



# Theory and Politics of European Integration

## Lecture 2: EU Institutions and Decision Making

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- **Course Overview**
- **EU History**
  - Why European Integration: Preventing another war in Europe
  - Two competing concepts: federalism vs. intergovernmentalism
  - Links between deeper integration and expansion
  - Europessimism
  - Single Market Programme 1992
  - Collapse of Communism
  - Eastern enlargement and ‘finalisation’ of Europe
  - German unification, Maastricht and EMU
  - EU Treaties and EU Constitution
  - Euro crisis



- **EU Institutions: A Primer**
  - Key Facts
  - EU Law
  - The “Big 5” Institutions
  - Legislative process
  - Budget
- **Decision making**
  - Task Allocation and Fiscal Federalism
  - Evolution of Voting Rules
  - Efficiency of Decision-making
  - Fair Power Distribution and Legitimacy



- **EU History, Institutions, Decision Making and the Budget**
  - Baldwin & Wyplosz (2015) “The Economics of European Integration”, McGraw-Hill, Ch. 2 + 3



- **EU Institutions: A Primer**
  - Key Facts
  - EU Law
  - The “Big 5” Institutions
  - Legislative process
  - Budget



- The Treaty of Rome was a far-reaching document: it laid out virtually every aspect of economic integration implemented up to the 1992 Maastricht Treaty.
- The Treaty’ s intention was to create a unified economic area = an area where firms and consumers located anywhere in the area would have equal opportunities to sell or buy goods throughout the area, and where owners of labour and capital should be free to employ their resources in any economic activity anywhere in the area:
  - “4 freedoms”: goods, service, workers and capital;
  - common policies where necessary.



- Free trade in goods: eliminate tariffs, quotas and all other trade barriers.
- Common trade policy with the rest of the world: Customs Union to trade deflection.
- Ensuring undistorted competition (to avoid “deals” that offset trade barrier removal):
  - state aids are mostly prohibited;
  - anti-competitive behaviour regulated by Commission;
  - approximation of laws (i.e., harmonization);
  - taxes (weak restrictions but no explicit harmonization).



- Unrestricted trade in services: principle of freedom of movement of services, but implementation has been hard.
- Labour and capital market integration:
  - free movement of workers;
  - free movement of capital in principle but many loopholes; very little capital-market liberalization until the 1980s .
- Exchange rate and macroeconomic coordination.
- Common policy in agriculture: set up in 1962, agriculture was much more important than it is today (e.g., about a third of French population was involved in agriculture in 1950s; today less than 5%). However, still 40 % of EU Budget are devoted to agriculture

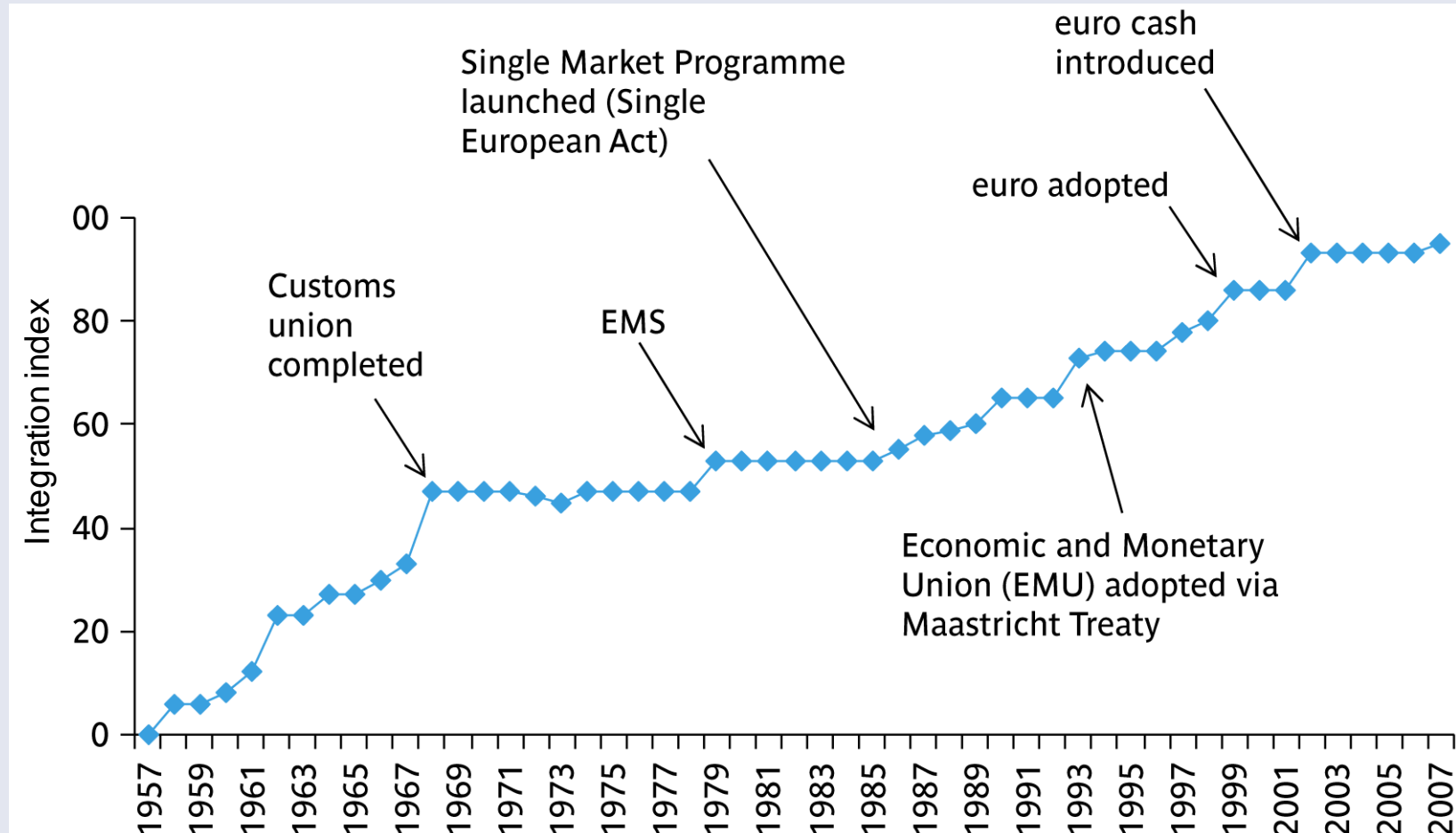




- Social policy: social harmonization very difficult politically:
  - nations have very different opinions on what types of social policies should be dictated by the government;
  - it is not as an exchange of concessions.
- Also, not clear that European economic integration demands harmonization of social policies:
  - national wage would adjust to offset any unfair advantage;
  - if lower social standards meant lower production costs, long term result would be higher wages that offset the advantage.
- Tax policy: like social policies, tax policy directly touches the lives of most citizens and it is the outcome of a national political compromise. Thus, EU leaders have always found it difficult to harmonize taxes.

# Quantifying European economic integration

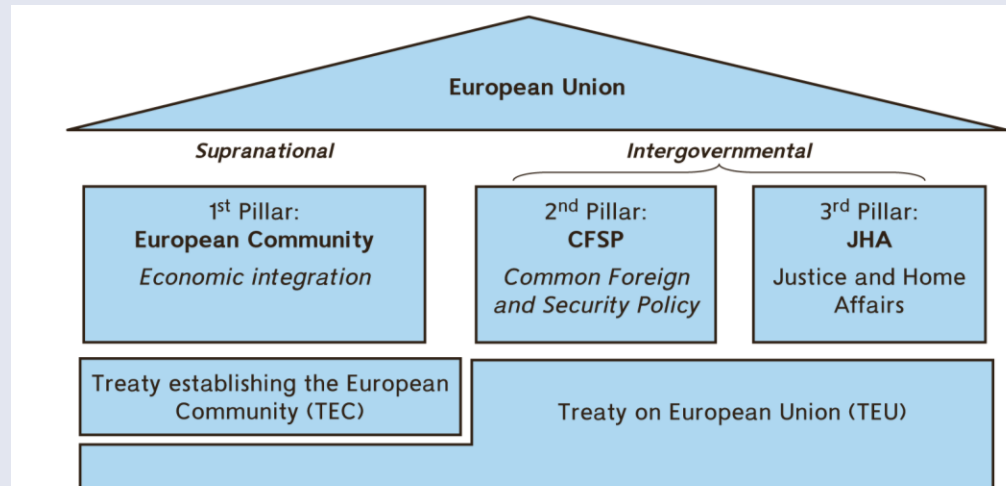
- Economic historians have quantified the extent of integration.



