

## Public policymaking and its analysis at National and European Levels

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### **Abstract**

The author describes the specific features of public policy process at the European Union level and its differences related to policy-making at national level. He underlines, among other things that the policy agenda in the European Union is being shaped differently. At the national level the agenda is under greater influence of politicians who are closely interconnected with voters. At the European Union level the technocratic (not directly elected) European Commission has a monopoly of legislative initiative. Furthermore, at the European level feasibility studies – as an element of the pre-decision stage in public policy-making – tend to be ignored. In nation-states we can see such analyses as a result of competition taking place between those who rule and their political opposition. At the European Union level it is not the case. The author points out that these mechanisms would have been beneficial for the EU member states. They would have halted the implementation of decisions which ran the excessive risk. He has also in mind the decision related to the introduction of the monetary union. In his opinion, this decision was made without a proper feasibility analysis (costs and profits). Basically, the decision on a common currency was made on political rather than substantive grounds. A large number of experts were against the idea as they perceived serious risks involved in it. The supporters of greater European integration ignored the fact that the monetary union deprived nation-states of many factors that affected the economic development in a positive way. The point is that they were under influence of “total optimism” expecting only good results of the monetary union. The mechanisms of crisis management, including exit scenario from the monetary union, or methods of supporting those members who need financial aid, have not been even created. Furthermore, the evaluation of the monetary union was not properly carried out as it was based on the assessment of the process (for example, smooth introduction of euro notes and coins or phasing out of the national currencies in 2002) and not of its results.

**Keywords:** public policy, policy analysis, policy evaluation, monetary union, European integration.

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## Tworzenie i analiza polityki publicznej na szczeblu narodowym i europejskim

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### Streszczenie

Autor wskazuje na specyfikę sposobu tworzenia polityki publicznej na poziomie Unii Europejskiej w porównaniu ze sposobem tworzenia polityki na poziomie krajowym. Podkreśla m.in. to, że w UE inaczej kształtowana jest agenda polityki. Na poziomie krajowym w większym stopniu kształtują ją politycy pozostający w bliskiej relacji z wyborcami. Na poziomie europejskim kształtuje ją Komisja Europejska, która posiada wyłączne prawo do inicjatywy ustawodawczej w UE i jest instytucją technokratyczną (nie pochodzi z bezpośrednich wyborów).

Ponadto na poziomie europejskim analiza wykonalności polityki publicznej bywa ignorowana (na etapie przed decyzyjnym). W państwach narodowych takie analizy są realizowane z uwagi na istnienie mechanizmów konkurencji między rządzącymi i opozycją. W strukturach UE nie ma takich mechanizmów. Jednocześnie autor wskazuje, że taka analiza mogłaby zapewnić Unii Europejskiej korzyści. Blokowałaby wprowadzanie w życie decyzji obciążonych nadmiernym ryzykiem. Ma tu na myśli również decyzję o wprowadzeniu unii monetarnej. Jego zdaniem, zapadła ona bez właściwej analizy wykonalności takiego przedsięwzięcia.

Decyzję o wprowadzeniu wspólnej waluty podjęto z uwagi na czynniki polityczne, a nie merytoryczne. Znaczna część ekspertów była przeciwna temu, wskazując na istotne ryzyko. Zwolennicy daleko posuniętej integracji gospodarczej w UE nie uwzględnili faktu, że integracja monetarna pozbawia państwa czynników, które mają pozytywny wpływ na rozwój gospodarczy. Jednak w gronach politycznych panował klimat „totalnego optymizmu” w odniesieniu do rezultatów unii monetarnej. Nie uwzględniano nawet scenariusza negatywnego. Nie stworzono mechanizmów zarządzania kryzysowego, w tym mechanizmów opuszczenia unii, sposobów wsparcia członków, którzy nie radzą sobie z członkostwem. Ponadto w niewłaściwy sposób dokonywano ewaluacji skutków unii monetarnej. Robiono to na podstawie osiągnięć technicznych (oceniało proces, a nie jego rezultat), jak sprawne wprowadzenie banknotów i monet euro, a także wycofanie walut krajowych w roku 2002.

**Słowa kluczowe:** polityka publiczna, analiza polityki publicznej, ewaluacja, unia monetarna, integracja europejska.

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As globalization of competition has intensified, some have begun to argue a diminished role for nations. Instead, internationalization and the removal of protection and other distortions to competition arguably make nations, if anything, more

important. National differences in character and culture, far from being threatened by global competition, prove integral to success in it.

M. Porter, *The Competitive Advantage of Nations*, p. 30.

Efforts at European unification are raising questions about whether the influence of nations on competition will diminish. Instead, freer trade will arguably make them more important.

