

## PRESS RELEASE

# **Annual Report on the State of the European Union**

June 24, 2004

The ISAE Report on the State of the European Union, which has reached its fourth edition, thoroughly investigates some of the main questions directly affecting the European economic trend and particularly the process of institutional and economic integration. After the difficult compromise reached by the European Council in Brussels, the EU Member States approved the Treaty establishing a Constitution for Europe, which is an act of the utmost importance. Indeed, over the past few months, the Union borders were enlarged to include further ten countries, eight of which belonged to the block controlled by the Soviet Union. The European currency unit – even though it created competition problems to the European exports - has been strengthening on the markets and the doubts on its solidity – sometimes stressed during the past few years – seems to have been dispelled. From a macroeconomic point of view, in spite of the delay and of the different intensity of the European recovery compared to the United States, the first half of 2004 brought growth to the EU. However, as it often happened in the Community history, the progress made is not complete, because it often consists of opposing thrusts, resistances, unforeseeable leaps forward and sudden external conditionings. Perhaps the only solution would be measuring the progress made in terms of gradual (and voluntary) reduction of the political and economic sovereignty of Member States.

The Report consists of six Chapters and the approval of the new Constitution (which is thoroughly analysed in the Chapter 1) is present throughout the whole Report. The satisfaction for the (non obvious) conclusion of a long-lasting and complicated process started with the Laeken European Council of the late-2001 (a satisfaction which will be full when 25 national Parliaments and, for the time being, 9 electorates, approve the Brussels Constitution) goes alongside with the disappointment for the missed opportunities due to oppositions and resistances, to the prevalence of intergovernmental procedures as against community ones in important matters, to the emergence of an “impregnable fortress” whenever the EU foreign and fiscal policies were discussed, to the adoption of the principle of unanimity even in matters (such as the multi-annual financial EU prospects) in which the attempt was made to opt for a majority vote, to the ever growing ability of minorities to form coalitions and resist within the Council thanks to a voting system which seems to halve the opportunities to create majority coalitions in the Council.

The present Report analyses the enlargement from different viewpoints, investigates the public finances of new entrants (Chapter 3), the risks to transmit voluntary disturbances in a delicate

transition period when the currencies of the new Member States have to respect new rules and show a higher stability (Chapter 5), the structure of welfare systems (Chapter 6). And yet, attention is also focused on the "stain" (documented in Chapter 3), namely the postponement of the implementation of one of the fundamental principles of the EU, i.e. the free circulation of workers, which is going to be substantially hampered for the next few years by the compromise asked for by Germany and welcome by almost all Member States.

The new and consolidated euro "strength" on the international markets was also mentioned. And yet, the macroeconomic stability – which seems necessary to guarantee that strength, if measured on the basis of the trend of the main public balances - has never proved to be so precarious and difficult as now. The Stability and Growth Pact (SGP) was questioned and created unprecedented tensions in the relationship between Commission and Council. Beyond the procedural questions and the credibility of the agreements which are at the basis of the SGP (which are apparently applicable to small Member States, but not to the large EU nations), and apart from the distinction between "Proposals" and "Recommendations", we have the impression that the Pact structure – which was conceived in periods of (non brilliant) expansion of the European economy – does not hold to the ongoing European economic slowdown (which is the longest in the past 25 years). The nasty dilemma – examined in Chapter 2 of the Report – between the respect of the SGP rules (but with the *de facto* introduction of pro-cyclical policies) and the adoption of an expansionary budget policy (which might go to the detriment of the economic and financial credibility of the EU area and of single Member States) raised again the problem of the need or at least the usefulness of short-term demand-supporting policies. We mentioned an economic system registering good growth rates. Nowadays the major thrusts seem to come from outside Europe, where the frantic development of the Chinese and Asiatic manufacturing firms go alongside with the new thrust of the American economy, in which the expansionary target of macroeconomic policies (the fiscal policy plus a monetary policy able to maintain interest rates at the lowest level since the Second World War) is accompanied by the ability to diffuse innovation. This means that in Europe there is not much genuinely endogenous.

The peculiarity of the process of institutional construction which is going on in the Union was already mentioned beforehand. As time goes by, the Union is taking up a very particular shape and there is no model of federal State or confederation which somehow resembles it. The Constitution approval and the discussion on the future multi-annual financial prospects – which intensified last year with the publication of the Sapir Report and grew in the past few months with the Commission Communication – both confirm the strange EU institutional array. Indeed, the EU has a highly-developed regulation function, affecting most public functions, alongside with an insignificant financial guide power (see the EU budget), mainly aimed at the CAP and at a form of

territorial redistribution which, compared to the much-discussed CAP structure, seems to work well. Thus, unlike what happens in any other federal system, there is a clear division in the EU between the decision-taking bodies and the financial and functional-managing roles, which creates complex problems of accountability definition and allocation and of effectiveness in the competence distribution.

In spite of its strange and unprecedented structure, the Union – particularly in the past fifteen years – has moved towards a system whereby the benefits of the “centre” (i.e. the Union) gradually strengthened till they reached their own constitutionalisation. However, the examples of the foreign and fiscal policies show the existence of a resistance on the part of sovereign Member States which won’t be easily overcome and which may be only gradually reduced. Indeed, there are matters – for examples, the pension systems analysed in Chapter 6 – for which, even on the basis of the theories on fiscal federalism, national solutions seem preferable to supranational ones, let alone for the enormous difficulties met in making different systems move towards a common formula.

In its Report Introductions, ISAE has often dealt with fiscal policy. At times of ferocious divisions – only partially narrowed – on some of the most important foreign policy topics (first of all the war in Iraq), it is inevitable to focus on the evolution of a structure which might help define the EU international role. In this sense, the new Constitution, on the one side, “armours” the unanimity vote on questions of foreign policy and common security and, on the other side, it openly introduces a “common” figure such as the Minister of Foreign Affairs, who is politically more powerful and legitimated compared to the present situation, and belongs to the Commission in his capacity of Vice-President endowed with his own diplomatic body, hence able to work with continuity on the definition and implementation of the EU foreign policy. Time will show whether and how those opposing trends find an equilibrium.

Given the complex situation, a remark – stimulated by the war in Iraq – should concern the European defence policy (thoroughly analysed in Chapter 4 of the Report). This is one of the areas in which Europe has tried to reconstruct a sort of integration, but in which in fact considerable delays were accumulated. Admittedly, the balance of powers stemming from the Second World War contributed to the limiting – with the obvious exceptions of France and the United Kingdom – of the financial effort for the defence policies. Chapter 4 of the Report investigates the statistical evidence in terms of historical series, by describing the situation of the Member Countries and of Europe as a whole as against the rest of the world and, in particular, the United States. The qualitative and quantitative gap between the EU and the USA is enormous and it has been widening over the past few years.

The end of the cold war and the reunification of Germany, the EMU construction and the enlarged EU, the ever growing need to have a say on the world scene, the economic and political conditionings which derive from that, all require integration between Member States and a supranational body with real powers. Some shy signals of this trend are emerging both in the European Constitution approved in Brussels and in the new financial framework 2007-2013 submitted by the Commission in March 2004. However those signals are not enough.

All in all, even considering the typical flexibility of Constitutional principles, the approval of the Brussels Treaty (also because of the unanimity clause) seems to have guaranteed a strong institutional thrust in favour of integration. Nobody knows which will be the next steps, unless the sovereign European Member States undergo some sort of euthanasia for the matters which are still – at least apparently – under their full control.