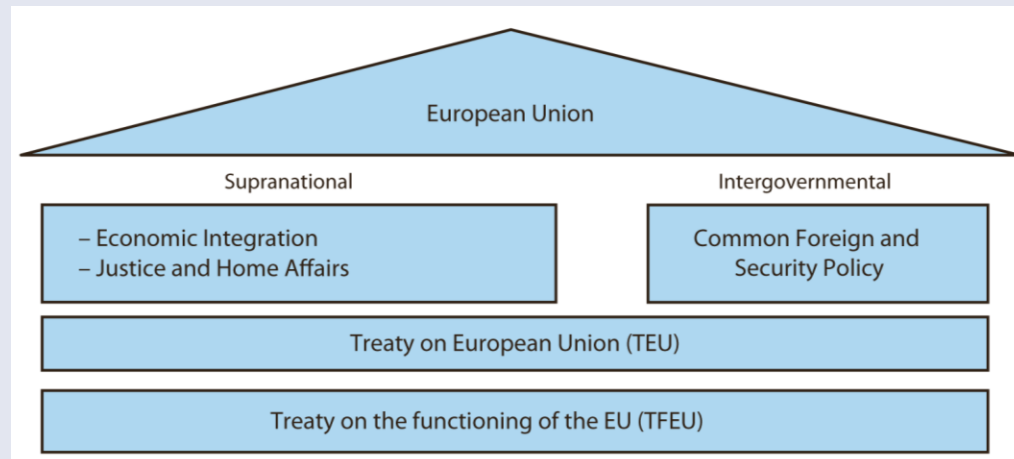


- Until the Maastricht Treaty, most integration initiatives were decided with supranational decision-making procedures. Two problems:
  - old schism between federalists and inter-governmentalists:
    - the 'vanguard' wished to spread European integration to areas not covered in the original Treaties;
    - the 'doubters' worried that supranational decision-making procedures were producing an irresistible increase in the depth and breadth of European integration;
  - integration that was taking place outside of the EU's structure.
- The Maastricht Treaty drew a clear line between supranational and intergovernmental policy areas: the 3-pillar organizational structure.
- The Lisbon Treaty has a roof and only 2 pillars: one for supranational issues and one for intergovernmental issues.

# EU structure: pre and post-Lisbon compared



Note: The first pillar also includes the highly specialized European Atomic Energy Community; it is often called Euratom.

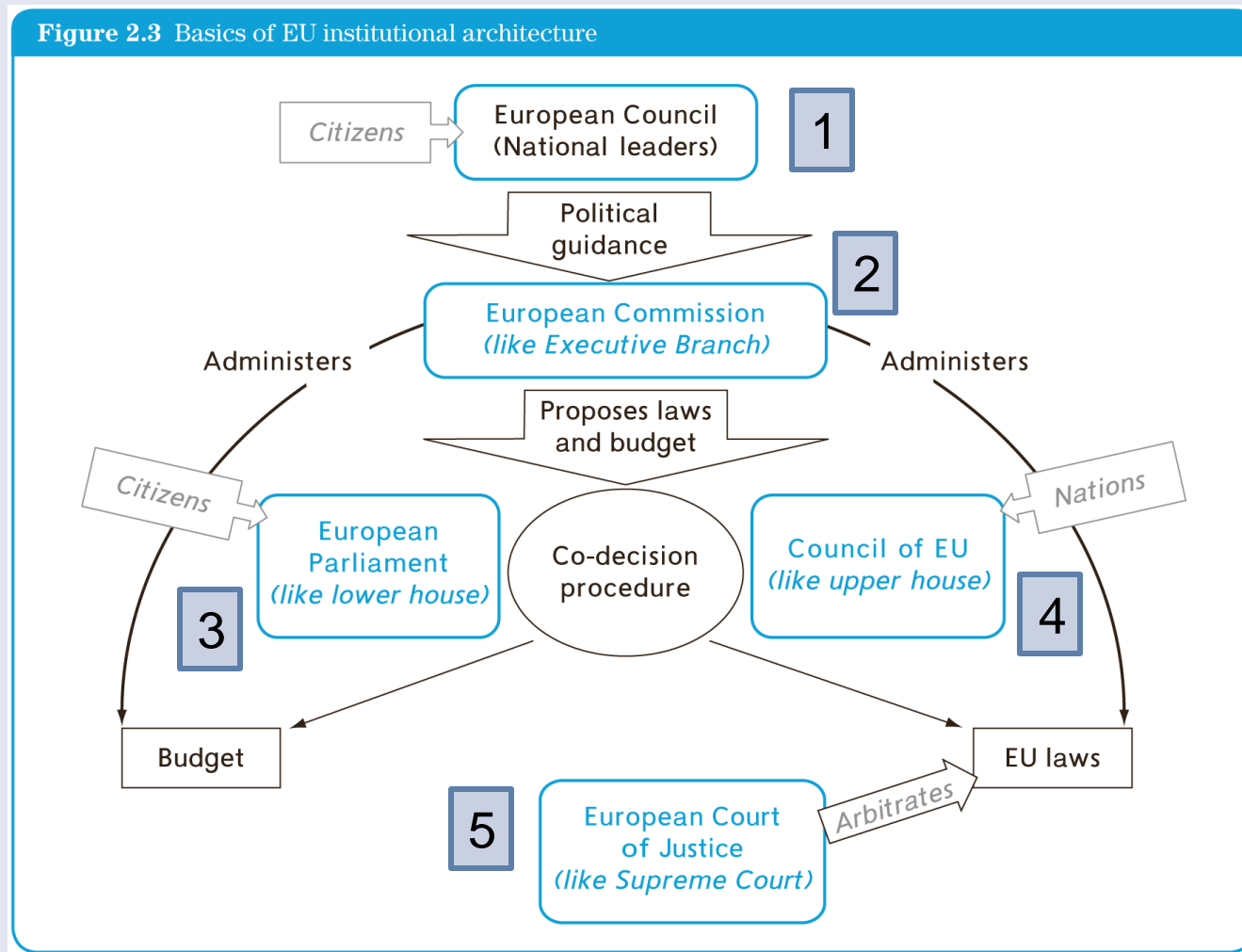




- One of the most unusual and important things about the EU is its supranational legal system. By the standards of every other international organization in the world, the European legal system is extremely supranational.
- Main principles:
  - direct effect: EU law can create rights which EU citizens can rely upon when they go before their domestic courts;
  - primacy: Community law has the final say (e.g., highest French court can be overruled) so that it cannot be altered by national, regional or local laws in any member state;
  - autonomy: system is independent of members' legal orders.

# The 'Big-5' institutions

- There are many EU institutions but the core ones are the “Big-5”:



- The European Council is the highest political-level body in the EU: it provides political guidance at the highest level (i.e., it initiates the most important EU initiatives and policies).
- It consists of the leaders of each Member State, the President of the European Council and the President of the European Commission.
- The Lisbon Treaty created the ‘President of the European Council’ who chairs the European Council for two and a half years and is selected by qualified-majority voting in the European Council.
- Current President?



