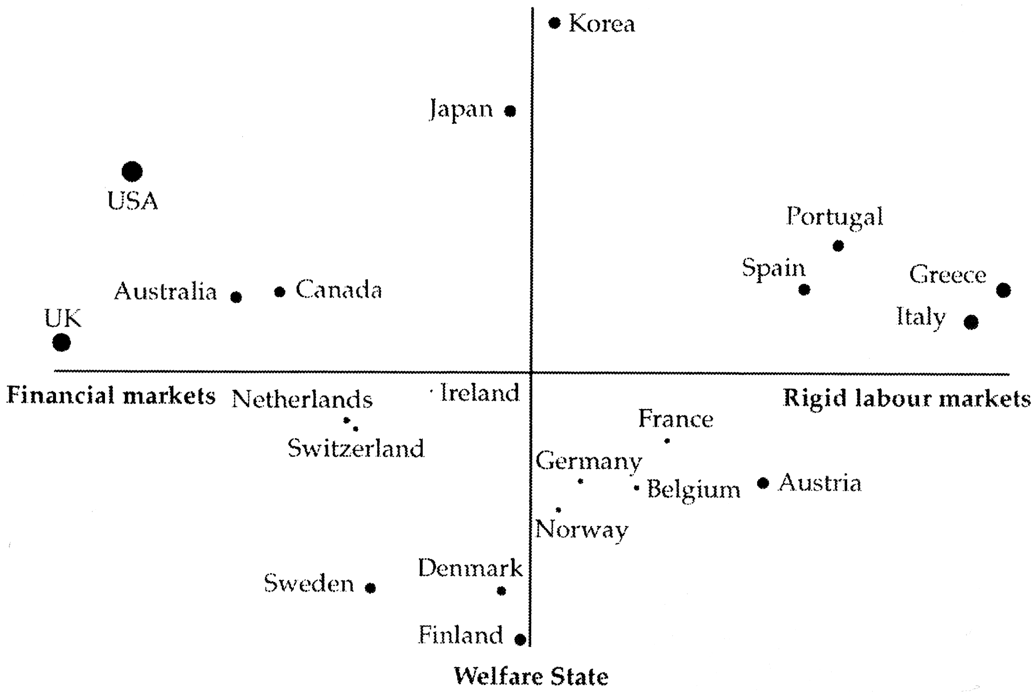
The high involvement of the State in the economy leads to a moderate social protection. This, therefore, is lower than in the Central European Model, since the Mediterranean Model is more focused on employment protection. Thus the social protection is focused on poverty alleviation and retirement wages.

Education

The educational policies, in the Mediterranean Model, represent a small part of the public budget and they reflect on a weak higher-education system, thus few public expanses also on research, with a relatively weak vocational education and no lifelong learning (except for the European Programmes). The educational system is characterised by low enrolment rates in the tertiary education and it is focused more on general skills and education rather than on specific knowledge.

In the European Union most of the capitalistic models are represented: the Market-Based Model is slightly and ambiguously adopted in the UK, the Social-Democratic Model is clearly in action in the Scandinavian countries, the Mediterranean Model is adopted in Southern Europe, and the Continental-European Model is, of course, the model followed by the Central-European countries, such as France and Germany. Their distinction can be seen in Fig. 5.2, where European countries look clustered into specific groups, sometimes very far from each other, which follow the classification described by Amable (2009).

Figure 5.2: Capitalistic Models Distribution



Source: Amable: 176, 2009.

5.3 Conclusions

The economic environment, as Hall and Soskice (2001) have clearly described, is a complex set of rules where firms, institutions and public entities play and interact creating specific patterns, which characterise the different models of capitalism. As Amable (2009) has analysed, it is possible to identify five different models, which are currently in use in the most important world economies.

The European economic environment is, as explained before, very heterogeneous. Within the Common Market, four different capitalistic patterns are currently existing. This heterogeneity implies, on one side, that a convergence towards a common model is needed, because, as Amable (Ch. 6, 2009) has pointed out, within the free common market (and moreover within the global market) the competition among Member States will become sooner a tax-based competition, where the country with the lowest tax imposition will win the competition against others. On the other side, the distribution of clustering groups emphasises how differentiate the economic background is in the European Union, and, therefore, how difficult it could be to satisfy the needs of each member with a common decision.

The diversities between the European economies emphasises the diversity in the political decision-making and the consequent difficulty to reach a common decision. As said in Chapter 3, the Council is the European Institution which represents the political power and also the national interests in the decision-making process. Because of this and knowing the importance of economy diversities within the EU and its consequent impact in the formation of decisional coalition, in the next chapter, the Council's decision-making is analysed.

Part III:

The European Union Governance

6 The European Union Governance: Social Choice and the Eurosclerosis

6.1 Looking for the Core Issue

Analysing the European Union under its different aspects (in particular the ones concerning the European organisation and governance, the European decision-making, the European Budget and lastly the European capitalistic models), one can argue that the European Union is subjected to different weaknesses which make its integration more difficult and slow. Moreover, those weaknesses do not affect only the European integration and its maintenance, but they also strongly influence the economy and the growth of the European Member States themselves.

Economists and scholars have largely discussed weaknesses and limits of the European integration, in particular concerning two different macro-categories: the European Governance, thus the political power management, and the European Budget, thus the European resources management. Within these broad categories, weaknesses can be divided again respectively into: division of the power (Tsebelis, 2008; Dur and Mateo 2010; Inotai, 2011), decision-making (Kirman and Widgren, 1995; Faini, 1995; Pokrivcak, Crombez, Swinnen 2006; Widgren, 2008, 2009; Bârsan-Pipu and Tache 2009) and policy issues on the governance side; and own sources, public spending (Alves and Afonso 2009; Osterloh, Heinemann, and Mohl, 2009; De la Fuente, Domenechy and Rant, 2010; Bukowski, 2011) and the EU as a borrower (Laopodis, 2008; Berben and Jansen, 2009; Alexopoulou, Bunda and Ferrando, 2010) on the budgetary side.

Unfortunately, it would be pointless to consider all of the issues arisen by the scholars and the economists altogether. Thus, a common issue which influences, directly or indirectly, most of the weaknesses arisen before must be found. Looking back at the EU limits that emerged in the previous chapters (the conflicts among institutions and Member States, the decisional sclerosis, the policy and budgetary ineffectiveness), it can be said that they are all connected with the decision-making process. The decision-making process is, in fact, the starting and the core point of all the European Union actions (policy, budget and legislation), as much as of any other institution. Therefore, if the decision-making process does not work effectively, results could not be obtained and issues could not be tackled. In Chapter 3, the European policy-cycle has been analysed, and it has been resulted particularly weak in the policy decision step and in the policy implementation one.

Thus, in order to improve the action of the EU it is necessary to improve the efficiency and effectiveness of those steps. The following chapter will focus on the third step of the policy cycle: the policy decision, since it is the starting point of any European action and it must be conducted in the most efficient and effective way to have consequent efficient and effective results in all the weak field of the European administration of power and resources.

In the European Union, all the decisions are taken by voting, but, differently from other institutions, the EU adopts different voting systems and voting majorities depending on the nature of the decision. As seen in Chapter 3, the decisions concerning important changes within the European institutions and, moreover, concerning the integration process are taken under the unanimity requirement, while policy and budgetary decision are generally taken under the Co-Decision Method, which requires both the Parliament (absolute majority) and the Council's (qualified majority, at least 255/345 vote, absolute majority of the Member States, 14/27, and verification that the qualified majority represent at least the 62% of the Union's population) approval.

6.2 The Social Choice and the Voting: The Arrow Impossibility Theorem and Multi-Person Games

6.2.1 The Social Choice

Voting is the best way to express social choice and it is the most commonly method adopted to take a decision, when different opinions and preferences are available. It is widely used as it could be a good method to make decisions, but a good decision, thus a good outcome of a voting process, is not obvious at all. In order to be a good method of decision-making, voting should present essential properties: reach a clear decision and provide an efficient outcome. Therefore it is important to find a set of rules which satisfy those properties. Depending on the decision that has to be taken, different voting methods, which satisfy the clear decision and the efficient outcome priorities, exist.

Before the explanation of the voting methods, it is essential to give the basic definitions of the *Social Choice Theory*. Social or collective choice is a decisional process taken by different people or groups of interest that, choosing an option, try to achieve, through the decision, their highest utility. Each decisional actor is different and has a different utility, thus collective choice outcome must maximise the utility of the sum of the decisional actors, in such a way there are no unsatisfied actors, Pareto efficient.

Since each actor follows a different utility outcome it has also a different rank of policies preferences. This means that each actor may have a different order of preference. In order to better explain the meaning of the collective choice Arrow's assumptions and definitions will be used (1963). In any decision-making process there is a set of alternatives, *S*, among which each actor has to choose one alternative, which is denoted by small letters $x, y, z, \cdots$. Each alternative may be preferred differently by the chooser, for instance x could be preferred to y, and y be indifferent to z. If there exists an alternative in the set *S* which is preferred over the others, then, the actor will select that alternative. In order to find the chosen alternative, instead of comparing them one by one, it is essential to order them from the most to the least preferred. Arrow (1963) formalises the relations between alternatives with the following propositions:

- $x \geqslant y$, which means "decision x is preferred or indifferent to y";
- $x > y$, which means "decision x is preferred to y";
- $x = y$, which means "decision x is indifferent to y".

These notation simplifies the formalisation of collective choice theory. Using the previous notation, it is now possible to express easily the collective choice axioms (Arrow: 13; 1963):

Axiom I: For all x and y, either $x \geqslant y$ or $y \geqslant x$.

A relation $\geqslant$ which satisfies Axiom I will be said to be connected.

Axiom II: For all x, y and z, $x \geqslant y$ and $y \geqslant z$ imply $x \geqslant z$.

A relation satisfying Axiom II said transitive.

A relation which satisfies both Axiom I and Axiom II has as a result a weak rank of the alternatives. The ordering is "weak" since two or more alternatives may be indifferent among each other, resulting with a weak decision. In order to have a strong order of the alternatives, it is necessary to have a "preferred to", $>$, relation between the alternatives. Axiom I and Axiom II together with the definition of indifference, $=$, and preference, $>$, lead to the *Lemma 1* (Arrow, 1963):

(a) For all x, $x \geqslant x$.

(b) If $x > y$, then $x \geqslant y$.

(c) If $x > y$, and $y > z$, then $x > z$.

(d) If $x = y$, and $y = z$, then $x = z$.

(e) For all x and y, either $x \geqslant y$ or $y > x$.

(f) If $x > y$, and $y \geqslant z$, then $x > z$.

Here there are the proofs of the previous statements:

(a) Considering Axiom I, let $x = y$, then it may be rewritten as, for all x, either $x \geqslant x$ or $x \geqslant x$, thus it implies $x \geqslant x$.

(b) If "$x > y$ is defined to mean not $y \geqslant x$" (*Definition 1*, Arrow: 14, 1963) then Axiom I can be rewritten as Lemma 1 (b).

(c) Following (b), from $x > y$ and $y > z$ one can deduce $x \geqslant y$. Now supposing $z \geqslant x$, then from $z \geqslant x$ and $x \geqslant y$ one can deduce $z \geqslant y$ by Axiom II. But from Definition 1 from $y > z$ one can not have $z \geqslant y$. Thus the supposition $z \geqslant x$ leads to a contradiction, hence one may say not $z \geqslant x$, or $x > z$, Definition 1.