M. Porter, *The Competitive Advantage of Nations*, p. 158.

## Policymaking and policy analysis in a democracy: the search for feasibility

According to the 1999 White Paper of the British government on *Modernising Government* “policy making is the process by which governments translate their political vision into programmes and actions to deliver “outcomes” – desired changes in the real world”. This definition greatly simplifies a very complex process, but even more complex definitions give no idea of how to deal, conceptually or in practice, with the whole sequence of steps through which policy is made, implemented, adapted, or terminated.

To provide the tools to understand and steer the entire process is the goal, or at least the ambition, of the (relatively) new academic field known as policy analysis. While law, economics, sociology and other traditional disciplines concentrate on particular stages or aspects of the policymaking process, policy analysis is primarily concerned with how its different parts fit together, and how they interact with the external environment. To give at least an intuitive idea of this general approach to public policy, one can start by distinguishing the two stages of a pre-and post-decision. Problem definition, agenda setting and feasibility analysis are the main components of the first stage of the process; the post-decision phase is characterized by implementation, evaluation, and accountability.

The essence of the decision itself, as President John F. Kennedy once observed, remains impenetrable to the observer, often to the decision maker himself. This is certainly the case of a single decision maker who assumes full responsibility for the final outcome, such as the American president; but even in the case of collective decisions – as in a cabinet system or, even more, in the complex decision-making system of the European Union – not even all the direct participants are in a position to know what the actual bargains were which made the final decision possible. For

example, German and French views of the meaning and purpose of the decision to move to the European monetary union, were, and continue to be, vastly different<sup>1</sup>.

The two phases of a pre- and post-decision are closely interconnected, and precisely these interconnections are mostly ignored by more traditional approaches to policymaking. Take, for example, a feasibility analysis – arguably the most important element of the pre-decision stage. Economists will consider the economic, and perhaps also the technological, constraints facing the policymaker(s); similarly the legal experts will call attention to potential or actual constitutional, administrative-law, or regulatory problems.

But of course there are many other constraints about which policymakers are, or should be, concerned: political, institutional, organizational, social, cultural, etc. Regardless of their nature, constraints always limit the freedom of choice of the policymaker, and this implicit cost must always enter the calculations of the policymaker and his or her advisors. As I wrote some years ago, such pervasive limitations on the powers of policymakers explain why optimization – which traditionally has been the main concern of economists – is such an elusive goal in the public sector, where suboptimal solutions will usually be the only feasible ones. A formal proof of this conclusion is provided by the second-best theorem of welfare economics.

This theorem states that the first-order conditions for an optimum are not, in general, valid policy criteria in a situation where, because of some constraints added to the usual budgetary and technical limitations, the conditions cannot be all simultaneously satisfied. But if sub-optimal (“second-best”) solutions are the only feasible ones, then it follows that feasibility, rather than optimality, should be the main concern of both policymakers and policy analysts; and also that political and institutional constraints should be taken as seriously as technical, economic, or legal limitations<sup>2</sup>.

A fully fledged feasibility analysis should consider at least two other issues. First, many constraints can often be removed, or made no longer binding, but at a cost; and, second, today’s constraints are not necessarily tomorrow’s constraints. Only some basic laws of nature – say, the law of gravity – are unconditionally binding; most economic, legal, institutional and cultural constraints could be relaxed – given sufficient time and resources. Thus, a good part of feasibility analysis consists in assessing the costs and the benefits of relaxing certain important constraints. A rational decision

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<sup>1</sup> G. Majone, *Europe As The Would-Be World Power: The EU At Fifty*, Cambridge University Press, Cambridge 2009.

<sup>2</sup> G. Majone, *Evidence, Argument & Persuasion In The Policy Process*, New Haven, CT Yale University Press 1989, pp. 75–81, pp. 147–155 of the expanded Polish edition, Warsaw 2004.

to proceed *rebus sic stantibus*, i.e., under the given conditions, should be justified by such a cost-benefit calculus, however intuitive.

On the other hand, constraints change over time: some disappear while new ones emerge; some are no longer binding limits to what can be done, but only minor nuisances; factors previously ignored turn out to restrict quite significantly the range of possible choices. This dynamic aspect of feasibility has far-reaching implications, which are often ignored. I tried to work out some of these implications in a paper titled “Implementation as Evolution” which I published with Aaron Wildavsky in 1979.

I drew part of the inspiration from a passage in Cardinal Newman’s *An Essay in the Development of Christian Doctrine* (originally published in 1845) in which this eminent theologian writes of ideas developing over time “through a combination of the most diversified aspects, with the suggestions and corrections of many minds, and the illustrations of many trials”.