Donald Tusk



- It meets at least four times a year, with the most important meetings usually coming in June and December (at the end of each six-month term of the Presidency of the EU).
- The most important decisions of each Presidency are contained in a document, known as the 'Conclusions of the Presidency'.
- One peculiarity is that the European Council has no formal role in EU law-making: its political decisions are translated into law following the standard legislative procedures.
- Confusingly, the European Council and the Council are often both called 'the Council'. And neither should be confused with the Council of Europe (an international organization set up in the 1940s and entirely unrelated to the EU).



- The Council is the EU's main decision-making body.
- It consists of one representative from each EU member authorized to commit its government to Council decisions, so Council members are the government ministers responsible for the relevant area.
- It uses different names according to the issue discussed:
  - e.g., EcoFin for financial and budget issues, the Agriculture Council for CAP issues, General Affairs Council for foreign policy issues.





- The Council has responsibilities in all first-pillar areas; it has the following powers:
  - to pass European laws (jointly with the European Parliament);
  - to coordinate the general economic policies of the Member States in the context of the Economic and Monetary Union (EMU);
  - to pass final judgment on international agreements between the EU and other countries or international organizations (a power it shares with the European Parliament);
  - to approve the EU's budget (jointly with the European Parliament).
- In addition to these tasks linked to economic integration, the Council takes the decisions related to Common Foreign and Security Policies.



- The Council has two main decision-making rules:
  - unanimity: for most important issues (e.g., Treaty changes, accession of new members and setting the multi-year budget plan);
  - 'qualified majority voting' (QMV): for most issues (about 80% of all Council decisions).
- The High Representative of the Union for Foreign Affairs and Security Policy is a new post created by the Lisbon Treaty.
- Previously, leadership and representation of EU policy on Common Foreign and Security Policy were divided between the Council of Ministers and the European Commission. Lisbon merged the two positions so that the new High Representative attends both Council and Commission meetings.

- Current High Representative?



Federica Mogherini

- The European Commission is the executive branch of the EU.



- It enforces the Treaties and is driving forward European integration:
  - it proposes legislation to the Council and Parliament;
  - it administers and implements EU policies;
  - it provides surveillance and enforcement of EU law in coordination with the EU Court.
- It represents the EU at some international negotiations (e.g., WTO).



- The Commission is made up of one Commissioner from each EU member (including the President and two Vice-Presidents).
- Commissioners are appointed all together and serve for five years.
- Commissioners are chosen by their own national governments and approved by the European Parliament. Commissioners are not supposed to act as national representatives and they are in charge of a specific area of EU policy, equivalent to a national ministry called Directorates-General (DGs).
- The Commission has a great deal of independence and often takes views that differ substantially from the Member States, the Council and the Parliament. However, it is ultimately answerable to the European Parliament since the Parliament can dismiss the Commission.



- The Commission's main law-making duty is to prepare proposals for new EU legislation.
- The Commission is the executive in all of the EU's endeavours, but its power is most obvious in competition policy.
- One the key responsibility of the Commission is to manage the EU budget, subject to supervision by the EU Court of Auditors.
- The Commission decides, in principle, on the basis of a simple majority: almost all of its decision are on the basis of consensus. The reason is that the Commission usually has to get its actions approved by the Council and the Parliament: a decision that does not attract the support of a substantial majority of the Commissioners will almost surely fail in the Council and/or Parliament.

- It has two main tasks:
  - sharing legislative powers with the Council of Ministers and the Commission;
  - overseeing EU institutions, especially the Commission.
- The Lisbon Treaty boosted the power of the Parliament substantially, making it equal to the Council on most types of EU legislation (i.e., noteworthy are the Parliament's new powers over the budget).
- Organization:
  - about 750 members (MEPs) directly elected (some are anti-European!);
  - number per nation varies with population but less than proportional;
  - MEPs physically sit left-to-right, not along national lines.





## → Democratic control:

- Parliament and Council are the primary democratic controls over the EU's activities;
- MEPs directly elected so in principle a way for Europeans to have a voices.
- voter turnout for EP elections has been falling since direct elections began (even though EP getting more powerful).

**Table 2.1** Results of the 2014 Parliamentary election by party groups

Party group name	Result (%)
Group of the European People's Party (EPP)	221 MEPs, 29
Group of the Progressive Alliance of Socialists and Democrats (S&D)	191 MEPs, 25
European Conservatives and Reformists (ECR)	70 MEPs, 9
Alliance of Liberals and Democrats for Europe (ALDE)	67 MEPs, 9
European United Left/Nordic Green Left (GUE/NGL)	52 MEPs, 7
The Greens/European Free Alliance (Greens/EFA)	50 MEPs, 7
Europe of Freedom and Direct Democracy (EFDD)	48 MEPs, 6
Non-attached Members (NI) – Members unattached to a political group	52 MEPs, 7

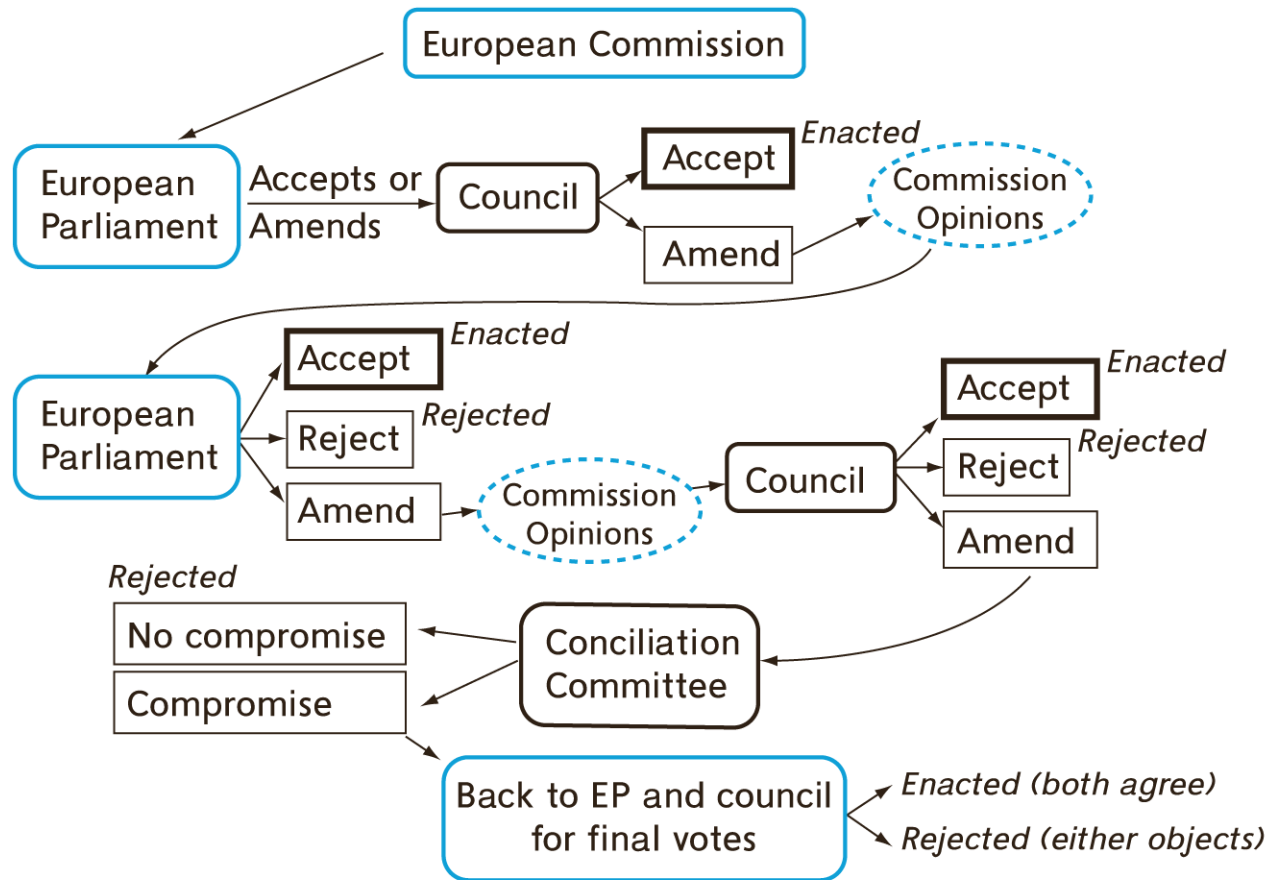
- EU laws and decisions are open to interpretation that lead to disputes that cannot be settled by negotiation:
  - Court settle these disputes, especially disputes between Member States, between the EU and Member States, between EU institutions, and between individuals and the EU;
  - Court has had a major impact on European integration via case-law.
- Organization:
  - located in Luxembourg;
  - one judge from each member appointed for six years;
  - also eight “advocates-general” to help judges;
  - Court reaches its decisions by majority voting.
- Court of First Instance set up 1980s to help with growing workload.