(d) If "$x = y$ means $x \geqslant y$ and $y \geqslant x$" (*Definition 2*, Arrow, 14: 1963), from $x = y$ and $y = z$ one can deduce $x \geqslant y$ and $y \geqslant z$, thus, from Axiom II, $x \geqslant z$. From $x = y$ and $y = z$ one can also have, by definition 2, $z \geqslant y$ and $y \geqslant x$, hence, from Axiom II, $z \geqslant x$. As both $x \geqslant z$ and $z \geqslant x$, by Definition 2, $x = z$.

(e) By Definition 1.

(f) Again supposing $z \geqslant x$, from $z \geqslant x$ and $y \geqslant z$ hence, from Axiom II, $y \geqslant x$. But $x > y$ implies not $y \geqslant x$, from Definition 1. Thus it is contradictory to suppose $z \geqslant x$. Consequently not $z \geqslant x$, or $x > z$.

Since the collective decision is a matter of choice, it is time to define $C(S)$ as the chosen alternative, or alternatives, within the set S of alternatives. $C(S)$ is the subset of S, where each element of $C(S)$ is preferred to all of the other elements of S and indifferent to all of the elements in $C(S)$.

"*Definition 3*: $C(S)$ is the set of alternatives x in S such that, for ever y in S, $x \geqslant y$" (Arrow: 15, 1963).

$C(S)$ can be considered a collective choice function. Arrow (1963) describe the choice function as a generalisation of the demand function under perfect competition, where S is the set of budget planes.

Now, considering a simple generalisation of a set S with two alternatives x and y, $[x, y]$. If $x > y$, thus $x \geqslant y$ and $x \geqslant x$, respectively from Lemma 1 (b) and (a), then x belong to $C([x, y])$. Moreover, since if $x > y$ then not $y \geqslant x$, y does not belong to $C([x, y])$. On the contrary, supposing that $C([x, y])$ contains a single element x, which implies that y does not belong to $C([x, y])$, hence not $y \geqslant x$ which, by Definition 1, means $x > y$. These considerations lead to *Lemma 2* (Arrow: 16, 1963):

A necessary and sufficient condition for $x > y$ is a that x be the sole element of $C([x, y])$. If, for all two-alternatives sets, $C([x, y])$ is known, then it is possible to define any possible relation ($>$, $=$, $\succcurlyeq$) between the two alternatives. Recalling Definition 3, if the relation between the two elements is $\succcurlyeq$, one may know the choice function $C(S)$ for all set of alternatives. Thus, due to the assumption of rational choice, it can be said that the choice in any environment can be verified knowing the choice of a two-alternatives environment.

The choice function, $C(S)$, represents the preferences function of a single agent, unfortunately for the economists, in reality, decisions are taken by many choosers with different choice functions and thus different ordering relations of the alternatives, due to the different values of each single agent. In order to generalise, let define $\succcurlyeq_i$ as the ordering relation for different social states alternatives from the individual i point of view, it is possible to define the collective choice function, or social welfare function as:

"*Definition 4*: by a *social welfare function* will be meant a process or rule which, for each set of individual ordering $\succcurlyeq_1, \ldots, \succcurlyeq_n$, for alternative social states (one ordering for each individual), states a corresponding social ordering alternatives social states, $\succcurlyeq$." (Arrow: 23, 1963)

Ideally, Arrow describes the social welfare function as a function that may describe all the universe of social choice possibilities, thus applicable to any community. In order to be applicable, the social welfare function must satisfy some particular conditions, which will be described later.

Without those particular conditions, the collective choice environment would be too complex to be analysed and formalised. But, unfortunately, decision-makers, voters, or public managers usually have to face decision over numerous alternatives. Moreover, alternatives ordering of each chooser could be very different and they could also lead to a zero-sum game. This high complexity in the decision environment expresses a high instability of the decisioning process which makes the theorisation of the collective choice harder.

Condorcet Paradox

An example of decisional instability and of the difficulty to find a socially efficient solution, by voting, has been described by the Marquis de Condorcet (1785). The Condorcet Paradox shows the instability of decisioning when there are more than two alternatives upon which a chooser can decide. The paradox is verified as follow. Suppose that there are three voters which can choose one of the candidates X, Y, Z, and the voters preference pattern of voter 1, voter 2, and voters 3 is described as follow:

1: X > Y > Z

2: Y > Z > X

3: Z > X > Y

Comparing the preference patters of each voters, the final vote will lead to a non-solution decision, since for two voters X > Y, for two voters Y > X, and for two voters Z > X.

Now assume that the system adopted by the voters to make a decision is an "*open agenda direct democracy*", thus:

- *Direct democracy*: voters, by majority voting, directly decide the outcome of the decision.
- *Sincere voting*: voters rank their preferences without faking their decision in order to change other voters' strategy.
- *Open Agenda*: voters can choose over a pair of alternatives, in a way that the winning policy will be posed against a new alternative in the following round.

Adopting this voting system, as a result, there would not be any solution, since the voting system will lead to a cyclical voting.

Proof: starting from X against Y, the voting decision will lead to the winning X against Z, but after this round Z will win and it will be posed against Y, which will win and be posed against X, and then the cycle will be repeat all over again.

In order to avoid such situation, Arrow (1963) has formulated the well known Impossibility Theorem, which identifies five different condition which a decision method should satisfy in order to achieve relevant and efficient results.

6.2.2 Arrow's General Impossibility Theorem

6.2.2.1 The Five Conditions

As said before, Arrow in 1951, in the book *Social Choice and Individual Value*, formulated a general theorem which ensures the impossibility of social choices. This theorem in order to be satisfied requires five different conditions.

The first condition concerns the possibility of knowing the individual ordering of any admissible individual: at least three alternatives, whose ordering is completely unknown in advance, exist in the set of the admissible orderings. This first condition tries to manage the impossibility to know those alternatives ordering *a priori* saying (Arrow: 24, 1963):

"***Condition 1***: Among all the alternatives there is a set *S* of three alternatives such that, for any set of individual orderings $T_1, \ldots, T_n$ of the alternatives in *S*, there is an admissible set of individual orderings $\succcurlyeq_1, \ldots, \succcurlyeq_n$ of all the alternatives such that, for each individual *i"*:

$$x \succcurlyeq_i y \iff x\, T_1\, y \;\forall\, x, y \in S$$

Condition 1 is also known as the *Transitivity* condition. In fact, the individual social orderings should be transitive, hence it would be always possible to make a decision from any set of alternatives, even when individual orderings are not known *a priori*.

By definition, in welfare economics, the social welfare seeks for the improvement of social condition. Thus, starting from this statement it is clear that the decision taken by the voters should be oriented to the best solution for the social welfare of the State. Within Arrow's conditions, this means that, considering a starting individual ordering $\succcurlyeq_1, \ldots, \succcurlyeq_n$, whose corresponding social ordering $\succcurlyeq$ is:

$$x \succ y$$

where $x, y \in S$ are two given alternatives of the set *S*, and $\succ$ is the preferences relation corresponding to the collective ordering $\succcurlyeq$. Now suppose a change in each individual ordering, call the new individual ordering $\succcurlyeq_1', \ldots, \succcurlyeq_n'$, where the corresponding social ordering is $\succcurlyeq'$ and the consequent preference pattern would be $x \succ' y$, where $\succ'$ is the preference ordering related to $\succcurlyeq'$. x is still preferred since the society formally ranks it above y. Moreover, consider a new couple of alternatives x′ and y′, such that $x' \neq x$ and $y' \neq x$, in order to have a possible solution on a voting process with the change in social ordering and alternatives, the second condition must be satisfied (Arrow: 26, 1963):

"***Condition 2***: Let $\succcurlyeq_1, \ldots, \succcurlyeq_n$ and $\succcurlyeq_1', \ldots, \succcurlyeq_n'$, be two set of individual ordering relations, $\succcurlyeq$ and $\succcurlyeq'$ the corresponding social orderings, and P and P′ the corresponding social preference relations. Suppose that for each I the ow individual ordering relations are connected in the following way":

$$\text{for } x' \neq x,\ y' \neq x,\ x' \succcurlyeq_i' y' \iff x' \succcurlyeq_i y'$$

$$\forall\, y',\ x \succcurlyeq_i y' \Rightarrow x \succcurlyeq_i' y'$$

$$\forall\, y',\ x \succ_i y' \Rightarrow x \succ_i' y'$$

Then:

$$x \succ y \Rightarrow x \succ' y$$

Condition 2 is also known as Pareto Criterion Condition (or Unanimity Condition), which means that if everyone agrees on the ordering of all the possible alternatives, then the group should do the same.

Another change from the starting condition could affect the set of alternative S. It could happen during decision-making process to find new solutions and/or to cut one or more alternatives, because of the impossibility to adopt them due to different reasons. Thus the original set S of the alternatives could be modified and the candidate solutions may be reduced. For instance, consider the situation in which there are three voters who have to take a decision upon four different solution x, y, z, and w. The preference ordering of the three voters is described in Table 6.1:

Table 6.1: Independent irrelevant alternative

Voter 1	*Voter 2*	*Voter 3*
x	x	z
y	y	w
z	z	x
w	w	y

The winning policy after the voting process, using majority voting, will be x. Now assume that because of insufficient funds, the y option would be impossible to adopt. Due to this new circumstance the set S of alternatives is now composed of x, z and w. The third condition of Arrow's Impossibility Theorem requires that the event which caused the reduction or the decrease of the alternatives, does not affect the result of the decision, hence, recalling back the example, even though y have been deleted as possible policy, the winning policy would still be x. More formally (Arrow: 27, 1963):

Condition 3: Let $\succcurlyeq_1, \ldots, \succcurlyeq_n$ and $\succcurlyeq_1', \ldots, \succcurlyeq_n'$, be two set of individual orderings and let $C(S)$ and $C'(S)$ be the corresponding social choice functions.

If:

$$x \succcurlyeq_i y \Leftrightarrow x \succcurlyeq_i' y \ \forall \text{ individuals } i \text{ and } \forall\, x, y \in S.$$

Then:

$$C(S) = C'(S).$$

Condition 3 is also known as Independence of Irrelevant Alternatives Condition.

Like in the Condorcet paradox previously shown, in Arrow's view of the social choice, each voter has to vote sincerely as it is an essential requisite of the democratic decision, thus the vote does not have to be imposed. More formally a social welfare function is said to be imposed when, given two alternatives x and y, the relation $x \geqslant y$ hold for any set of individual orderings $\geqslant_1, \dots, \geqslant_n$ where $\geqslant$ is the social ordering related to $\geqslant_1, \dots, \geqslant_n$. Hence assuming that each individual is free to vote sincerely the forth condition is:

"***Condition 4***: the social welfare function is not to be imposed." (Arrow: 29, 1963)

Condition 4 is also known as Unrestricted Domain Condition, as the social choice method adopted should allow any possible individual ordering of alternatives.

Another kind of distortion of the voting process is when there is one chooser who decides for all of the other voters, this voter is called dictator and his decision represents the decision of all the other voters. Hence if the dictator prefers x to y, the society does as well, instead if he is indifferent between x and y, presumably he will let the decision to the other members of the society.
More formally "a social welfare function is said to be dictatorial if there exist an individual i such that, for all x and y, $x >_i y$ implies $x > y$ regardless of the ordering $\geqslant_1, \dots, \geqslant_n$ of all individuals rather than *i,* where > is the social preference relation corresponding to $\geqslant_1, \dots, \geqslant_n$" (Arrow: definition 6, p. 30, 1963). Since the objective of a social choice is to find the collective method to decide the right decision, it is important to impose the fifth condition:

"***Condition 5***: the social welfare function is not to be dictatorial." (Arrow: 30, 1963)

Condition 5 is know as Non-dictatorship Condition.