This struck me as a good characterization of how policy ideas develop, and led me to view policies as being “continuously transformed by implementing actions that simultaneously alter resources and constraints”. In other words, *implementation shapes policy*: “the discovery that some constraints are no longer binding can suggest to implementers possibilities that the original planners did not envisage or desire... How well policies respond to opportunities, how well they facilitate adaptation and error correction, are qualities insufficiently discussed”. The key point is that “we choose after the act as well as before”<sup>3</sup>.

Thus, while feasibility considerations are a key element of what I have called a pre-decision analysis, they continue to remain important after the initial policy decision has been taken. This concern with the entire process of making, implementing, and adapting policy is, to repeat, what distinguishes policy analysis from the economic, legal or other narrower approaches to the theory and practice of public policy.

Concern with agenda setting is another feature setting a policy analysis apart from more specialized views of the policy process. The starting point here is the observation that objective conditions are seldom so compelling or unambiguous that they determine the policy agenda. The student of agenda setting attempts to trace the causal paths along which public issues travel, and to predict which issues may eventually reach the decision agenda.

A policy idea that fails to meet a preliminary feasibility criterion is unlikely to be considered as a serious contender for place on the public agenda, at least in democracies with a well-developed government-opposition dialectic; in a system where this dialectic is absent, as in the European Union (EU), the situation is quite different,

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<sup>3</sup> G. Majone, A. Wildavsky, *Implementation as Evolution*, 1979, p. 186.

as will be seen in the following pages (in a later section I shall consider the most important elements of a post-decision analysis: policy evaluation and accountability).

To understand the process of agenda setting, it is important to know whether some individual or institution is in a position to control the agenda. In the United States, for example, each congressional committee has jurisdiction over a specific subset of policy issues. Within their jurisdiction, committees possess the monopoly right to bring alternatives to the status quo up for a vote before the legislature. The agenda power held by the committee members implies that successful coalitions, on a given issue, must include the members of the relevant committee: without these members the bill will not reach the floor for a vote. Thus committee veto power means that, from among the set of public policies that command a majority against the status quo, only those that make the committee better off are possible.

In the EU it is the unelected European Commission that has a monopoly of policy initiation. No national government can induce the Commission to make a specific proposal change the status quo, unless that proposal also makes the Commission better off. It is important to understand clearly what is implied by the Commission's monopoly of agenda setting<sup>4</sup>.

The most immediate implication is that it is up to the Commission to decide whether the EU should act and, if so, in what legal form, and what content and implementing procedures should be followed. Also, the Commission can amend its proposal at any time while it is under discussion in the Council of Ministers, but the Council can amend the proposal only by unanimity. The importance of the Commission's monopoly of legislative initiative is demonstrated by the fact that the European Parliament has never claimed the right to initiate legislation. At any rate, it is clear that in both cases – the US Congress and the EU – agenda control turns out to be crucial for understanding policy outputs.

These preliminary remarks serve two main purposes. First, to point out that there are crucially important aspects of public policymaking that are not adequately covered by specialized approaches and methodologies, whether economic, legal, or strictly political. Only an approach which at least attempts to address all the dimensions of policymaking – with the assistance of specialized disciplines where necessary – can aspire to give a realistic view of policymaking. Both in Europe and in America, a policy analysis has been developed almost exclusively in the context of national or sub-national politics and policy.

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<sup>4</sup> G. Majone, *Europe As The Would-Be World Power: The EU At Fifty*, Cambridge University Press, Cambridge 2009, pp. 160–161.

Hence the second purpose of this introduction is to alert the reader to the fact that terms like “policy making” and “policy analysis” have rather different meanings when applied to the supranational (European) level. For example, the notion of feasibility, so crucially important at the national level, has often been completely overlooked, not only by European policymakers, but also by legal scholars and political scientists specializing in European affairs.

This fact already suggests that the political culture prevailing in Brussels must differ significantly from the political culture of contemporary democracies. Again, we know that most EU policies are implemented by the national authorities. But if it is true that implementation shapes policy, then it follows that there is no single, clearly defined, European policy, but as many “European” policies as there are member states of the EU implementing broad supranational objectives. This observation can be generalized: many European institutions and policies bear the same names as national institutions/policies which in fact operate according to very different principles and in very different contexts. The most obvious example: the European Parliament cannot initiate legislation, like any self-respecting national legislature.