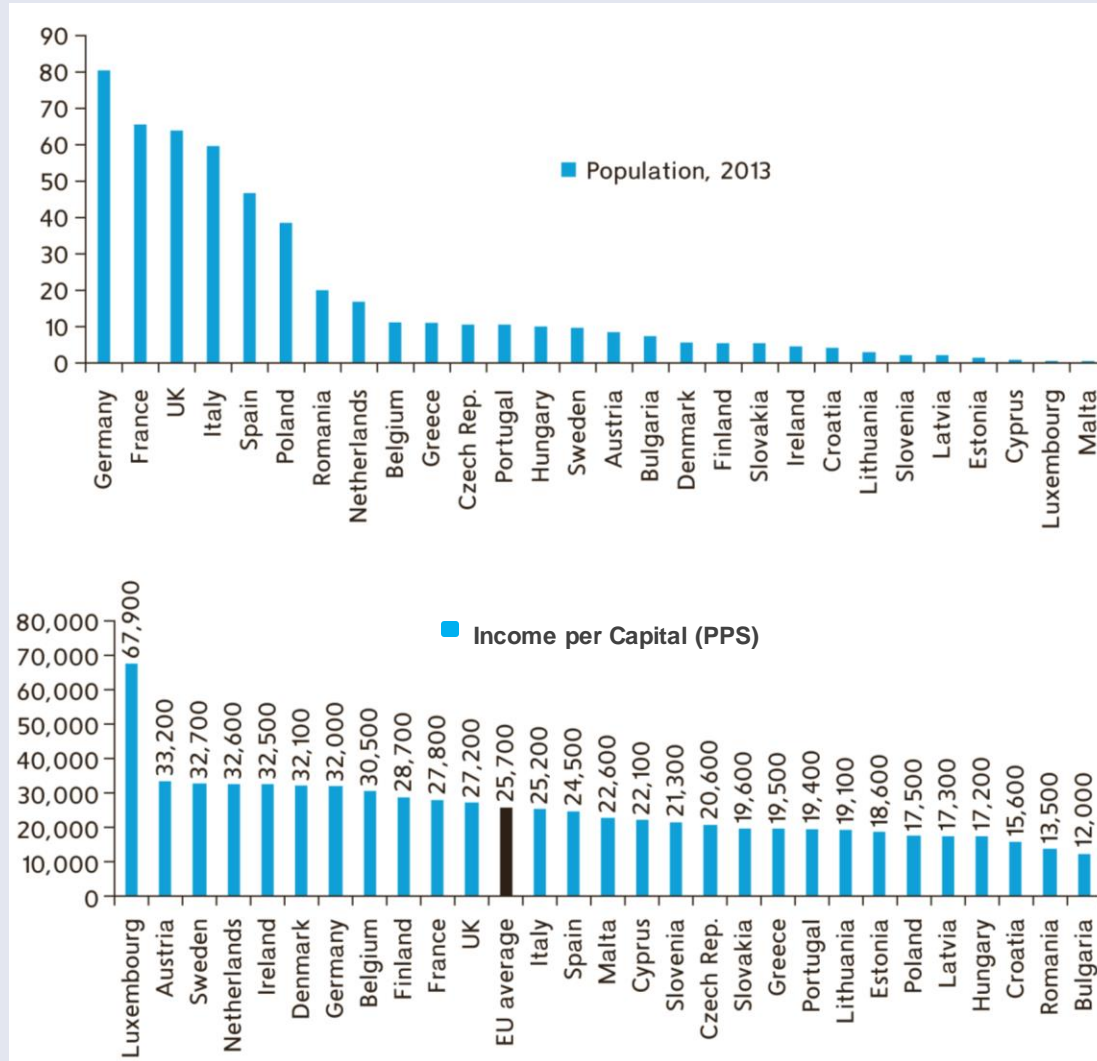


- The European Commission has a near-monopoly on initiating the EU decision-making process: right of initiative allows the Commission a good deal of power over which new legislation gets considered.
- Once developed, the Commission's proposal is sent to the Council for approval. Most EU legislation also requires the European Parliament's approval (exact procedure depends upon the issue).
- Procedures:
  - 'ordinary legislative procedure': gives the Parliament and the Council equal power in terms of approval/rejection and amendment;
  - 'consultation procedure': Parliament only gives opinion;
  - 'consent procedure': Council adopts legislation (proposed by the Commission) after obtaining the consent (without amendments) of Parliament.

**Figure 2.6** Ordinary legislative procedure



# Some important facts



# The budget: expenditures

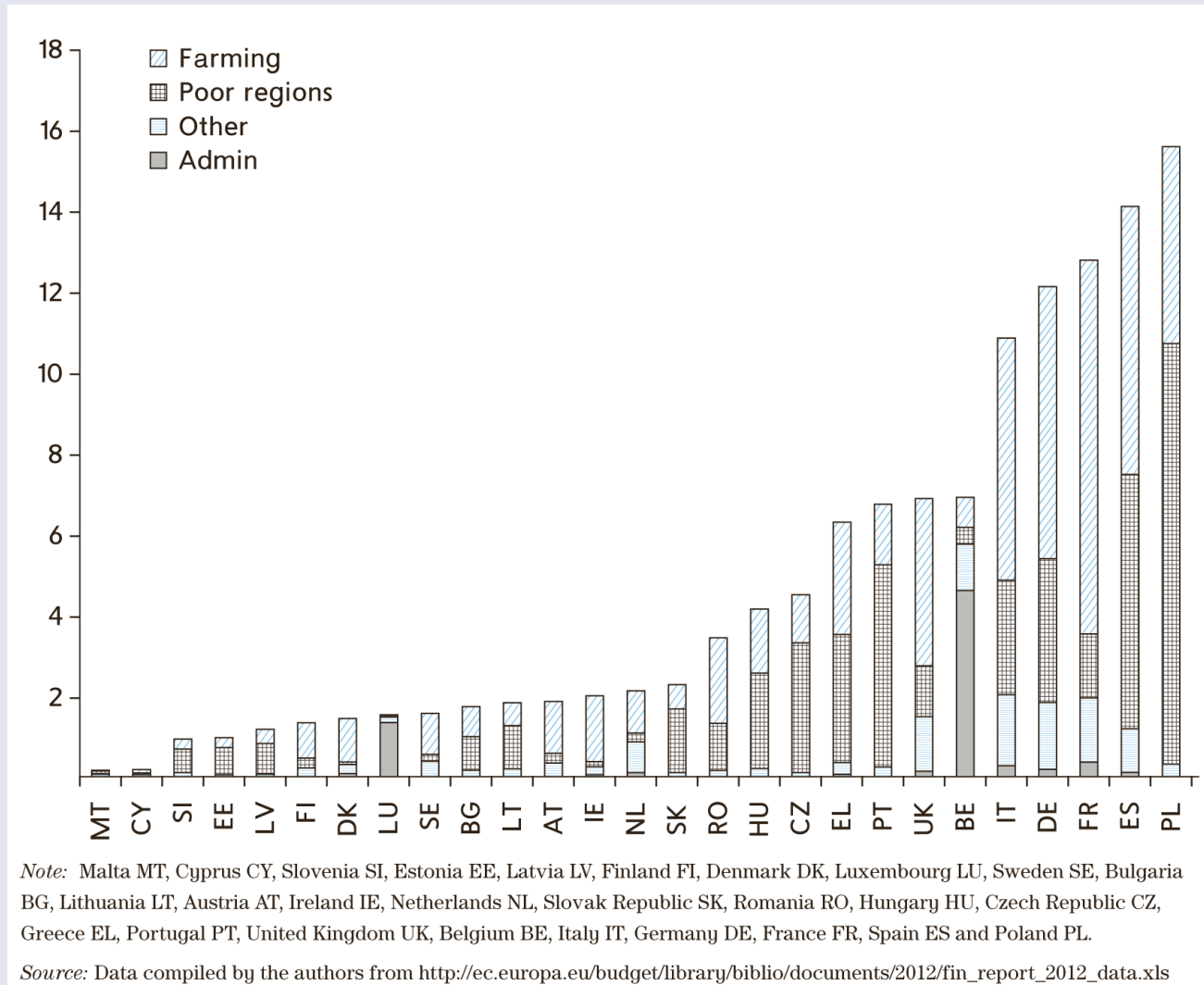
- Total EU spending 2014-2020 over €1 trillion = ~ 1,1% EU27 GNI.