6.2.2.2 The Theorems

Since it is hard to find a social welfare function which largely satisfies all five Conditions simultaneously, consider the simplest case of a decision taken upon two alternatives.

"***Theorem 1***: If the total number of alternatives is two, the method of majority decision is a social welfare function which satisfy Conditions 2-5 and yields social ordering of the two alternatives for every set of individual orderings." (Arrow: 48, 1963)

By majority method or majority rule it is meant a social welfare function where:

$$x \succcurlyeq y \Leftrightarrow x \succcurlyeq_i y \geq y \succcurlyeq_i x$$

Thus, where the decision x is socially accepted, if the number of choosers who rank x over y are as greater as the ones who rank y over x.

Majority rule, under the two alternatives condition only, satisfies each of the five Conditions as it will be shown. To satisfy Condition 1 it must be shown that the relation $x \succcurlyeq y$ is connected and transitive. Be $N(x,y)$ the number of voters who prefer x over y, $x \succcurlyeq_i y$, and conversely $N(y,x)$ is the number of voters who prefer y over x, $y \succcurlyeq_i x$. Hence:

$$\left.\begin{array}{l} x \succcurlyeq y \Leftrightarrow N(x,y) \geq N(y,x) \\ y \succcurlyeq x \Leftrightarrow N(y,x) \geq N(x,y) \end{array}\right\} \forall\, x \text{ and } y,\ x \succcurlyeq y \text{ or } y \succcurlyeq x.$$

Therefore $\succcurlyeq$ is connected. To demonstrate the transitivity, suppose $x \succcurlyeq y$ and $y \succcurlyeq z$, but since by definition there are only two alternatives, it must be $z = x$ or $z = y$. Supposing $z = x$, $x \succcurlyeq z$ it will be $x \succcurlyeq x$, which will result in $N(x,x) \geq N(x,x)$ that is true. Thus, transitivity and moreover Condition 1 are proved to be satisfied.

To show that Condition 2 is satisfied, consider the set of individual orderings $\succcurlyeq_1, \ldots, \succcurlyeq_n$, be in the way that $x > y$, which means $x \succcurlyeq y$ and not $y \succcurlyeq x$. Therefore, the majority rule can be rewritten as:

$$N(x,y) > N(y,x). \ (1)$$

As in the Condition 2 consider a new individual ordering $\succcurlyeq_1', \ldots, \succcurlyeq_n'$ satisfying $x' \neq x$ and $y' \neq x$ if and only if $x' \succcurlyeq_i y'$; thus:

$$x \succcurlyeq_i y' \Longrightarrow x \succcurlyeq_i' y', \ (2)$$

$$x >_i y' \Longrightarrow x >_i' y'. \ (3)$$

If $y' = y$ it can be rewritten as:

$$x \succcurlyeq_i y \Longrightarrow x \succcurlyeq_i' y, \ (4)$$

$$x >_i y \Longrightarrow x >_i' y. \ (5)$$

Conversely some voter, i, can follow the preference pattern $y \succcurlyeq_i' x$ which by Definition 1 means not $x >_i' y$, then not $x >_i y$. By Lemma 1 (e) this preference pattern can be written as:

$$y \succcurlyeq_i' x \Longrightarrow y \succcurlyeq_i x.$$

Considering again the individuals' number, N, be $N'(x,y)$ the number of voters which follow $x \succcurlyeq_i' y$ individual ordering, and on the opposite $N'(y,x)$ the number of voters which follow $y \succcurlyeq_i' x$ individual ordering. From (4) every agent which follows the pattern $x \succcurlyeq_i y$ has as well the property $x \succcurlyeq_i' y$.

Thus:

$$N'(x,y) \geq N(x,y)$$
$$N'(y,x) \geq N(y,x)$$

From what relation (1) says it can be written:

$$N'(x,y) > N'(y,x) \text{ or } N'(x,y) \geq N'(y,x)$$
$$\text{and not } N'(y,x) \geq N'(x,y).$$

This last conclusion means that $x \succcurlyeq' y$ not $y \succcurlyeq' x$ or $x \succ' y$, where $\succcurlyeq$ correspond to the social ordering of the individual orderings $\succcurlyeq_1', \ldots, \succcurlyeq'_n$. Hence Condition 2 is proved to be satisfied.

Condition 3 is satisfied, as the set S of possible alternatives contains just two elements by definition, thus $C(S)$ is described by individual orderings of set S elements as there are no other elements.

Recalling Condition 4 a social welfare function is imposed, if, for two given alternatives x and y, $x \succcurlyeq y$ holds for any individual ordering $\succcurlyeq_1, \ldots, \succcurlyeq_n$. Suppose that $y \succ_i x$ for all i, thus for everybody holds $y \succcurlyeq_i x$ while $x \succcurlyeq_i y$ holds for no one. By (1), $N(y,x) \geq N(x,y)$ and not $N(x,y) \geq N(y,x)$, hence $y \succ x$ and not $x \succcurlyeq y$. Hence $x \succcurlyeq y$ is not independent from individual orderings $\succcurlyeq_1, \ldots, \succcurlyeq_n$.

Lastly, let suppose that there is an agent d who satisfies the definition of dictator. Let suppose that $x \succ_d y$ when $y \succ_i x$ for all $i \neq d$, thus $x \succcurlyeq_d y$ and not $x \succcurlyeq_i y$ for all $i \neq d$, in such situation $N(x,y) = 1$ since just the dictator supports this voting view. Thus, $x \succcurlyeq_i y$ for all $i \neq d$ is $N(y,x) \geq N(x,y) = 1$, this situation leads to a majority of $x \succcurlyeq y$, than not $y \succ x$. But by the dictator's definition $x \succ_d y$ implies $x \succ y$, hence, as the voting result is $x \succcurlyeq y$, there cannot be a dictator and the Condition 5 is satisfied.

As demonstrated, majority voting rule applied to a set S of two alternatives verifies Arrow's five Conditions. More generally it can be said that Condition 2, 4 and 5 are independent from the number of the alternatives. It can also be added that Condition 3 can be extended towards a more general set S of numerous alternatives as the number of alternatives do not affect the result of the proof. More generally, majority voting rule for any space of alternatives is a welfare social function which satisfies Conditions 2-5. It cannot be said the same for Condition 1 since, as already explained by Condorcet paradox, increasing the number of alternatives a situation which does not satisfy the connection and transitivity property can be created.

Analysing a more general social welfare function, where alternatives are freely ordered by individuals, an interesting result comes up. In fact, if a general social function is taken the five Arrow's Conditions cannot hold simultaneously otherwise they lead to a contradiction. Arrow noticed that:

"***Theorem 2***: If there are at least three alternatives which the members of the society are free to order in any way, then every social welfare function satisfying Condition 2 and 3 and yielding a social ordering satisfying Axioms I and II must be either imposed or dictatorial" (Arrow: 59, 1963).

In fact, with three or more alternatives, even though there exists a social welfare function where Conditions 2 (Pareto Criterion) and 3 (Independence of Irrelevant Alternatives) are satisfied, and Condition 1 (Transitivity) is taken as true, if one assumes that voters may order alternatives in any way they want then either Condition 4 (Unrestricted Domain) or Condition 5 (Non-dictatorship) must be violated, not to fall in contradiction [49].

Summarising, it is possible to find a collective voting method whose output is efficient and stable, if and only if the decision is taken upon two alternatives and the voting method follows Arrow's five Conditions[50]. In all other situations, hence with more than two alternatives, it would be impossible to find an efficient and stable collective voting method. To be more explicit: if there are no *a priori* assumptions about preference orderings, there is no social welfare function which avoids the Condorcet paradox.

6.2.3 Multi-Person Game and the Voting Power Indices

Since in the real world, voting decisions over three or more alternatives are taken, the voters behaviour during a voting-process will be now discussed. A decision-making-process can be seen, as already done before, as a game[51] with two or more players. The Theorem 1 is a decision game applied to two players, while Theorem 2, instead, could be described by a multi-person game. Theorem 2 can be rewritten as a game with *n* players, such that:

- each player *i* has a finite set of strategies, or preferences ordering, $\succcurlyeq_i$, $\forall\ i \in \{1, 2, \cdots, n\}$;
- each player *i* has a pay-off utility function u_i, $\succcurlyeq_1 \times \succcurlyeq_2 \times \cdots \times \succcurlyeq_n \rightarrow \mathbb{R}$.

Each player *i* votes simultaneously a strategy $s_i \in \succcurlyeq_i$ and receives a pay-off u_i. In order to describe a game, it is essential to know the strategies s_1, s_2, $\cdots$, s_n, and their relatives pay-offs u_1, u_2, $\cdots$, u_n. The solution, Nash Equilibrium, of this game can be found in the set of strategies which give the

[49] For the proof of the Theorem 2 read Arrow: 48-59, 1963.

[50] Some authors refers to the Arrow's five Conditions with the acronym INPUT, recalling the first letter of the five conditions: Independence of irrelevant alternatives, Non-dictatorship, Pareto Criterion, Unrestricted Domain, and Transitivity.

[51] A game is a set of *rules* within which a certain number of agents (called *players*) acts (*play*) in order to reach a certain result (called *payoff*). The players can play following different actions (*strategies)* in order to reach a certain *payoff.*

highest utility, more formally:

$$u_i\ (s_{N1}, s_{N2} \cdots s_{Nn}) \geq u_i\ (s_1, s_2, \cdots, s_n)\ \forall\ s_i \in\ \succcurlyeq_i$$

The solution $r_{N1}, r_{N2} \cdots r_{Nn}$ is a Nash Equilibrium strategy if:

$$\frac{\delta u_i}{\delta s_i}(s_{N1}, s_{N2} \ldots s_{Nn}) = 0$$

and when $\delta u_i/\delta s_i = 0$ gives a unique solution then the Nash Equilibrium of the game is one and one only, which is the stationary point of the function u_i, and

$$\frac{\delta^2 u_i}{\delta^2 s_i} < 0, \forall i$$

will be the local maximum of the function. The limit of this game is that all players have to know the Nash Equilibrium and that they have to play the Nash Equilibrium strategy.

Multi-person games can be divided into: non-cooperative, such as Arrow's assumptions, where each player decides individually its decision, without looking for aggregation of interests, in order to have a stronger decision power; and cooperative, which are, conversely, games where players can group together in coalitions, as it happens generally in many political voting systems (such as the Italian or the German one), where players with similar interest group together to reach a higher voting power. The cooperative games will be shown later, as they better describe the dynamics of policies decision-making adopted in the European Union Institutions, such as the European Council. Between non-cooperative and cooperative games there are the partially-cooperative games, which are games where coalition are allowed but the division into coalition is not so extent to call them cooperative.