Another important example: the European Central Bank often has been described as an institution designed according to the blueprint of the old (pre-monetary union) Bundesbank. In a perceptive article published in *Spiegel On Line* of 15 February 2012, Wolfgang Muenchau rejects what may be called the Clausewitzian view of the ECB as a continuation of the old Bundesbank by other means. Muenchau, an Associate Editor and well-known columnist of the *Financial Times*, argues that the crisis of the euro zone has definitely shown that the ECB is not a clone of the German central bank.

In fact, it should have been clear all along that the Bundesbank model could not have been replicated at the European level, for at least three reasons. First, the broad domestic consensus concerning the importance of price stability, budgetary discipline and international competitiveness does not exist in other countries of the euro zone having greatly different histories and political cultures.

The second reason is the economic, social, and political homogeneity of Germany, which contrasts with the great heterogeneity of the euro zone. The third, and according to Muenchau most important, difference between the ECB and the old Bundesbank is that the German economy, for all its strength, is a fairly small relative to the world economy. This means that the old Bundesbank did not have to worry too much about the impact of its decisions outside Germany. By contrast, the ECB cannot overlook the impact of its policies on the world economy because of the size of the euro zone. A clear indication of the international significance of the euro crisis, I would add, is the concern of the president of the United States, as well as of the leaders of China and of the other BRIC countries, about the risk of sovereign



defaults in the euro zone. Thus, none of the three conditions which made it possible for the Bundesbank to operate successfully at the national level, are satisfied at the European level.

But the ECB is also different from the United States Federal Reserve which, according to its statute, must pursue not one but two objectives: price stability *and* full employment. Thus in early 2011, the ECB raised the interest rate because of the risk of higher inflation, while the Fed was easing monetary policy because of a rise in unemployment. The main difference between the two institutions, however, is that the governor of the Fed has a political counterpart in the Secretary of the Treasury, while the political counterparts of the president of the ECB are 17 heads of state or government, 17 finance ministers, the president of the European Commission, and the Commissioner responsible for economic and monetary affairs. It follows that the president of the ECB will never be able to play a role with respect to the multi-headed governance of the euro zone comparable to that of the governor of the Federal Reserve vis-à-vis the federal government of the United States. Muenchau concludes that as an institutional “hermaphrodite” (“Zwitter”) the ECB can only play a secondary role in the current crisis.

In sum, using the same labels for European and national institutions and policies can be quite misleading – a point whose importance this paper will, hopefully, demonstrate.

In the next section I start by discussing the political culture developed in more than half a century of European integration; I argue that this peculiar political culture explains, among other things, the reluctance of European leaders to discuss the feasibility of their projects and even to consider the possibility of policy failure.

## A political culture of total optimism

When the euro was introduced, an American political economist wrote: “Prudence might have counselled that the European Union take certain steps well before the creation of the euro area”<sup>5</sup>. He was referring to what has been called the “dark secret” of monetary union: the fact that the relevant article of the Maastricht Treaty is so ambiguous that it is not clear who is actually responsible for the exchange rate of the euro.

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<sup>5</sup> C.R. Henning, *U.S.-EU Relations after the Inception of the Monetary Union: Cooperation or Rivalry?*, in Id. and Padoan, P.C. *Transatlantic Perspectives on the Euro*, The Brookings Institution, Washington, D.C. 2000, p. 41.



Again, even Wim Duisenberg – who as (first) president of the ECB should have been better informed about the financial conditions of would-be members of the monetary union--was absolutely delighted when, in January 2001, Greece adopted the euro. Like many other Euro-enthusiasts the Dutch banker was convinced that for the sake of European integration it was important to have as many countries as possible in the monetary union, including Greece. These are only few examples of the unconcerned attitude which until recently prevailed among EU leaders-not just in monetary policy but in all areas of European competence.

Henning, like the majority of American experts, had counselled prudence, but the truth is that prudential reasoning is foreign to the philosophy of *fait accompli*, which goes back to the beginnings of European integration. This philosophy assumes that the success of a decision is determined by the decision makers themselves rather than by those who will be affected by the decision; hence, the possibility of failure is excluded a priori. For example, there is no indication that the feasibility of the goal of the 1970 Werner Plan – to achieve monetary union by 1980 – was ever seriously considered.

Again, the Single European Market was supposed to be achieved by 1992. In fact, we are more distant from the goal today than we were in the 1990 s, mainly because the services sector, which keeps growing, is still largely regulated at the national level. Over the years, the strategy of “*fait accompli*” has generated the political culture – the values, beliefs, and emotional attitudes – prevailing in Brussels and in several national capitals, when dealing with European affairs.