Note: Commitments; adjusted for 2018.

Source: European Commission, Reflection Paper on the future of EU finances, 2017.

# EU Spending by member and type, 2012





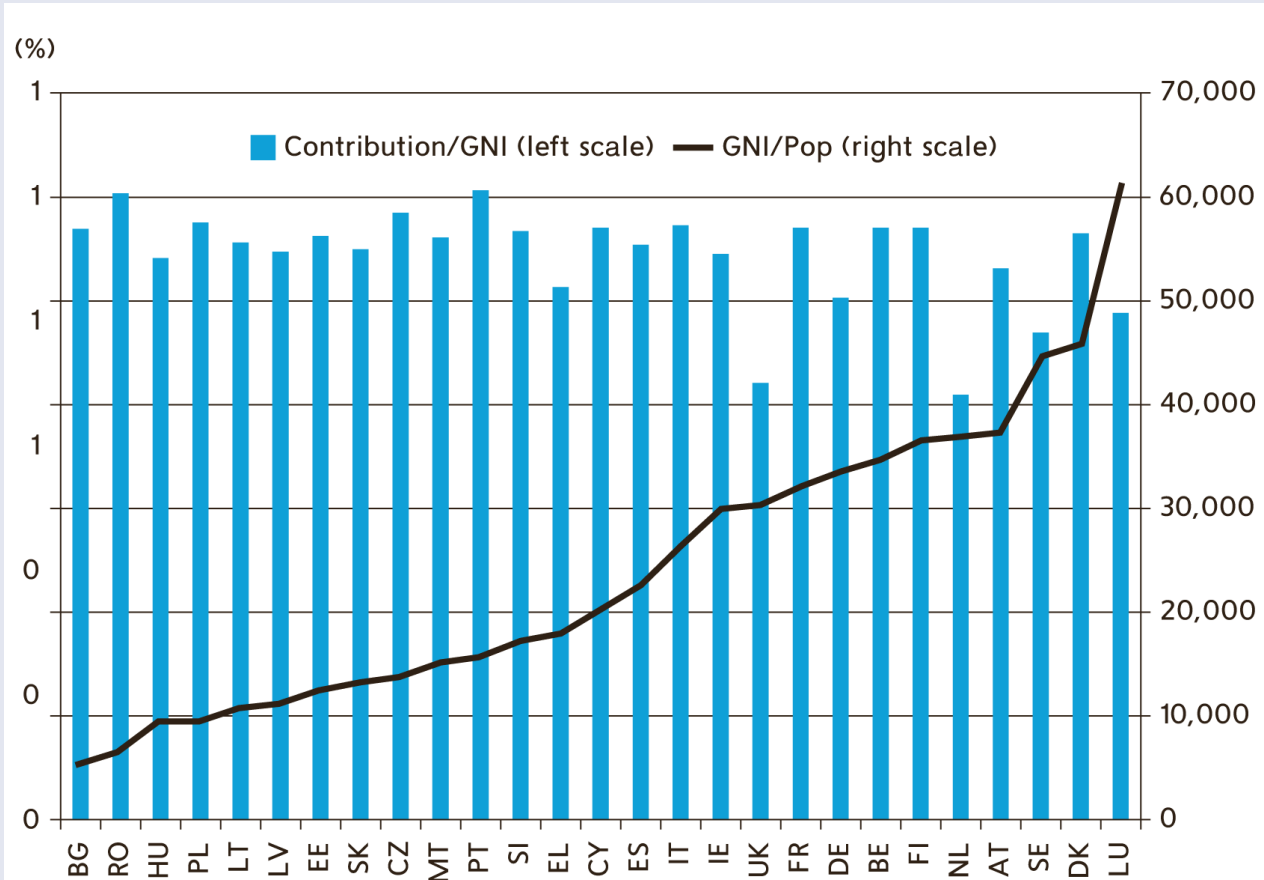
- The EU' s budget must, by law, be balanced every year.
- Four main sources:
  - tariff revenue;
  - 'Agricultural levies' (tariffs on agricultural goods);
  - 'VAT resource': like a 1% value added tax (reality is complex);
  - GNP based: tax paid by members based on their GNP.



# Contribution versus GDP (2012)



EU funding amounts to 1% of each member's GDP, not progressive as in most nations (i.e., richest nation pays less of its GDP than the poorest nation).



Note: See Figure 2.10 for the country abbreviations.

Source: Based on data from DG budget website ([http://ec.europa.eu/budget/index\\_en.cfm](http://ec.europa.eu/budget/index_en.cfm))



- **Decision making**
  - Task Allocation and Fiscal Federalism
  - Evolution of Voting Rules
  - Efficiency of Decision-making
  - Fair Power Distribution and Legitimacy



- Which level of government is responsible for which task?
  - Why centralize, why decentralize? What are the trade-offs?
  - Which task at which levels?
- How efficient and fair are the EU's decision rules?
  - Ability to act
  - Distribution of power



- **Typical policy areas:**
  - foreign policy
  - school curriculum
  - speed limit
  - trade policy
- **Typical levels**
  - local
  - regional
  - national
  - EU / supranational
- **Task allocation (“competencies” in EU jargon)**



- Which level of government is responsible for policies in the EU?
- ‘exclusive competences’: EU decides alone;
- ‘shared competences’: responsibility shared between the EU and Member States; two types:
  - members cannot pass legislation in areas where the EU already has;
  - existence of EU legislation does not hinder members’ rights to make policy in the same area;
- ‘supporting, coordinating or complementary competence’ where the EU can pass laws that support action by members;
- ‘national competences’: national or sub-national governments alone decide.



**Table 3.1** Allocation of competences to the EU

Exclusive	Shared		Support, coordinate or supplement
Customs union	Exclusive if EU has policy	Non-exclusive	Certain human health policies
Competition policy	Internal market	R&D policies	Industry
Eurozone monetary policy	Certain social policy	Outer space policies	Culture
Conservation of marine resources	Cohesion policy	Development cooperation	Tourism
Common commercial policy	Agriculture and fisheries	Humanitarian aid	Education and training
	Environment		Civil protection and disaster prevention
	Consumer protection		Administrative cooperation
	Transport		Coordination of economic, employment and social policies
	Energy		Common foreign, security and defence policies
	Old third pillar 'Area of freedom, security and justice'		
	Certain public health policies		

Source: The main provisions are in TEU Articles 1, 4, 5, 6, Protocol No. 2



- The use of the tasks is guided by **two principles**:
    - **subsidiarity**: keep decisions as close to the citizen as possible without jeopardizing win–win cooperation at the EU level (i.e., EU action only if it is more effective than action at national, regional or local level);
    - **proportionality**: the EU should undertake only the minimum necessary actions.
- The ‘burden of proof’ lies on the instigators of EU legislation: they must make the case that there is a real need for common rules and common action. National parliaments are ‘subsidiarity watchdogs’.