The description of partially-cooperative games may be useful to understand easily the behaviour of a more general cooperative game. Assume that a number n of individuals i group together in two categories, say Party A and Party B. The game, G, allowed three possible coalitions: the null coalition, where nobody is part of it, C_0; the coalition made up by Party A, C_1; the coalition formed by Party B, C_2; and the grand coalition which gathered all n individuals i, C_3. Formally:

$$G = \sum_i C_i \text{ from } i = 1 \text{ to } 3$$

Assume that the two coalitions have to vote for a policy, which is welcomed by the public opinion, and denote with ω (C_i) the characteristic function of C_i (which in this case expresses the pay-off for each coalition), if:

- both Parties decided to vote against the policy, thus in case of null coalition the pay-off is zero, by definition: $\omega\ (C_0) = 0$;
- Party A votes for the policy and Party B against it, Party A will get 3, or, as well as if Party B

votes for and Party A against: ω (C_i) = 3 where i = 1,2;

- both Parties vote for the policy they will get a pay-off: ω (C_3) = 8[52].

These results show how bigger coalitions reach a higher pay-off than what each party can earn playing alone. Hence, in a situation with three or more players, it can be deduced that there are incentives to form grand coalition to maximise the pay-off.

On the contrary, increasing the size of the coalition, will decrease the pay-off that each player will get. In fact, consider now three coalitions which, like in the previous example, get a pay-off of 3 if they vote alone for the policy and they get 9 if all coalitions vote together for the policy. In this case the three coalitions are indifferent to either voting alone or in a grand coalition. For this reason, in 1962, Riker developed the *minimal winning coalition theory*, which states that a coalition tries to minimise its membership in order to dodge the eventuality to share the pay-off with other unnecessary players. Moreover, as Gamson (1961) noticed, usually the faction within a coalition pretends to share the pay-off proportionally with the voting power of each faction (*minimum resource theory*). Therefore, from this assumption it will follow that there a coalition which can guarantee the smallest majority will be formed, in order to win and not to share the pay-off to unnecessary players. By assumption, each faction of a coalition should receive a share of the winning pay-off, called *imputation*, which must be an amount at least as big as the pay-off that the faction will get if it has played alone.

In a general cooperative multi-person majority game (which can describe the behaviour of a general decision taken under majority voting), players can gather in coalitions freely according to the agenda changes. Within a coalition there could be subgroups of players which are called *factions*. Factions can vote together creating coalitions, the coordination between factions could be ruled by agreement or by choice. The winning coalition is the one that reaches the majority of the votes and the minimal winning coalition is the one that cannot lose any vote without losing its majority. With a small winning gap, there could be factions within coalitions which are pivotal. A pivotal faction inside a coalition is a faction which can turn a coalition from the losing side to the winning one by the merit of its vote, or conversely a faction that turns a coalition from the winning side to the losing one by the withdrawal of its vote. A cooperative multi-person majority game has the same properties of sincerity, completeness and transitivity of the Arrow's social welfare function.

As it can be deduced from the minimal winning theory and fom the minimum resource theory, the

[52] By definition a cooperative game assume that:

- ω ($C_i \cup C_j$) ≥ ω (C_i) + ω (C_j) for any i,j = 1, 2, … , n and $i \neq j$
- ω ($C_i \cap C_j$) = ∅
- if $C_i \supseteq C_j \Rightarrow$ ω (C_i) ≤ ω (C_j) for any i,j = 1, 2, … , n and $i \neq j$

voting power is a crucial index for the coalition clustering and later on for the pay-off sharing. The concept of voting power and coalition clustering is essential to understand the behaviour of the European Council and the impact of the Council voting system in the policy decision making process.

Shapley Value and Shapley-Shubik Index

An index which expresses the power of a faction within a coalition is the *Shapley value*, which estimates the *a priori* power of each faction. Consider a game, G, with n factions which can vote together creating a coalition C. Suppose that the coalition C is denoted by a number of s faction f_i such that:

$$G = \{f_1, f_2, f_3, \cdots, f_n\} \supseteq C = \{f_1, f_2, f_3, \cdots, f_s\} \neq \emptyset$$

Hence, f_i has $s-1$ partners and it is selected among $n-1$ factions. Thus there is,

$$(1)\frac{(n-1)!}{(s-1)![(n-1)-(s-1)!}$$

is the number of possible coalitions that faction i can make. Rewriting (1) as its reciprocal it can be seen the weight of i in the coalition:

$$(2)\frac{(s-1)!(n-s)!}{(n-1)!}.$$

Now assume that all coalitions are of the same size, the weight of any coalition of size s with $i \in s$ is then:

$$(3)\frac{(s-1)!(n-s)!}{n!}$$

Consider the characteristic function of the coalition C, identified by $\omega\ \{C\}$, thus now f_i is not part of the coalition C anymore, its characteristic function will be $\omega\ \{C-i\}$, hence the value that i gives to the coalition C is:

$$(4)\omega\{C\}-\omega\{C-i\}$$

The Shapley Value, denoted by $\mathbb{S}\ (f_i)$, is defined as the summation of the weight of i in any possible coalition not containing i, (3), multiplied by the value that i give to the coalition C, (4):

$$(5)\mathbb{S}(f_i) = \sum_{s \subseteq n/\{i\}} \frac{(s-1)!(n-s)!}{n!}\left[\omega\{C\}-\omega\{C-i\}\right]$$

This expression gives an interesting view on the relevant variable which influences the voting power of a faction. It must be underlined that the Shapley Value assumes that all coalitions are all of the same size, which is a particular case that may happen, but is not so common.

Another index, developed by Shapley and Shubik in 1954 and used in 1965 to analyse the power of the five permanent members of the United Nation Security Coucil (the USA, the UK, France, China and the former URSS) is the Shapley-Shubik index. As done with the Shapley Value, consider a game, G, with n factions which, for voting purposes, group together into various coalitions, C_i, as follows:

$$G = \{f_1, f_2, f_3, \cdots, f_n\} \supseteq C = \{f_1, f_2, f_3, \cdots, f_s\} \neq \emptyset;$$

The Shapley-Shubik index, $\mathbb{SS}(f_i)$, is defined as follows:

$$(6)\mathbb{SS}\left(f_i\right) = \frac{\sum_{i=1}^{n} C_i \text{ where } f_i \text{ is pivotal}}{n!}$$

The Shapley-Shubik index is of a value between 0 and 1, where 0 represents the absence of voting power and 1 is the absolute power.

Banzhaf Index

Another index that looks at the effects of both pivotal and critical factions is the *Banzhaf index* (also known as Penrose - Banzhaf index), which analyses the number of coalitions, where the faction i is pivotal or critical. Using the same notation as before, *Banzhaf absolute power* can be define as follows:

$$(7)\mathbb{b}(f_i) = \frac{\text{Number of winning coalitions for } i \text{ is critical}}{\text{Total number of coalitions to which } i \text{ belong}}$$

The *Banzhaf absolute power* value is $0 \leq \mathbb{b} \leq 1$, but the sum of the *Banzhaf absolute power* of each n faction will be higher than 1, thus in order to have a clearer view of the value it is essential to normalise it:

$$(8)\mathbb{B}(f_i) = \frac{\mathbb{b}\left(f_1\right)}{\sum_{i=1}^{n} \mathbb{b}\left(f_i\right)}$$

B (f_i) is called *Banzhaf index* and its value is between 0 and 1, where 1 is the absolute power, it gives a normalise expression of the Banzhaf absolute power.

Johnson Index

A different index which evaluates the reciprocal of the number of the critical factions is the *Johnson index*. Using the same notation as before, consider a game with n factions/players which vote together forming the coalition C of size s, and call f_i an individual faction of C. Formally:

$$C = \{ f_1, f_2, \cdots, f_i, \cdots, f_s \}.$$

Consider the number for which the absence of f_i is critical, and call it k, such that winning coalition where is critical:

$$\{ C_1, C_2, \cdots, C_i, \cdots, C_k \}.$$

Now denote the number m of critical factions in any coalition, with $m < s$. In other words, m_1 denotes the critical faction in C_1, m_2 the critical faction in C_2, m_i in C_i and m_k in C_k, and so on. The *total Johnson power* can be formalised as:

$$(9)\, \mathrm{jp}(f_i) = \frac{1}{m_1} + \frac{1}{m_2} + \ldots + \frac{1}{m_i} + \ldots \frac{1}{m_k}.$$

Normalising the Johnson power one can get the *Johnson Index*, whose value is between 0 and 1, with 1 representing the absolute power, since it is a normalised index:

$$(10)\, \mathrm{J}(f_i) = \frac{\mathrm{jp}(f_i)}{\sum_{i=1}^{n} \mathrm{jp}(f_i)}.$$

Deegan-Packel Index

With a similar reasoning of Johnson index, but analysing the number of minimal factions, there is the Deegan-Packel index. Differently from before, consider k as the number of minimal winning coalitions and m the number of factions in each coalition. Such that m_1 denote the number of factions in C_1, m_2 the number of factions in C_2, m_i in C_i and m_k in C_k, and so on. Following these assumption set-up, the total Deegan-Packel power can be formalised as follows:

$$(11)\, \mathrm{dp}(f_i) = \frac{1}{m_1} + \frac{1}{m_2} + \ldots \frac{1}{m_i} + \ldots + \frac{1}{m_k}$$

Like for the other indices, it is essential to normalise the total Deegan-Packel power in order have a clearer interpretation of it. The Deegan-Packel index represents the normalised from of the total Deegan-Packel power, and its values are between 0 and 1, with 1 representing the absolute power:

$$(12)\, \mathrm{D}(f_i) = \frac{\mathrm{dp}(f_i)}{\sum_{i=1}^{n} \mathrm{dp}(f_i)}.$$

As shown in this section, in a multi-person game, such as the decision-making process, the voting power distribution represents one of the most effective ways to interpret and represent the voting systems and their efficiency.

6.2.4 The Compensation Principle

Both Arrow in his Possibility Theorem and the Multi-Person Game Theory focus on the actions of N players, which, by assumption, may vote in accordance with their ideals and beliefs. Unfortunately most of the time, in the real world, in the decision-making-process, voters take their final decision taking into account all the possibilities which maximise their utilities, this means that sometimes voters do not vote following their individual ordering, because there could be external benefits if they vote differently. In other words, sometimes voters agree to vote differently from their individual ordering, since, if they do so, they will receive a compensation which fills the gap between their original decision and the new one. More formally, the *compensation principle* says that: given two alternatives x and y which will give to the voter i an utility, respectively, X and Y with X > Y, i, which originally vote $x > y$, will vote $y > x$ if he will receive a compensation which would fill his gap of utility X – Y.

This principle is important to understand the decision-making connected with coalition decision where voters try to group together. It has been argued that this theory is not plausible, since it is hard to define the concept of utility within social choice, as it can be referred both to ethical value and to economic pay-off. Looking at the nature of the voters in the European Institutions, as already said in Chapter 3, it can be said that the only Institution which acts as a political institution is the European Parliament, all other places of voting decision (the European Council and the Intergovernmental Congress) order their preferences looking at their national utility (thus, concerning an economic outcome).

As the theoretical knowledge given in the previous chapters and sections is sufficient to understand the real European situation, it is now the time to use the acquired knowledge to criticise the European Union Governance.

6.3 From Theory to Practice: European Governance

After the explanation of Arrow's Impossibility Theorem and the Multi-Person Game Theory, a question spontaneously rises: is it possible to find an efficient voting rule which guarantees a democratic result and avoids the European decisional sclerosis? This question is difficult to answer and the solution is hard to find, since it is what the European Union has tried to solve for many years, not having achieved efficient results yet. The purpose of this dissertation is not to find an answer to this question, but at least to see in what direction the European Union should procede.