*Fait accompli* – the accomplished fact which makes opposition and argument useless – is the foundation of the so-called Monnet method. The best characterization of this method has been provided by Pascal Lamy, former European Commissioner and erstwhile lieutenant of Commission President Jacques Delors: “Europe was built in a St. Simonian [i.e., technocratic] way from the beginning, this was Monnet’s approach: The people weren’t ready to agree to integration, so you had to get on without telling them too much about what was happening”.

However, Lamy was honest enough to add: “Now St. Simonianism is finished. It can’t work when you have to face democratic opinion”<sup>6</sup>. The culture of total optimism emerged in the 1960 s and early 1970 s – the age of “permissive consensus”, when the integration project was taken for granted by European publics, as part of the political landscape, and did not seem to require any kind of accountability by results.

This optimistic attitude was facilitated by the fact that most European policies were too remote from the daily problems of the people to seriously concern public

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<sup>6</sup> Cited in G. Ross, *Jacques Delors and European Integration*, Polity Press, London 1995, p. 194.

opinion. The total optimism of EU leaders is supported by two different groups. On the one hand, federalists derive confidence in the final success of their cause from the conviction that the nation state is no longer viable, at least in Europe. Therefore, sooner or later European citizens will acknowledge the necessity of political union, and will also understand why in certain situations it is necessary to accept risks that would be considered unacceptable under different circumstances. But also EU leaders who are not in favour of full political union find it convenient to display total optimism concerning the outcomes of the collective decisions taken in Brussels.

This is because they have a vested interest in the preservation of a system that allows them to take unpopular measures *in camera*, rather than in a direct confrontation with the opposition parties at home. Moreover, most decisions taken in Brussels must satisfy different, even conflicting, interests. The decision to proceed with the Economic and Monetary Union (EMU), for example, was supported by leaders who saw EMU as a necessary step towards political union; by governments that wished to terminate the “tyranny of the German Mark”; and by leaders who correctly assumed that membership in the euro zone would immediately improve the credit rating of their countries, allowing them to borrow at significantly lower rates of interest.

When the same decision must satisfy so many different interests, the attention of the bargainers tends to be focused on immediate benefits rather than on long-term consequences. A political culture of total optimism could hardly survive in the conflictive politics of modern mass democracies, but it did take roots at the supranational level, where it actually could facilitate decision-making. The fact that long-term consequences are heavily discounted explains, not only the absence of contingency plans and of any other instrument of crisis management, but also the willingness of European leaders to increase the risk of future failure for the sake of immediate advantages.

It is indeed hard to find a better example of the willingness of EU leaders to compromise their collective credibility than the decision to proceed with the monetary union before there was any agreement on the political union, and leaving a number of technical and institutional problems unresolved. Nor can one find, in the entire history of European integration, a better illustration of the complete disregard, not only of expert opinion, but also of such basic principles of crisis management as the timely preparation of contingency plans, and careful attention to signs that may foretell a crisis. The lax application of the convergence criteria of the Maastricht Treaty, and of the rules of the Stability and Growth Pact, introduced in 1996 at Germany's request, are other examples of the same tendency to increase the risks of an already risky project. Similar, if less striking, examples can be easily found in most other policy areas.

## Monetary union and the paradox of policy harmonization

Harmonization of the laws and policies of the member states is one of the three legal techniques which the Treaty of Rome (Article 100) made available to the European Commission for establishing and maintaining a common European market – the other two techniques being liberalization and the control of anti-competitive behaviour. The legal literature distinguishes three main modes of harmonization: total, optional, and minimum harmonization. From the early 1960s to the early 1970s the Commission's approach was characterized by a distinct preference for *total harmonization* – detailed measures designed to regulate exhaustively the problems in question, to the exclusion of previously existing national policies. Under total harmonization once European rules have been put in place, a member state's capacity to apply different rules is excluded.

The European Court of Justice initially supported this exclusive Community competence, judging it to be necessary to the construction of the common market and, more generally, to the autonomy of the Community system. Already by the mid-1970s, however, the limits of total harmonization had become visible. The idea of a common market structured by one body of uniform European rules had to be given up once it was realized that total harmonization confers on the Community an exclusive competence which it is ill-equipped to discharge. The emphasis shifted from total to optional and minimum harmonization. *Optional harmonization* aims to guarantee the free movement of goods, while permitting the member states to retain their traditional forms of regulation for goods produced for the domestic market. Under *minimum harmonization*, the national governments must secure the level of regulation set out in a directive but are permitted to set higher standards, provided that the stricter national rules do not violate Community law.