- Before looking at the theory, what is the practice in EU?
- Task allocation in EU guided by “subsidiarity” principle (Maastricht Treaty)
  - Decisions should be made as close to the people as possible
  - EU should not take action unless doing so is more effective than action taken at national, regional or local level
- Background: “creeping competencies”
  - Range of task where EU policy matters was expanding.
  - Some Member States wanted to discipline this spread.
- British renegotiation attempt tried to cut down supranational competencies (but did not help to avoid BREXIT)





- 3 Pillar structure delimits range of:
  - Community competencies (tasks allocated to EU).
  - Shared competencies (areas where task are split between EU and member states).
  - National competencies.
- 1<sup>st</sup> pillar is EU competency.
- 2<sup>nd</sup> and 3<sup>rd</sup> are generally national competencies
  - details complex, but basically members pursue cooperation but do not transfer sovereignty to EU.

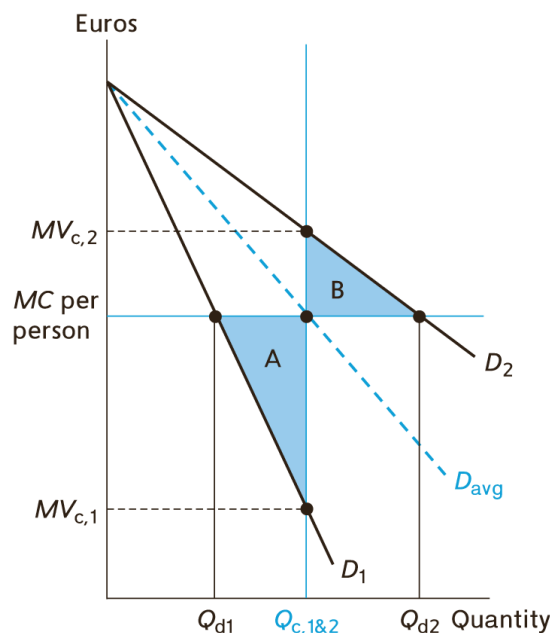


- What is optimal allocation of tasks?
- Basic theoretical approach is called “Fiscal Federalism”.
- Name comes from the study a taxation, especially which taxes should be set at the national vs. sub-national level.



- What is the optimal allocation of tasks?
  - There is no clear answer from theory, just list of trade-offs to be considered.
- Optimal allocation of tasks depends on trade-offs:
  - **diversity and local informational advantages:** if people have different preferences, centralized decisions create inefficiencies;
  - **scale economies:** cost savings from centralization;
  - **spillovers:** negative and positive externalities of local decisions argue for centralization (or, at least, cooperation);
  - **democracy:** control mechanism that favours decentralization;
  - **jurisdictional competition:** the fact that people can move (e.g., move between cities) forces decision makers to pay closer attention to the wishes of the people. This favours decentralization because if all decisions are centralized, voters do not have the 'exit' option.

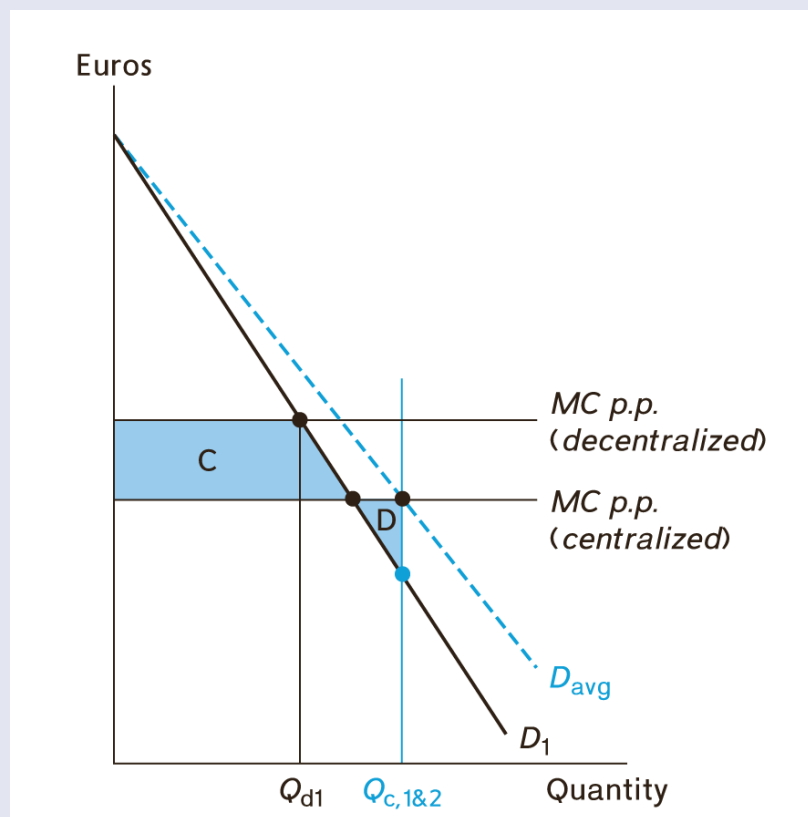
- One-size-fits-all policies tend to be inefficient since too much for some and too little for others.
- Central government could set different local policies, but local government likely to have an information advantage.



*Note:* The diagram assumes that individuals in each region are identical and the governments are 'benevolent'.

*Technical note:* The  $MC$  per person =  $MV$  criterion is identical to Samuelson's famous sum of  $MV$  condition since  $MC/N = MV$  implies  $MC = N * MV$ , where  $N$  is the number of people in the region.

- Producing public goods at higher scale reduced average cost.
- This leads to centralization: transport; medical services; etc.