6.3.1 The Voting Systems According to Arrow's Social Choice Theory

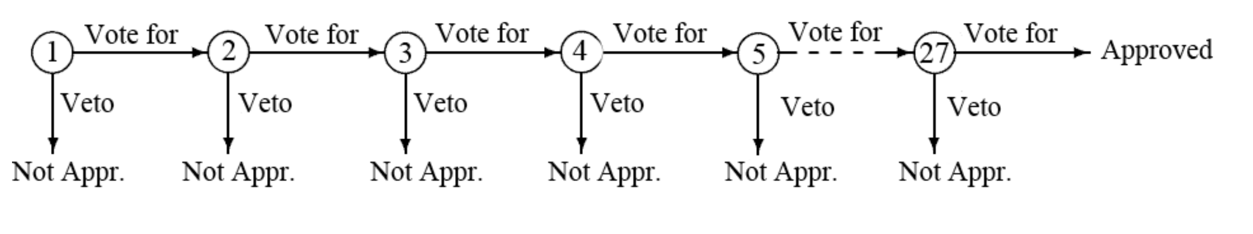
Currently, in the EU most of the decisions are taken under two different regimes (as already said in Chapters 3 and 4): on one side, the decisions concerning radical changes in the European Institutional framework and concerning the European Integration are taken under unanimity voting in the Intergovernmental Congress; on the other side, the great majority of the decisions concerning the European policies and the European Budget are taken by Co-Decision method, thus the triple qualified majority voting by the European Council and simple majority voting by the European Parliament. Thus, it is clear that the European voting systems are both (unanimity voting and Co-Decision methods) characterised by many veto players which deeply influence the decisional process and that drastically increase the possibility of policy stability[53]. Policy stability, in this particular situation, has a negative meaning, as it means that it is very difficult to change old policies or create new ones, in particular, in a period were responsiveness to Member States and Union issues is essential.
According to Arrow's Impossibility Theorem, especially to Theorem 2, in case of three or more alternatives, which individuals can order freely, every social welfare function, which satisfies Conditions 2 and 3, must be either imposed or dictatorial.

Unanimity Rule

In case of unanimity, adopted by the Intergovernmental Congress for decisions such as the "European Constitution", every player has to $x > y$ in order to result in a approved decision, so if a player i decides to vote against, y > x, he can invalid all of the other votes. The voter i is a veto player as he can block a decision just by voting against it. The veto player, assuming there are no other veto players, is the one who belongs to all the winning coalitions, as if he votes for the decision it will be approved, and if he votes against he will block it. Following this definition, a veto player can be seen as a dictator in the decisional process, hence, unanimity rule is a dictatorial social welfare function. One can imagine a unanimity voting procedure as a centipede game, described by Figure 6.1, where each player can vote once and he can decide to vote either for or against the policy. Voting against, since unanimity is required, is like imposing negative decision to all other players.

[53] It has to be remembered that also lobbies and group of interest can influence the European institution decision creating a sort of veto during the decision process, but this eventuality will not be take into account since the decision maker are the European Institutions and theirs members.

Figure 6.1: Unanimity Centipede Game



Under unanimity rule, just one player can block the approval of a policy. From the Amsterdam Treaty onwards, the EU has decided to add the possibility for a voter to abstain from a decision without running into a veto decision. This possibility was taken into account in order to avoid the possibility of blocking a decision by a voter who is neither for nor against the decision. Looking at the five Arrow's Conditions, this voting method satisfies the Pareto Criterion (Condition 2), the Unrestricted Domain (Condition 4) and the Independence of Irrelevant Alternatives Condition (Condition 3), but, on the contrary, it does not satisfy the Transitivity (Condition 1) and the Non-dictatorship Condition (Condition 5). As it has been written in Chapter 5, in the European Union, each European country represents a different capitalistic model, which is expressed in the different individual preferences of each Member State.

As already seen, some countries focus more on social policies and others focus more on employment protection policies. The different points of view, in national economy, reflect in the different ways in which each country orders priorities in the European voting. In order to avoid cyclical results due to intransitive individual orderings, it has been chosen to permit a sort of dictatorship given to the veto players. From a positive point of view, this decision gives, as a result, a strongly shared and wanted legislation taken by unanimity, hence, cyclical preferences are avoided as much as frequent changes in the institutional and legislation framework. But on the contrary, it favours, thanks to the veto power, the maintenance of stronger players' *status quo* and also a weak responsiveness to cope with the fast changes of the world economy.

The negative effects of unanimity voting can be seen in detrimental decisions, such as: the European Constitution in 2006 (where France and the Netherlands did not ratify the Constitution, thus it was not approved); the institution of a European Bond (decision opposed by Merkel, Germany, and Sarkozy, France); and lastly European helps to the Greek Economic Crisis (again opposed until the beginning of 2012 by Merkel, Germany). On the contrary, it has to be said that all the decisions which are taken with the unanimity voting method regard decisions involving the Member States's sovereignty (Intergovernmental model, Chapter 3)[54]. Thus these decisions are ruled by international treaties which, in order to be adopted, foresee their ratification by all the treaty's signatory States. Under this circumstance, in order to avoid the weakness of unanimity European Union, Member States should adopt a different decisional framework rather than the international treaty mode.

Co-Decision: Qualified Majority Voting Rule

From the Treaty of Lisbon onwards, all the decisions within the European Institutions concerning policies and budgets, both new adoptions and changes, are taken by the so called Co-decision. As already written in Chapter 3, the Co-decision requires the approval of both the European Parliament and the European Council to approve a decision, Fig. 3.6. More precisely, the absolute majority of EP and the triple qualified majority of the Council are required to adopt a decision.
Even though the EP has gained more decisional power over the years, and now its decisions have the same strength of the Council's ones, its voting rule will not be analysed, as it adopts the absolute majority rule on decisions taken between two alternatives, thus it follows what said in Arrow's Impossibility Theorem 1. Moreover, as it has been written in Chapter 3, the European Parliament, since it is directly elected by European citizens, is divided into political coalitions, which vote according to their political values. Thus the EP voting and its coalitions' behaviour is not interesting for the purpose of the dissertation.
More interesting and complicated are the voting rules and the players' behaviour in the European Council. The triple qualified majority voting rules with which the European Council approves decision are:

- 67% of the Member States (18 Member States), 50% of the decision is a Council's proposal (14 Member States);
- 77% of the voting weight (255/345 votes);
- 62% of the population represented (at least 311 millions of citizens represented).

Qualified majority shows that, in order to veto a decision, it is necessary to reach an amount of votes against representing respectively:

- 33% of Member States;
- 23% of voting weight;
- 38% of the population representation.

[54] Unanimity decisions within the European Union institutions have been drastically reduced after Nice Treaty as with an enlargement to 27 Member States it would have been impossible to take any decision. It is now required only in case the European Council has to adopt a decision upon which the European Commission has given a negative opinion.

According to this view, it can be said that, differently from the unanimity voting rule, not all the voters can be veto players, but only the players which can create a coalition representing at least one of the previous veto proportion. Looking at the majority threshold, it is clear how easier it is to block a decision instead of approving it. Just to give an example if, hypothetically, Germany (16,5% of EU population, see Table 6.2[55]) can gather a coalition together with France (12,9%) and the UK (12,4%), they can block any decision in the European Council.

The Treaty of Lisbon, signed in 2007, foresaw a new double qualified majority, starting from 2014 onwards:

- 65% of the European citizens represented;
- 55% of Member States, if the decision is concerning a Commission of High Representative's proposal, 72% in other cases.

Moreover, there is the possibility to block the decision by the veto of at least four countries.

Analysing the qualified majority rule, under Arrow's Impossibility Theorem's point of view, the lack of the Transitivity and of the Pareto Criterion Condition, which are hard to be satisfied in the European context, where the individual orderings of each country differ from the others, can be seen. More in general, Arrow's assumptions of rationality can be argued saying that in the EU there are different ways of thinking, and thus, different rationalities. The Independence of Irrelevant Alternative Condition is theoretically satisfied, since original individual orderings should not change by adding a new alternative, but in the real-world politics this is not obvious. The Unrestricted Domain Condition is instead satisfied since the vote is not imposed. The Non-dictatorship Condition is partially satisfied, since officially there are no veto players and no dictators, if voters are considered individually, even though, since each voter can cooperate with others, there may be possibilities to create veto coalitions or dictatorial coalitions. With the new Lisbon Treaty rules the Non-dictatorship Condition is not satisfied as the possibility to block a decision by the veto of at least four Member States is explicitly foreseen.

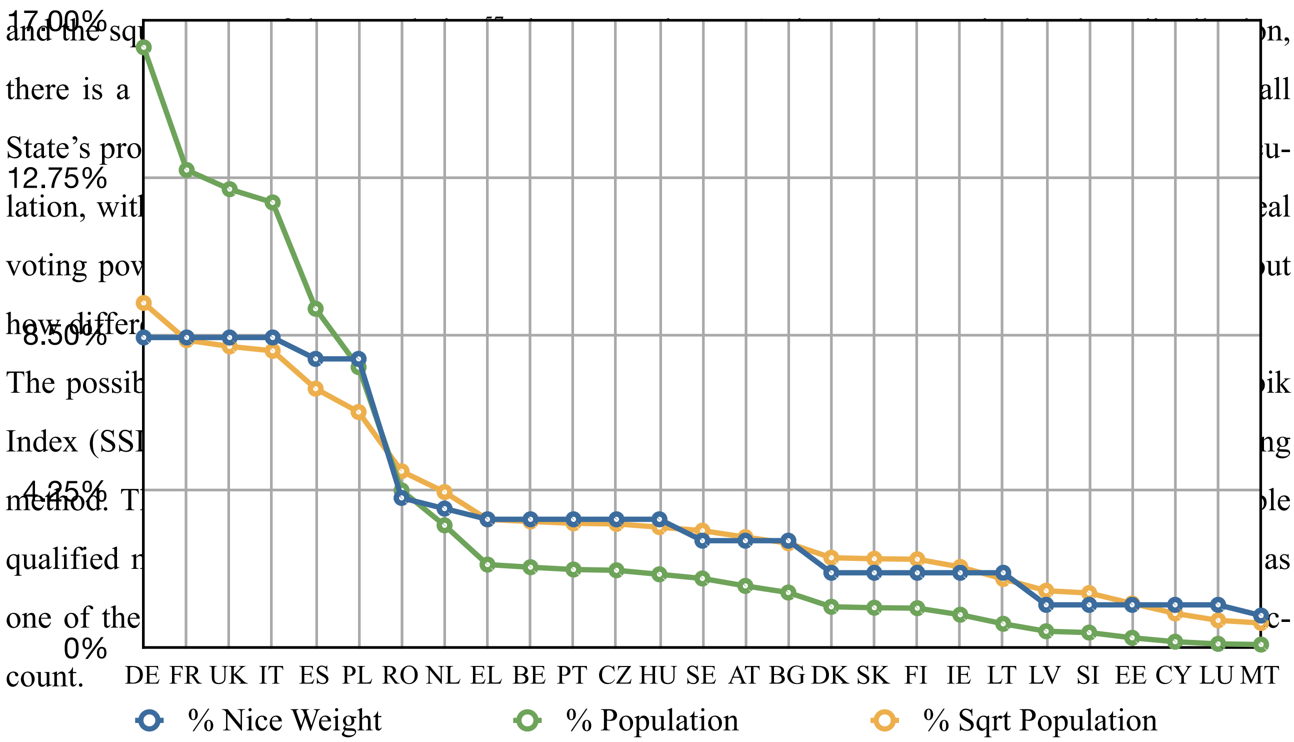
6.3.2 The European Member States' Voting Power