Concerns about what already in the 1970s some member states considered excessive centralization became more intense after the Single European Act (SEA) introduced qualified majority voting for harmonization measures having the internal market as their object. Even before the SEA was ratified, in 1986, Alan Dashwood, a noted British expert in European law, had observed that in the Economic Community harmonization tended to be pursued not so much to resolve concrete problems encountered in the course of constructing the common market as to drive forward the general process of integration. This, he pointed out, was bound to affect the judgment of the Commission, inclining it towards maximum exercise of the powers available under Article 100 of the EC Treaty, and towards solutions involving a high degree of uniformity between national laws. In fact, the shifts from total to less stringent

forms of harmonization were “the inevitable adjustments to the notion of uniformity demanded by a Community structure that is supporting an ever-increasing number of Member States and an ever-increasing range of functions”<sup>7</sup>.

Since these lines were written the number of member states has almost doubled, the range of EU competences has greatly expanded, and socioeconomic diversity among the member states has increased exponentially. In spite of all these changes, the boldest experiment in total harmonization was launched on 1 January 1999, when the final stage of monetary union entered into force with the irrevocable fixing of the exchange rates of the currencies of 11 (soon to become 12, and eventually 17) member states, and the pre-emption of national action in the monetary area. What is most striking about this rather paradoxical return to total harmonization is the contradiction between the centralization of monetary policy and the mutation of the fairly homogeneous EU-15 into a highly heterogeneous bloc of 27 states – a contradiction which tends to reduce the benefits of a common monetary policy. What the American economists Eichengreen and Frieden pointed out already in 1995 is even truer today:

Given the risks and uncertainties that pervade the process [of monetary integration] there would have to be a clear margin of benefits over costs for economic considerations, narrowly defined, to provide a justification for such a radical departure in policy. The absence of such a margin implies that the momentum for monetary union must therefore derive from other, primarily political factors<sup>8</sup>.

Unfortunately, the political benefits of the monetary union have been even less clear than the economic ones. This is particularly true in the case of Germany. German leaders worked hard to convince their voters that the sacrifice of the beloved D-Mark was justified by the prospect of a decisive advance towards political union. In fact, the introduction of the common currency has hardly increased the credibility of the commitment of Germany’s partners to political union.

In Germany itself popular support for the political integration of Europe has significantly decreased in recent years. After the reunification of the country, the disappearance of the Soviet menace, and a fading memory of the horrors of World War II, Germany is no longer so dependent on the political support of its European partners. It has even been argued – in particular by Wolfgang Muenchau writing in *Spiegel On Line* of 26 September 2012 – that a united and economically strong Germany sees itself less as a member of the EU than as an autonomous, medium-size

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<sup>7</sup> S. Weatherill, *Law and Integration in the European Union*, Clarendon Press, Oxford 1995, p. 148.

<sup>8</sup> J. Eichengreen, J.A. Frieden, op.cit., p. 274.

power that can deal directly with Americans, Chinese, and Russians, without worrying too much about its EU partners.

## Early warnings

In 2009 EU leaders were surprised and shocked by the first major crisis of the common currency – even though they had been warned about the risks of the monetary union since the early 1990s, see below. Shocked surprise is the impression one gathers from the evident absence of contingency plans, the overreaction of some leaders, the abrupt and unexplained changes of attitude – for example, about the proper roles of the European Central Bank (ECB) and of the International Monetary Fund (IMF) in the crisis, or about the stringency of the “no-bailout” clause of the Maastricht Treaty. The finance minister of Germany’s Christian-Democratic and Social-Democratic coalition government was one of the first European leaders to speak about the unspeakable. At an event organized by his Social-Democratic party in Duesseldorf on 16 February 2009, Peer Steinbrueck acknowledged that some states of the euro zone were in a “very difficult situation”, thus confirming what until then only currency market speculators or independent researchers had dared to say.

Then the finance minister went a good deal further: “If one euro zone [member] gets into trouble, then collectively we will have to be helpful”. The admission was tantamount to a complete reversal of previous official positions. Until then, no political leader had been willing to discuss the possibility of aid measures for countries in a financial emergency. Now Steinbrueck was conceding that “[t]he euro-region treaties don’t foresee any help for insolvent countries, but in reality the other states would have to rescue those running into difficulty”. Just one week before the Dueseldorf meeting, the same German politician had struck a very different tone, telling the other finance ministers of the euro zone that they should not take too seriously the “horror scenarios” painted by the media. Also the then president of the ECB, Jean-Claude Trichet, had commented reports of the problems some governments were starting to have in obtaining fresh capital with the words: “I think these rumours are unfounded”.