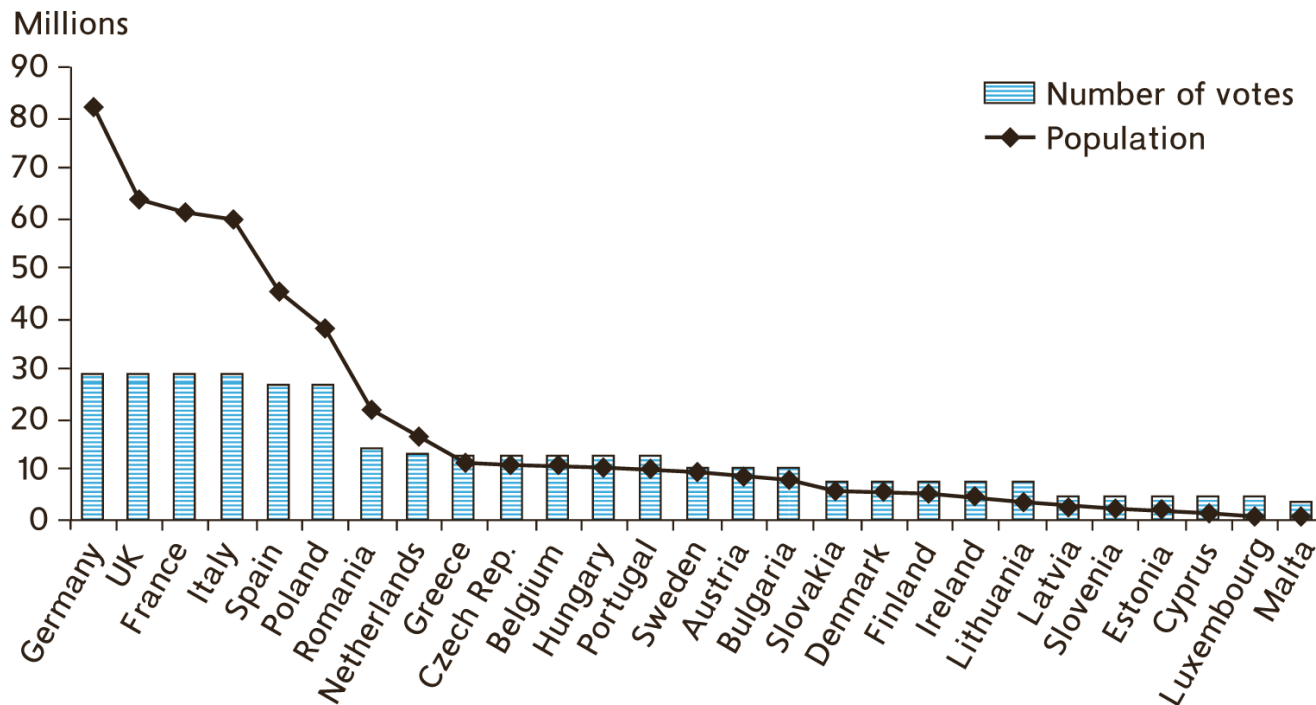




- If policy is in the hands of local officials and these are elected, then citizens' votes have more precise control over what politicians do.
- High level elections are take-it-over-leave-it for many issues since only a handful of choices between 'promise packages' and many issues.
- This logic is important: it underpins the basic presumption that decisions should be made at the lowest practical level of government (i.e., as close to the voters as possible).



- EU has several different decision-making procedures. But about 80% of EU legislation is passed under the ‘ordinary legislative procedure’: the Council adopts legislation by a ‘qualified majority voting’ (QMV) and the European Parliament adopts it by a simple majority.
- Current QMV rules from Nice Treaty: Lisbon Treaty simplifies rules but not before 2014 (and a last-minute political compromise means that an EU member can invoke the Nice Treaty rules up to 2017):
  - each Member State’s minister casts a certain number of votes (increasing in population but less than proportional);
  - a proposal passes the Council with at least 255 votes (out of 354) equal to 74%;
  - agreement of 50% of Member States representing at least 62% of the population.



*Note:* Passing a proposal in the Council under Nice Treaty QMV requires ‘yes’ votes from a group of members that have at least 74 per cent of the votes, 50 per cent of the membership and 62 per cent of the population.





- In economics, efficiency means an absence of waste. In EU decision-making, efficiency means ‘ability to act’.
- The perfect measure of efficiency would predict all possible issues to be voted, decide how members would form coalitions, and use this to develop an average measure of how easy it is to get things done in the EU. Such predictions, of course, are impossible!
- Instead, ‘passage probability’ measures how easy it is to find a majority under a given voting scheme (for a given issue):
- Passage probability =  $\frac{\text{number of possible winning coalitions}}{\text{number of possible coalitions}}$

# Passage probability in a simple example

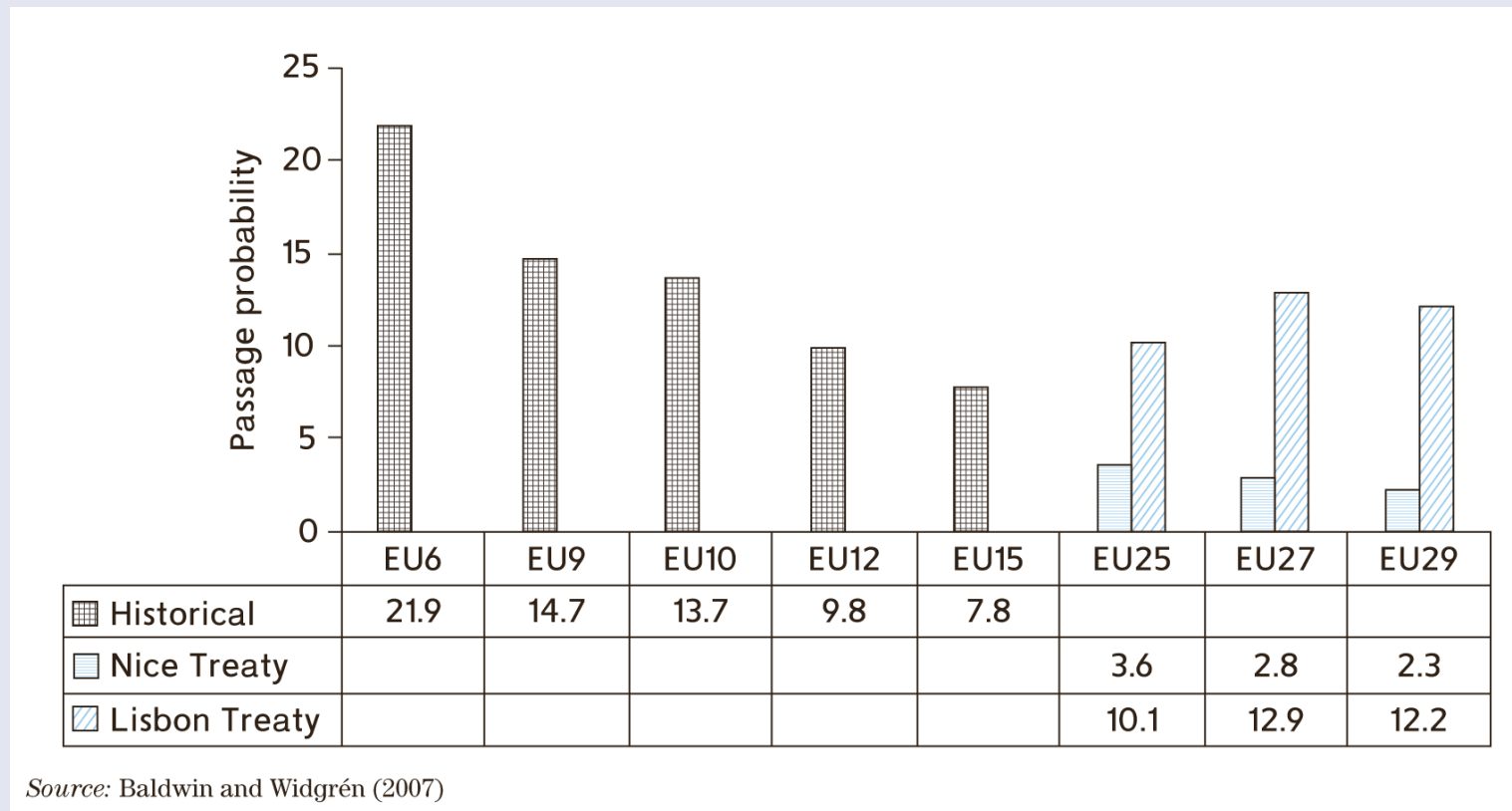


**Table 3.2** Passage probability in a simple example

A	B	C	Vote allocation #1		Vote allocation #2	
			10 votes each	Qualified majority (50%)?	20 votes to A, 5 to B and 5 to C	Qualified majority (50%)?
Yes	Yes	Yes	30	Yes	30	Yes
No	Yes	Yes	20	Yes	10	No
Yes	No	Yes	20	Yes	25	Yes
Yes	Yes	No	20	Yes	25	Yes
No	No	Yes	10	No	5	No
Yes	No	No	10	No	20	No
No	Yes	No	10	No	5	No
No	No	No	0	No	0	No
Passage probability (50% majority threshold) (%)				50.0		37.5
Passage probability (70% majority threshold) (%)				12.5		37.5