The triple qualified majority voting underlines how important the analysis of the Member States' voting power within the European Council voting process is, since there could be a high possibility of veto coalition by bigger Member States. The big disparity between bigger and smaller countries

[55] Source Member States Weighting Votes: Treaty of Nice; 2011 Member States Population source: Eurostat.

can be seen in Chart 6.1[56], where the Member States' population, the Treaty of Nice voting weight

Chart 6.1: Distribution of Population and Treaty of Nice Weight among EU Member States



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The Treaty of Nice

Table 6.2: Countries' Weight on European Council Decisions						
Member State	*Population*	*% Population*	*Nice weight*	*% Nice weight*	*Sqrt of pop.*	*% Sqrt of pop.*
DE	81,751,602	16.27%	29	8.41%	9,041.659	9.34%
FR	65,048,412	12.95%	29	8.41%	8,065.260	8.33%
UK	62,435,709	12.43%	29	8.41%	7,901.627	8.16%
IT	60,626,442	12.07%	29	8.41%	7,786.298	8.04%
ES	46,152,926	9.19%	27	7.83%	6,793.594	7.02%
PL	38,200,037	7.60%	27	7.83%	6,180.618	6.39%
RO	21,413,815	4.26%	14	4.06%	4,627.506	4.78%
NL	16,655,799	3.31%	13	3.77%	4,081.152	4.22%
EL	11,309,885	2.25%	12	3.48%	3,363.017	3.47%
BE	10,951,266	2.18%	12	3.48%	3,309.270	3.42%
PT	10,636,979	2.12%	12	3.48%	3,261.438	3.37%
CZ	10,532,770	2.10%	12	3.48%	3,245.423	3.35%
HU	9,985,722	1.99%	12	3.48%	3,160.019	3.26%
SE	9,415,570	1.87%	10	2.90%	3,068.480	3.17%
AT	8,404,252	1.67%	10	2.90%	2,899.009	3.00%
BG	7,504,868	1.49%	10	2.90%	2,739.501	2.83%
DK	5,560,628	1.11%	7	2.03%	2,358.098	2.44%
SK	5,435,273	1.08%	7	2.03%	2,331.367	2.41%
FI	5,375,276	1.07%	7	2.03%	2,318.464	2.40%
IE	4,480,858	0.89%	7	2.03%	2,116.804	2.19%
LT	3,244,601	0.65%	7	2.03%	1,801.278	1.86%
LV	2,229,641	0.44%	4	1.16%	1,493.198	1.54%
SI	2,050,189	0.41%	4	1.16%	1,431.848	1.48%
EE	1,340,194	0.27%	4	1.16%	1,157.667	1.20%
CY	804,435	0.16%	4	1.16%	896.903	0.93%
LU	511,840	0.10%	4	1.16%	715.430	0.74%
MT	417,617	0.08%	3	0.87%	646.233	0.67%
TOTAL	502,476,606	100.00%	345	100.00%	96,791.163	100.00%

lately.

$$WG_2 = [620 : 163,130,124,120,92,76,43,33,23,22,21,21,20,19,17,15,11,11,11,9,7,4,4,3,2,1,1]$$ [58]

$$WG_3 = [255 : 29,29,29,29,27,27,14,13,12,12,12,12,12,10,10,10,7,7,7,7,7,7,4,4,4,4,4,4,3]$$

Under these requirements, the winning coalition Shapley-Shubik Index (SSI) can be computed by solving each weighting game. Conversely, to find the SSI of the veto coalition, it is just needed to change the quota q with the value $(n_i - q_i)$, where n_i is the total number respectively of votes, population and weight, and q_i is the value of the winning quota of each weighted game.

Table 6.3: SSI under Treaty of Nice Rules

Country	*SSI %*
Germany	8,74
France	8,72
The United Kingdom	8,70
Italy	8,69
Spain	8,02
The Netherlands	3,67
Greece	3,40
Belgium	3,40
Portugal	3,40
Sweden	2,81
Austria	2,81
Denmark	1,95
Finland	1,95
Ireland	1,95
Luxemburg	1,10
EU15	69,31
Poland	7,99
Romania	3,98
The Czech Republic	3,40
Hungary	3,40
Bulgaria	2,81
Slovak Republic	1,95
Lithuania	1,95
Latvia	1,10
Slovenia	1,10
Estonia	1,10
Cyprus	1,10
Malta	0,82
Total	100,00

[58] Population representation requirement is expressed by percentage multiplied by 10, thus 62% requirement is 620, germany population ratio is 16,27% thus 163 and so on, revising upward.

Computing the SSI value for each country under the triple qualified majority rule it results[59] that, as expected, bigger countries have a higher value compared to the others. Another interesting result that emerges from Table 6.3 is the strong power of the EU15 compared to the new members.

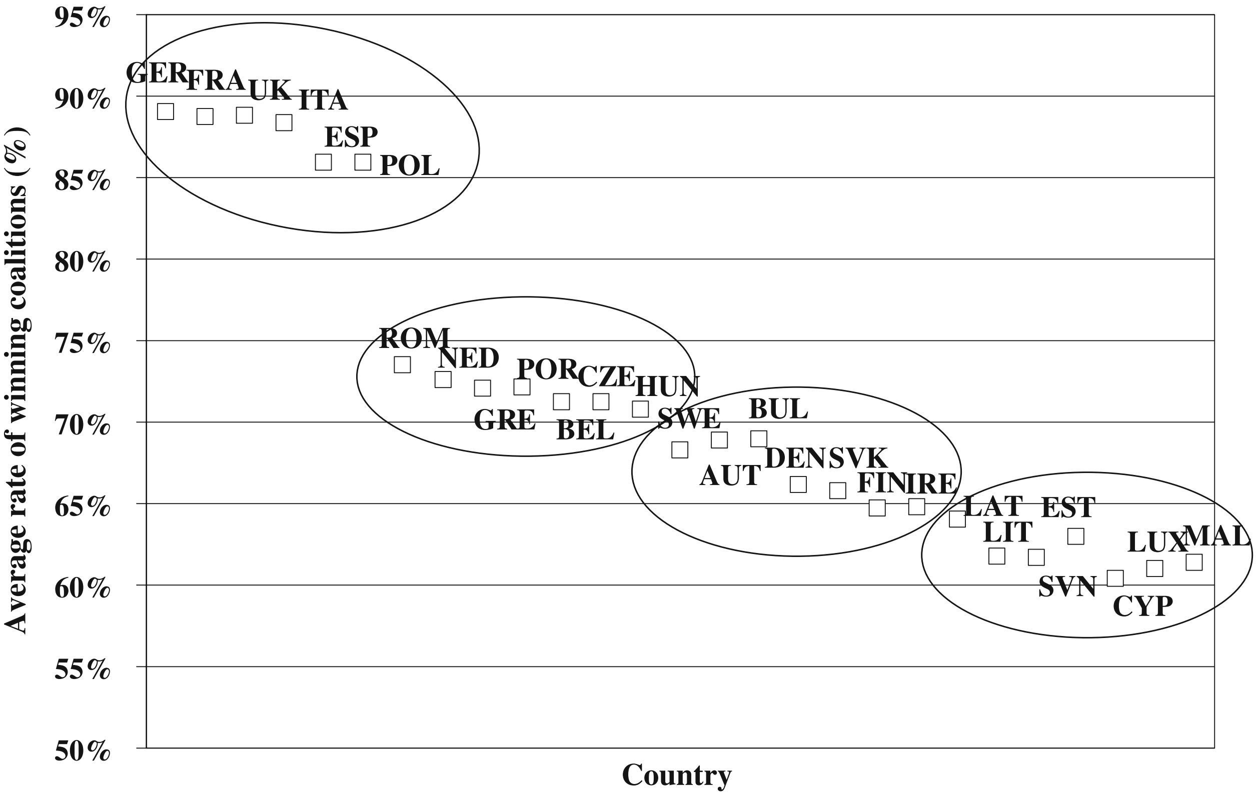
Since the SSI gives the value of each voter's power as a pivotal player, it can just give an approximate idea on how the power is distributed and who are the stronger players. Hence, to have a more accurate view of what could happen during a decision, it is important to analyse how coalitions can be set in order to reach a winning coalition.

A very helpful simulating method has been developed by Nicolae Bârsan-Pipu and Ileana Tache (2009), who simulated a cooperative game under the triple majority rules, focusing both on the winning power and the veto power (since if a veto coalition can veto a decision, it has reach its winning result). Chart 6.2 shows their results which emphasised how, under the Nice rules, bigger countries, for example the first winning coalition cluster, have a possibility to be part of a winning coalition which is higher than 85%. The second and the following winning coalitions' clusters are below 75% threshold, which means that other countries have a strongly lower possibility to be part of a winning coalition. Needless to say, the first cluster of countries can easily block most of the decisions, in particular thanks to WG_3, where the blocking threshold is 38%, and Germany alone can gather the 16,2% of the European population. Nevertheless both the SSI and Chart 6.2 demonstrate that other Member States, such as France, the UK, Italy, Spain and Poland, under the Treaty of Nice's rules have almost the same possibilities as Germany to be part of a winning coalition and to impose their will.

Another interesting data which can be collected from the analysis both of Widgren (2008), and of Bârsan-Pipu and Tache (2009), is that the *passage possibility* of a decision, taken by the Council, is 2%. The *passage possibility* represents the probability that a decision will pass thanks to the vote of "*randomly chosen coalition*" (Widgren: 16; 2008). This, for sure, will never happen in the real world but, in a certain extent, the *passage probability* gives a relevant data about the ability of the European Council "*to act changes when the rules are changed*" (Widgren: 16; 2008). And since the *passage possibility* value is 2%, it underlines how rigid this voting rule is, which, in a certain way, favours the policy stability.

[59] SSI Value source: Widgren, M, p. 11; 2008.

Chart 6.2: Winning Coalitions Distribution: Nice Treaty Rules



Source: Nicolae Bârsan-Pipu and Ileana Tache: 402, 2009

The Treaty of Lisbon

The rules decided with the Treaty of Lisbon concerning the Council's voting follow the decision taken during the European Constitution bargaining and the Inter-Governmental Agreement in 2007. As it has be done for the Treaty of Nice's rules, also the Treaty of Lisbon can be rewritten as a dual majority weighted game, DMWG. Where the double constrains are the 55% of the Member States and the 65% of the European population represented. Thus the game can be written as:

$$DMWG_{Lisbon} = \begin{bmatrix} WG_1 \\ WG_2 \end{bmatrix}$$

Where the sub-weighted-games are:

$$WG_1 = [15 : 1,1,1,1,1,1,1,1,1,1,1,1,1,1,1,1,1,1,1,1,1,1,1,1,1,1,1]$$

$$WG_2 = [650 : 163,130,124,120,92,76,43,33,23,22,21,21,20,19,17,15,11,11,11,9,7,4,4,3,2,1,1]$$

The resulting SSI will represent the power of the population ratio, as it is the most relevant requirement to satisfy, and the one which makes the difference from country to country. In Table 6.4[60]the

[60] Source: Own Computation thanks to the Shapley Index Calculator available in: http://www.cut-the-knot.org/Curriculum/SocialScience/ShapleyShubikIndex.shtml.

power distribution among the Member States can be seen. Under this decision rules, the distribution is less homogeneous than under the current Treaty of Nice's rules, and bigger countries still gather the majority of the power. But, this time, the gap is bigger and also the gap between bigger countries is wider than before, with the result of a neat prevalence of Germany's decision power. Therefore the distribution of the power among the smaller countries is more homogeneous than before. Another consideration can be made looking at the distribution of the power between the elder EU15 Member States and the new Members: the power held by the EU15 is enough to make any decision, even if not agreed by the new Members.