It would take another year before European institutions and national governments would admit that the procedures so far in place to coordinate policies and re-establish economic equilibrium were insufficient for weathering a serious crisis. A report made available by the European Commission in January 2010 noted what should have been clear all along, namely that the members of the euro zone differ greatly in terms of competitiveness, and also that some countries had taken advantage

of the low interest rates following membership in the monetary union, to accumulate enormous deficits. EU aid for Greece was still excluded with the argument that it would set a dangerous precedent for other countries such as Portugal, Spain, or Ireland. Already the following month, however, the heads of government of the EU agreed to help Greece, but only in case of absolute necessity, i.e., in case of a serious risk of state bankruptcy.

In March, 2010, the German chancellor went so far as to suggest that the member states should seriously consider the possibility of expelling from the euro zone a repeated rule-breaker. The EU kept insisting that it had a plan to help Greece, should the need arise, but lacking details as to what the plan might look like commentators were inclined to doubt that assertion. The dearth of details offered by Brussels was especially disturbing for Greece. The Greek prime minister tried to put some pressure on his European partners by hinting that he was thinking of approaching the IMF for assistance. Up to that time, Germany, France and most other member states, as well as the European Commission and the ECB, had categorically excluded that the IMF could play within the euro zone a role similar to the one it had traditionally played in the less developed countries of Asia and Latin America. Eventually, however, it had to be admitted that IMF's financial assistance and technical expertise were needed also in the case of serious problems of members of the euro zone.

The confusion of EU leaders confronted by the first serious crisis of the new monetary union was obvious and to some extent understandable in light of the prevailing political culture of total optimism. Still, the total absence of contingency plans is particularly striking in this case because of the many early warnings concerning the risks of the monetary union without the political union, and even in the absence of fiscal coordination. Thus, Tsoukalis' widely-used textbook on the economics of European integration, published shortly after ratification of the Maastricht Treaty, explained clearly why the monetary union was a high-risk project with no easy exit options if things went wrong. The Greek economist concluded his discussion by pointing out that the chosen strategy accorded no place to failure. Ten years later the same economist noted that the combination of a complete centralization of a monetary policy, a highly decentralized fiscal policy, and a disconnected European political system, had no precedent in history: "The architects of Maastricht have produced a complex design of arguably postmodern inspiration, which seems to defy the law of gravity"<sup>9</sup>.

A very articulate argument about the political and economic risks of the monetary union was made by Martin Feldstein – professor of economics at Harvard, former

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<sup>9</sup> L. Tsoukalis, *Economic and Monetary Union*, in: *Policy-Making in the European Union*, fourth edition, eds. H. Wallace, W. Wallace, Oxford University Press, Oxford 2003, p. 169.

chairman of the Council of Economic Advisers of the U.S. President, and head of the prestigious National Bureau of Economic Research – in an article published in *The Economist*<sup>10</sup>, even before the Maastricht Treaty came into force. Feldstein begins by rejecting the claim, made by a number of EU leaders and especially by the European Commission, that the adoption of a single currency was necessary to perfect the single market's free trade in goods and services.

He points out that it is possible to have all the benefits of free trade without a common currency: nobody seriously suggests that Canada, the United States, and Mexico, as members of the North American Free Trade Agreement (NAFTA), should form a currency union. Even before the formation of NAFTA, trade relations between Canada and the U.S. were extremely close – much more so than between any two members of the EU – but no monetary union between the two countries has ever been seriously considered. The case for linking the monetary union to the creation of the single market was based on the notion that eliminating currency fluctuations within Europe would increase trade among the members of the EU. However, statistical studies that measured the effect of exchange-rate volatility on trade in Europe failed to find any significant impact. Further evidence that currency volatility does not inhibit trade, Feldstein added, is the sharp increase in the volume of American imports during the 1980s when the dollar gyrated sharply. Also, the fluctuations of the yen relative to the dollar and to European currencies have never been a serious barrier to the ability of Japanese firms to increase exports.

Having disposed of this specious argument in support of monetary union, the American economist goes on to remind his readers of two conditions that have to be met to make it worthwhile for a group of independent countries to adopt a single currency: first, the economic shocks that hit the individual countries are similar, so that the appropriate monetary policy is generally the same everywhere; and, second, labour is highly mobile among countries. It is easy to see that Europe is not, in this sense, an optimal currency area. Individual countries tend to suffer substantially different shocks because of differences in the mix of the products they produce, in the foreign markets to which they sell, and in a host of other relevant socioeconomic factors. Labour mobility across Europe, on the other hand, is and will remain limited by differences in language and culture and, we may add, in other important factors such as the variety of welfare-state regimes.