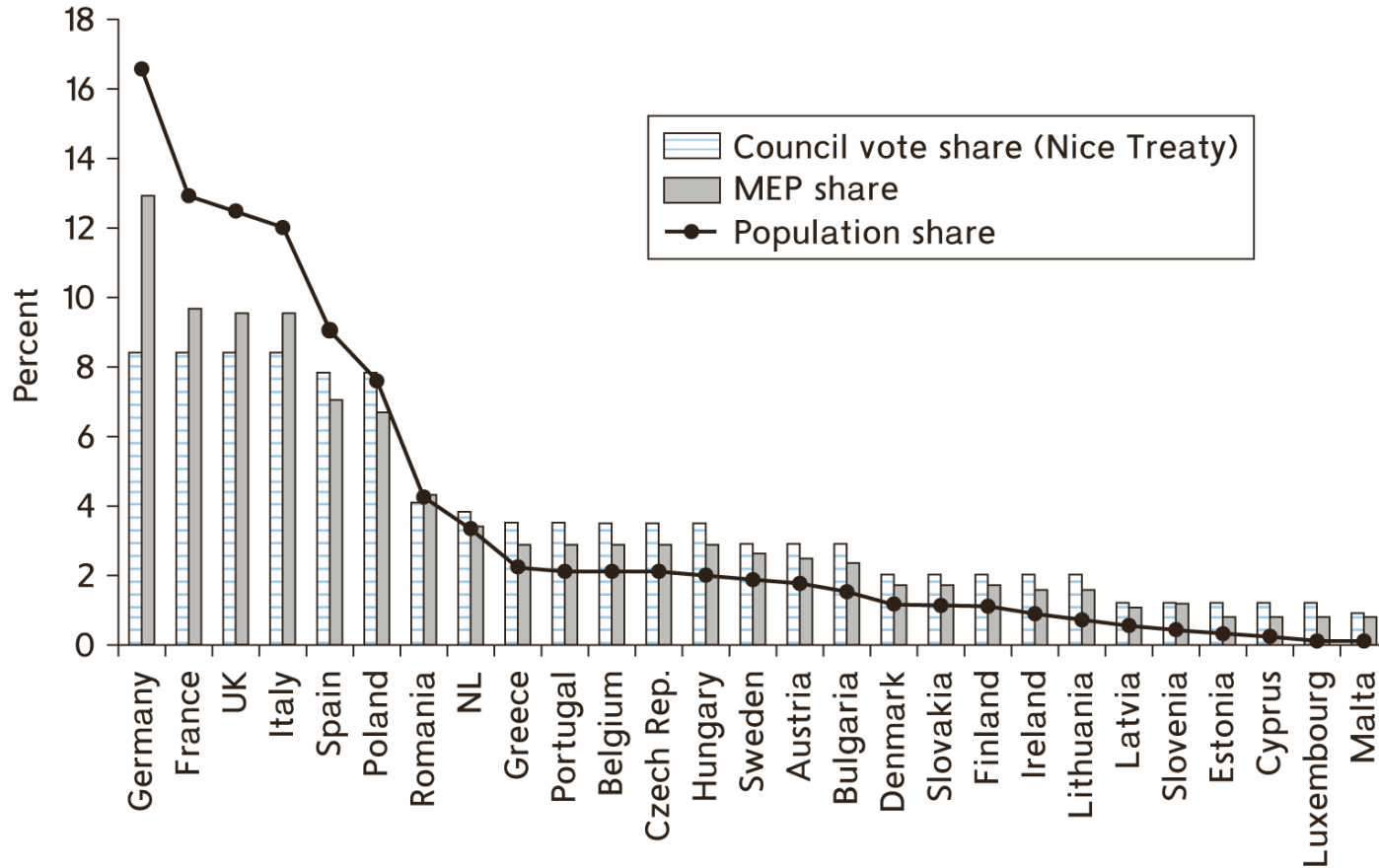
# EU ability to act: decision-making efficiency

- How has EU's efficiency changed over time as a result of reforms and enlargements?



# The distribution of power among EU members

**Figure 3.5** Share of MEPs, Council votes and population in the EU27



Source: Factsheets on <http://www.europarl.europa.eu/aboutparliament/en/displayFtu.html>

# The distribution of power among EU members



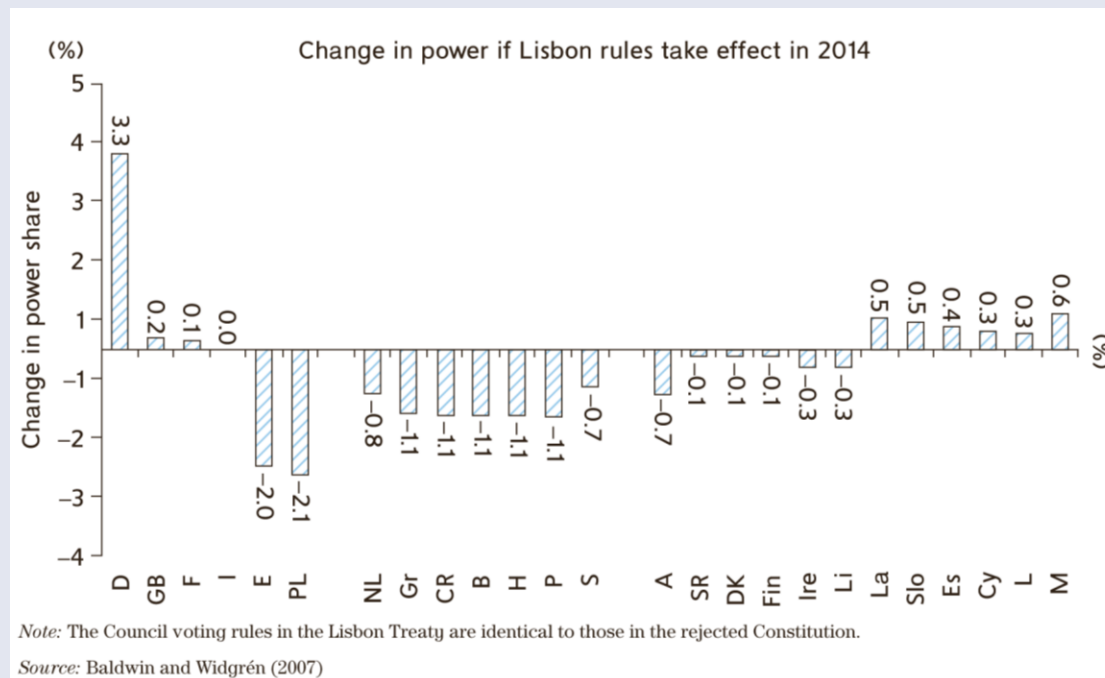
- No perfect measures available for distribution of power (i.e., influence) among EU members:
  - most direct and intuitive measure is national voting shares in the Council, but it has severe shortcomings;
  - probability of making or breaking a winning coalition = Normalized Banzhaf Index (NBI): although more sophisticated, the NBI for the EU15 is not very different from the national vote-share measure. The measures are also quite similar for EU27.
- Notice that budget allocations are an observable manifestation of power.



- Why use fancy, formal power measures and not simply voting shares?
- A simple example:
  - 3 voters, A, B & C
  - A = 40 votes, B=40 votes, C=20 votes
  - Need 50% of votes to win.
- All equally powerful!
- Next, suppose majority threshold rises to 80 votes.
  - C loses all power.

# Power shifts in 2014 (or 2017)

- Voting rules introduced by the Lisbon Treaty has become into effect in 2014. And, at the insistence of Poland they were suspended at the wish of a single member up to 2017 (and old Nice rules apply).
- The Lisbon Treaty grants more power to smallest states and Germany while Spain, Poland and middle-sized states are biggest losers.





- **November 19, 11:00-13:00 hours**
- **Topic: Microeconomics of Trade and Tariffs and Preferential Trade Liberalisation**
- Baldwin & Wyplosz (2015) “The Economics of European Integration”, McGraw-Hill, Ch. 4-5.