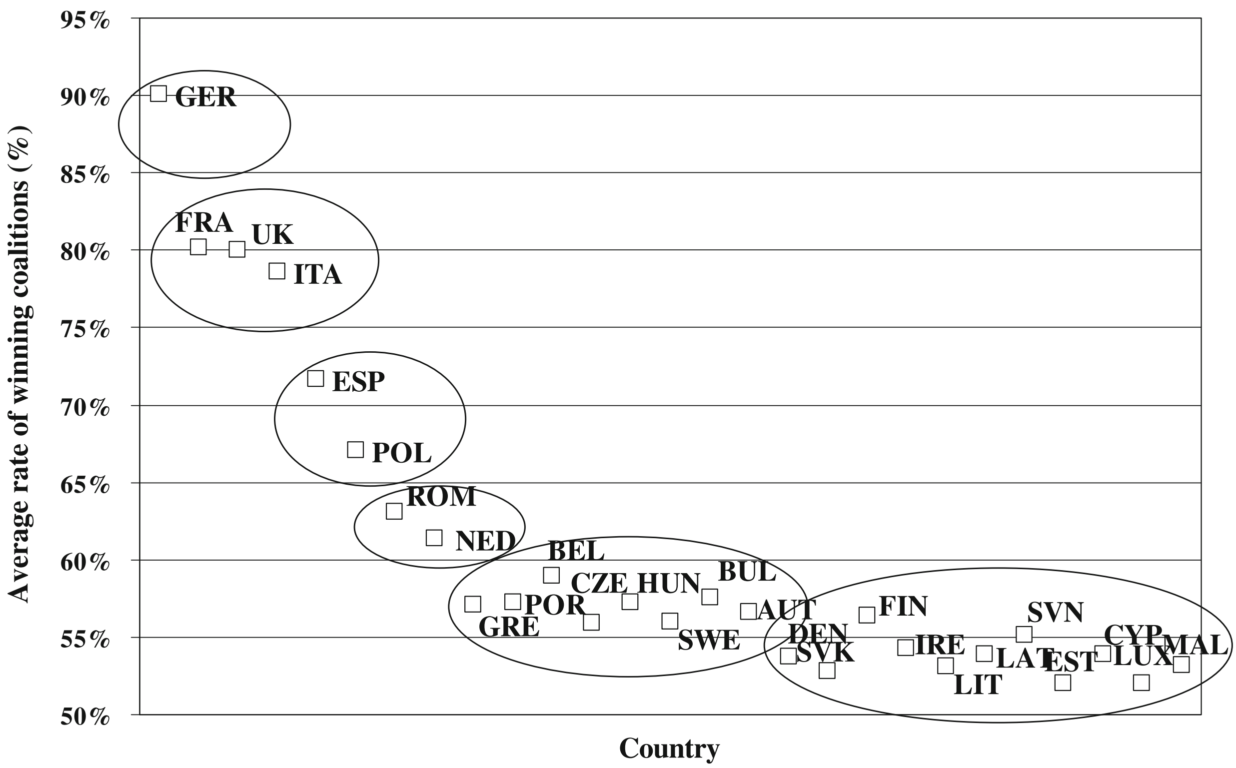
Table 6.4: SSI under Treaty of Lisbon Rules

Country	*SSI %*
Germany	17,50
France	13,35
The United Kingdom	12,62
Italy	12,15
Spain	8,99
The Netherlands	3,14
Greece	2,26
Belgium	2,06
Portugal	1,97
Sweden	1,78
Austria	1,59
Denmark	1,02
Finland	1,02
Ireland	0,83
Luxemburg	0,10
EU15	78,79
Poland	7,38
Romania	4,17
The Czech Republic	1,97
Hungary	1,87
Bulgaria	1,40
Slovak Republic	1,02
Lithuania	0,65
Latvia	0,37
Slovenia	0,37
Estonia	0,28
Cyprus	0,18
Malta	0,10
Total	100,00

The distributional result of this different decision making rules is even more clear looking at Chart 6.3 which show the results of the Bârsan-Pipu and Tache's (2009) simulation. Looking at the simulation results it can be seen how Germany, under these rules, has the highest power. This is slightly over 90% of the probability to be part of a winning coalition, which means that it is very likely to be in a position of absolute power.

Under the Lisbon voting rules, while Germany overreached 90%, the other Member States have lost their power. France, the UK and Italy are now around 80% of the probability and they have the same gap with Germany as the one that the first cluster have with the second cluster under the Nice Treaty. To be more clear, under the Lisbon Treaty, Germany will be as much strong as before, but France, the UK and Italy will be strong as much as Romania, with the current rules.

Chart 6.3: Winning Coalition Lisbon Treaty



Source: Nicolae Bârsan-Pipu and Ileana Tache: 403, 2009

All the other countries, from the third cluster on, have a probability lower than 75%, and the smaller countries (starting from Denmark, 5,5 millions citizens) have a probability lower than 55%. This means that the smaller countries, under this distribution, will lose most of their representation in the European Council and also the bigger countries, except from Germany, will be largely affected by the new rules. The less homogeneous distribution outlined by the Lisbon Treaty guaranteed, on the contrary, a higher passage probability which is around 17,1% (Widgren, 2008). This means that, even though there is a big loss of power by many Member States, in favour of a greater power for Germany, this method of power distribution is more efficient than the Treaty of Nice's one, as it will decrease greatly the probability of policy stability. This results can be achieved because the great majority of the Member States all have almost the same power. Chart 6.3 clearly shows how bigger countries will have a highly differentiate distribution of the power, but, on the contrary, medium and small countries will be equally distributed.

The Jagiellonian Model

Proposed by the Polish Government during the European Constitution bargaining, the Jagiellonian Model adopted the method developed by Penrose in 1946. Penrose proposed to adopt a voting method which weighted each country by the square-root of the its population. The original method foresaw a winning majority of 55%.

The Jagiellonian Model was developed by two researchers of the Jagiellonian University of Krakow, Slomczynski and Zyczkowski, which, following Penrose's idea, proposed a voting method based on the square-root of the populations and approximating the optimal winning majority to 61,6%.

The complete formula to compute the weight of each country is :

$$\omega_i = \sqrt{\frac{N_i}{10^k}} = 10^{-\sqrt{k}} \bullet \sqrt{N_i}$$

Where ω_i is the weight of the country i, N_i is the population of country i, and 10^k represents the units of population with k=0, 2, 3, 4, 5, 6. In order to have a clearer weight of each country, it is useful to normalise the weight distribution, finding the normalised weight w_i:

$$w_i = \left\langle \frac{\omega_i}{\sum_{j=1}^{27} \omega_j} \right\rangle$$

Applying the formula to each European Member State, the valued shown on the seventh column of Table 6.2 will result. Writing a weighted game describing the Jagiellonian University proposal it will result a weighted game with a single constrain, JMWG, related to the square-root of the Member States' population, as follows:

$$JMWG = [616:93,83,82,80,70,64,48,42,35,34,34,34,32,32,30,28,24,24,24,22,19,15,15,12,9,7,8]$$

In this game, the total weight is represented by 1000 units, the majority threshold is 616 and each country has a weight corresponding to its population ratio over 1000.

Computing the SSI of each player of this game, it will result that the distribution of the power is more homogenised than the Treaty of Lisbon's power distribution, but less than the Treaty of Nice's one. In a certain way, this power distribution, which follows a square-root function of the population distribution, is a middle result between the results obtained analysing the previous cases. It is possible to see in Table 6.5[61] the SSI distribution:

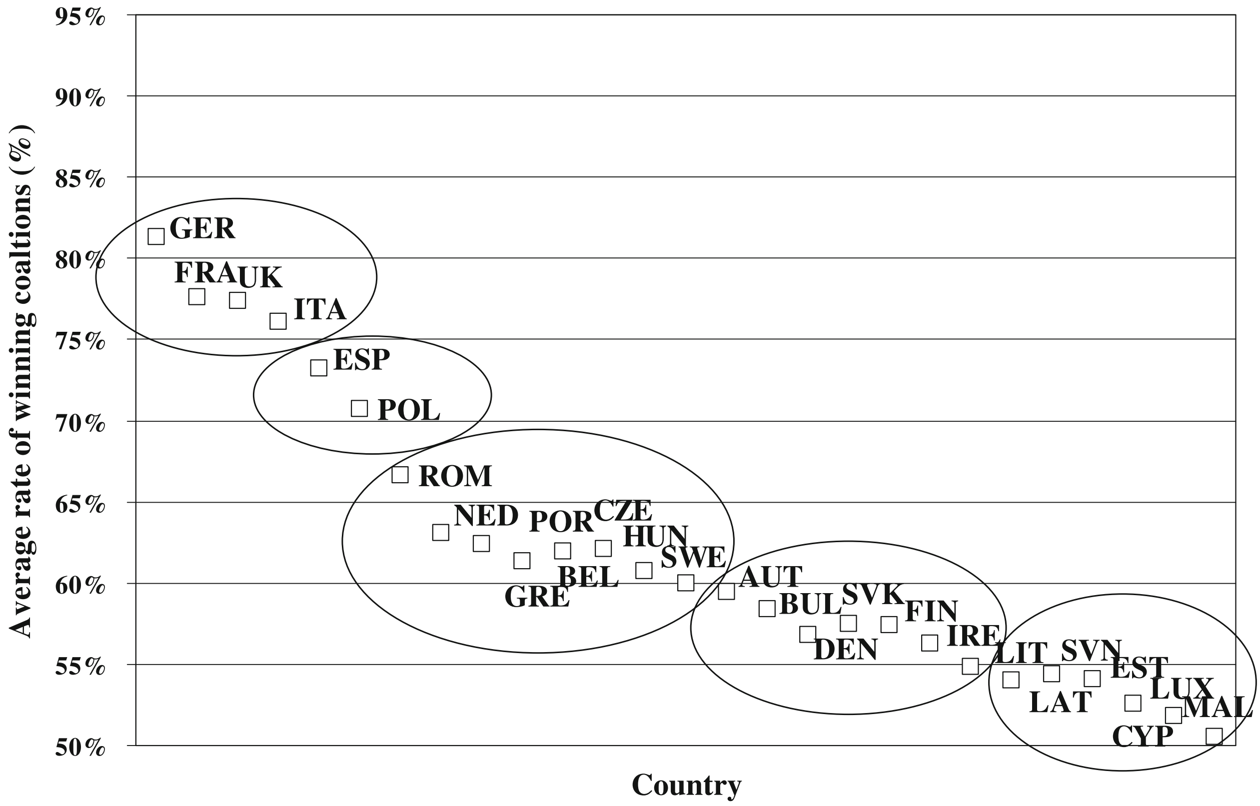
Table 6.5: SSI under the Jagiellonian Model

Country	*SSI %*
Germany	9,71
France	8.56
The United Kingdom	8,45
Italy	8,22
Spain	7,11
The Netherlands	4,14
Greece	3,43
Belgium	3,33
Portugal	3,33
Sweden	3,13
Austria	2,92
Denmark	2,33
Finland	2,33
Ireland	2,13
Luxemburg	0,76
EU15	69.88
Poland	6,46
Romania	4,76
The Czech Republic	3,33
Hungary	3,13
Bulgaria	2,72
Slovak Republic	2,33
Lithuania	1,83
Latvia	1,44
Slovenia	1,44
Estonia	1,15
Cyprus	0,86
Malta	0,67
Total	100,00

[61] Source: Own Computation thanks to the Shapley Index Calculator available in: http://www.cut-the-knot.org/Curriculum/SocialScience/ShapleyShubikIndex.shtml.

Reminding the shape of the square-root function, it is clear why the power distribution under this model has been reduced for big countries and increased for small countries compared to the previous voting rules. This redistribution of the countries' power, thus, favours the medium and small populated Member States compared to the bigger one: in a certain way it flattens the big disparity between the big countries and the other ones, since in the other models the first four or five countries (according to their population) have at least 10% of voting power more than the rest of the Member States, which deeply influences the decision making of the Union. To emphasise even more the reduction of the big countries' and old Members' power there is the EU15 power share, which under this method is almost 10% less than the power that the EU15 will have from 2014 when the Treaty of Lisbon will become effective. Looking at the winning coalition distribution shown in Chart 6.4 (Bârsan-Pipu and Tache's simulation, 2009), the flatten result of the square-root function is even more clear. This voting model shows the reduction of voting power and the probability to be part of a voting coalition for almost every Member State, but this power reduction is due to a redistribution which decreases the disparities among the EU countries, as it is visibly spotlighted by Chart 6.4.

Chart 6.4: Winning Coalition Jagiellonian model



Source: Nicolae Bârsan-Pipu and Ileana Tache: 405, 2009

The first cluster of winning coalition is made by the four bigger countries of the EU, their probability to be part of a winning coalition is between the 82-76%, which is drastically lower than in the previous cases of Nice and Lisbon Treaties. However, the gap between the first and the second cluster is closer than before, and, more generally, the gap between each country is more uniform than in the other voting models.

The flattener redistribution of the Jagiellonian Model influences the flexibility of the Union to react to rule changes and in fact the passage probability's value is 10% (Widgren:16, 2008). Thus, it is more flexible than the one in the Nice Treaty, but also less than the Lisbon Treaty's one to avoid policy stability.

6.4 Conclusions: European Perspectives

Through this thesis many aspects of the European Union have been spotlighted and described. Each aspect has been useful to better understand the complex mechanisms which rule the European Union and its political-economic framework. Summarising what has been written previously, the European Union is a supranational organisation which started, about sixty years ago, because of a political interest. In the course of its history, it has achieved its results and it has increased its power upon the Sovereign States thanks to an economic integration (Chapter 2). The integration history is sparkled with political conflicts because of policy, budget and economic matters (Chapter 2 and 4). These conflicts are due to a differentiate culture which characterises each European country (Chapter 5). Convergent policies have tried to smooth the diversities over the years, but each country's point of view, which is strictly connected with the history of the country itself, is still difficult to change. This knowledge, together with the notion of voting and the explanation of each voting system, can help to ideally picture the future of the Union. In the first chapters how decision-making rules are pivotal issues in the European Union emerges, as an efficient decision-making process cannot be possible without a proper voting method.

6.4.1 The Economic Model's Diversities and the Voting Behaviour

The theories (concerning social choice and voting power distribution) shown in this chapter present different limits as they assume that each Member State is interested in creating coalitions with any other Member State – which is a plausible situation – but in the political reality this never happens. As it has been said before, the Members of the Council vote following national interests, thus each Member State tries to improve his national economy. This also means that a Council's Member votes for a policy which improves the economy of his country, and votes against or blocks a decision that worsens its national economy. Following this reasoning, the Member States with an equivalent economy could vote similarly, hence, they could possibly be part of the same coalition. Using the economic model differentiation shown in Chapter 5, consider, for instance, the behaviour of the Central-European Model's countries and the Mediterranean Model's countries if a new employment policy, which emphasises the employment protection, in introduced. According to the two different economic models, Central-European Model's countries would probably vote against the new policy, as they prefer a moderate employment protection. On the contrary, the Mediterranean Model's countries would probably vote for the new policy, as they culturally favour a high employment protection.

The notion of an economic model clustering gives a clearer vision of the Member States' behaviour in the Council decision-making process, in particular concerning the voting. Figure 5.2 (p. 109) can be now read, not only, as the clustering distribution of the European economic models, but also as the representation of the possible voting coalitions. Looking at Figure 5.2, it is in fact possible to see how countries like France and Germany are close and, thus, may pursue similar objectives at European level, while the Mediterranean countries (Greece, Italy, Portugal, Spain) may have the need to push forward different actions.

This voting behaviour interpretation is partly verified by voting behaviour evidences. In can be seen, for instance, in France's and Germany's political behaviour, in the European Integration history and, in particular, in the last years. In the European decision-making process, in fact, Germany and France have strongly worked together to achieve their national interests, along with their cultural value (restrictive monetary and fiscal policies, in particular, public debt reduction and sovereign balanced budget). Another example which testifies the *economic model clustering approach* in voting behaviour is given by the UK actions in the European level. As seen in Figure 5.2, the UK is far from the other countries, creating its own cluster. This diversity in the economic model reflects the political behaviour of the UK in the European decisions, in fact it acts independently and not following any particular coalition. Hence, even though the UK and Italy, for instance, which have a voting power similar to Germany and France (with the Treaty of Nice rules), rarely have achieved results against the France-Germany coalition, as their votes are not aligned thus less effective.

These strong voting coalitions have created, over the years, the possibility of a policy stability. Just to give a simple example, in December 2011, the Italian Prime Minister, Mario Monti, has proposed to the EU, in particular to France and Germany, the possibility to create an European Bond in order to pay the national public debt of the Eurozone Member States. Since this decision would have created economic disadvantage both to Germany and to France, the proposal was denied, even though it may have helped more generally the Eurozone (see: Laopodis, 2008; Alves and Afonso 2009; Berben and Jansen, 2009; Osterloh, 2009; Alexopoulou, Bunda and Ferrando, 2010; De la Fuente, Domenechy and Rant, 2010; Bukowski, 2011). This example shows how, even if on a theoretical level the bigger European Countries all have the same voting power and, thus, the same possibility to put forward a particular policy, in the concrete, there is the possibility to create a veto-coalition which can easily block the decision-making process. In order to avoid the existence of policy stability in the European decision-making, a bargaining process has emerged. The bargaining process has resulted crucial in many occasions, such as, for instance, in the joining of the UK in the Union (1972). In this occasion, in fact, France vetoed its admission until the other Member States bargained it with the Common Agricultural Policy, which would have favoured in particular the French agricultural sector. This example of bargaining reveals a sort of compensation method, which has been adopted in many occasions to change or to introduce the policies that stronger voters would have blocked. This need for bargaining, in order to change a policy or to introduce a common rule in the EU, is emphasised by the existence of veto players or coalitions. These have to be compensated in a certain way to accept the worse off of their political or economic position due to the policy introduction or change. As it has been said before, the current voting method favours the creation of veto coalitions and thus policy stability, due to the high threshold of the triple qualified majority to approve the decisions.

6.4.2 The Effects of the Lisbon Treaty

In 2014**,** Nice Treaty's voting rules will be changed and the forthcoming Lisbon Treaty's voting rules will come into force. As shown in paragraph 6.3.2, with the new voting rules based on population ratio, the voting power of Germany, the biggest Member States, will drastically increase compared to the one of the other Member States. As shown by the SSI Index and the Bârsan-Pipu and Tache's voting simulation model**,** the new power distribution will considerably change from the current situation. What is relevant to underline, from the results estimated by SSI Index and the Bârsan-Pipu and Tache's voting simulation model, is that on one side the new rules will increase the flexibility of the Council to adapt to political-economical changes, as the passage probability will rise from 2% to 17,1% (Widgren, 2008). On the other side, an increasing difficulty to approve a decision which could be against the Germany's will is shown. In fact, the voting simulation model estimates that the probability which a Member State will be part of a winning coalition will decrease, for any country except for Germany whose probability will slightly rise. This means that it would be harder for any other Member State to approve a decision in contrast with Germany (to be more precise, according to the coalition simulation Chart 6.3, the probability that a decision will pass against the Germany's will is 10%).

According to the Lisbon Treaty rules, in order to block a decision either the representation of 35% of the European population or the veto of at least four Member States in needed. Using the *economic model clustering approach*, this means that the Central-European Model's countries (Austria, Belgium, France, Germany, Ireland, Luxembourg and the Netherlands), which represent 37,37% of the European population, as a coalition could possibly block any European decision. Thanks to the additional rule, according to which a veto of at least four Member States can block a decision, on one hand, the theoretical Central-European coalition would strongly strengthen its veto power; but, on the other hand, four small Member States can also possibly block a decision. Recalling what has been said before, the existence of veto coalitions increases the persistence or the creation of bargaining processes before the decision has been taken, and thus the chance of compensation. Hence, the decision to allow veto coalitions of at least four players creates: on one side, the possibility for small countries to defend their interests voting against decisions which favour bigger countries; but, conversely at the same time this rule allows the constitution of a veto coalition which can ease an excessive policy stability.

6.4.3 The Jagiellonian Model

Looking at the three different voting rules exposed in Section 6.3.2, it is possible to see that the voting model developed by the Jagiellonian University of Krakow is the most equilibrate, as it presents features which increase the voting power's homogeneity. This higher homogeneity of the power distribution is due to the properties of the square-root function (concave monotonic non-decreasing function). Which guarantees a reduction of veto-coalition creation thanks also to the higher blocking threshold set to 38,4% of the vote against the decision. Recalling back the hypothetical Central-European countries' coalition, with Jagiellonian voting rules its voting weight would be 31,24%, hence it would need the support of other countries to block any decision, due to both the higher blocking threshold and its lower voting weight. Other consequences of the Jagiellonian model would be the higher impact of medium and small countries in the decision-making process, and the higher passage possibility due to the lower majority threshold compared to both Nice and Lisbon Treaty.

6.4.4 Political Changes and Unforeseeable Future Scenarios

Nowadays, The European future is even more unknown after the recent French presidential elections (April 2012), which made the Socialist Francois Hollande the new President of the French Republic, the European future is even more unpredictable. As soon as he has been elected, he has stated to prefer public spending rather than austerity to face the crisis. His different political view, compared to Nicola Sarkozy's one (former President), could lead to an alteration of the Germany-France coalition. The different European Member States' political assets, together with an increasing voting power of Germany from 2014, due to Lisbon Treaty rules, the European Union will lead to new unforeseeable scenarios. It is clear that France and Germany since the early beginning of the ECSC have led the European continent with their decisions, but also that political changes within the Member States have sometimes drastically affected the EU political assets and its institutional framework. Political Economics and Game Theory can be useful to analyse and understand the past events of the EU and to peer at its future, keeping in mind that the European Union is more bound to its Member States' politics rather than to the EU social Common utility, at least within the current framework.

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