If Europe is not an optimal currency area, as all experts agree, then it becomes crucially important to understand the disadvantages of losing an independent national monetary policy. Textbooks on international trade tell us that if demand

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<sup>10</sup> M. Feldstein, *The case against EMU*, "The Economist" 1992, June 13<sup>th</sup>, pp. 19–22.



for the products of a country falls, the country will suffer lower employment and output unless wages and prices fall as well. In practice, wages and prices adjust only slowly, so output and employment suffer. These negative effects can be mitigated with devaluation of the national currency or lower domestic interest rates – both remedies being impossible, however, if the country is member of a monetary union. Why then have most EU member states opted in favour of a monetary union that was not necessary to facilitate trade, but likely to add to cyclic instability of incomes and employment?

The American economist understood what today everybody admits, namely that there political, rather than economic, reasons behind the decision to proceed with monetary union. On the one hand, France's opposition to the leadership role of the Bundesbank in Europe and, on the other hand, the hope of pro-integration leaders that monetary union would force, sooner or later, political union. Feldstein found it quite understandable that those who favoured a politically united Europe were prepared to accept the adverse economic effects of monetary union in order to achieve a federal union. What he could not understand "are those who advocate monetary union but reject any movement towards a federalist political structure for Europe. That is a formula for economic costs without any of the supposed political benefits". The reference is, of course, to France.

While Feldstein analysis is particularly detailed, similar warnings have been issued by a number of well-known experts, including Nobel Prize-winning economist Milton Friedman, who went as far as predicting that EMU would not last more than fifteen years. Hence the obvious question: how could democratic policymakers launch the most ambitious integration project in complete disregard of expert opinion and without a contingency plan spelling out what to do in case of a serious crisis? And also: how could the same political leaders take on such risks without informing their voters, and even against the opposition of a large majority of their voters, as in the case of Germany? The most direct answer to both questions is that this is the way all important decisions have been taken in the EC/EU for more than half a century.

What was possible in the past, however, is no longer politically acceptable today. Even aside from the current crisis, monetary union has fundamentally changed the public perception of European integration, inducing much more sober assessments of the risks, as well as the benefits, of deep integration. It is hardly necessary to point out that no national government would have dared to take such a serious and controversial decision without paying attention to expert opinion, and especially without making sure that the majority of their voters would support the decision.

## Wise advice from Poland

Monetary union is considered part of the *acquis communautaire* – the rights and obligations deriving from EU treaties, laws, and regulations, which applicant countries must accept at the time of accession. Since monetary union has been proclaimed to be part of the *acquis*, it follows that new member states *must* join EMU once they satisfy the so-called convergence criteria: they are not allowed to opt out of monetary union as the UK and Denmark did. However, it seems likely that after the crisis of the euro zone, the new member states will reassess more carefully the benefits and costs of monetary union, as has been suggested by Sławomir Skrzypek, the late president of the National Bank of Poland. Shortly before dying in the Smolensk air crash in which the President of Poland and numerous other personalities lost their life, Mr. Skrzypek published an article in the “Financial Times” of 13 April 2010, titled *Poland should not rush to sign up to the euro*. In this article, the central banker pointed out that in 2010, when Europe was plagued by concerns over excessive public debt in Greece and elsewhere, the Polish economy was projected to grow 2.7 per cent, accelerating to 3 per cent in 2011<sup>11</sup>. One important reason for this, he wrote, is that as a non-member of the euro, Poland has been able to profit from the flexibility of the zloty exchange rate in a way that has helped growth and lowered the current account deficit without importing inflation... because Poland’s currency is not bound by the Exchange Rate Mechanism II, we have been able to adjust the value of the zloty in line with domestic requirements.

The decade-long story of peripheral euro members drastically losing competitiveness, Mr. Skrzypek added, has been a salutary lesson. The “Greek imbroglio” (as he called it) shows that there is no substitute for countries’ own efforts to improve competitiveness, boost fiscal discipline and increase labour and product market flexibility – whether or not they are in the euro zone. This banker’s advice to his fellow citizens:

[W]e must temper the wish to adopt the euro with necessary prudence. We should not tie ourselves to timetables that may be counterproductive. Solid economic growth and sensible policies are possible both within and outside the euro zone. Nations in a hurry to join the euro may end up missing their overriding objectives.

A cautious approach similar to the one suggested by Mr. Skrzypek has been followed by Sweden since it joined the EU in 1995. This country, not a member of the EU when the Maastricht Treaty was ratified, could not obtain a *de jure* opt out from EMU, like the United Kingdom and Denmark. It did however ask, and was

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<sup>11</sup> S. Skrzypek, *Poland should not rush to sign up to the euro*, “Financial Times” 2010, April 13, p. 11.

granted, a derogation – in practice, a *de facto* opt out – when it became a member of the Union. Swedish leaders have decided that future membership of their country in the euro zone shall depend, not on EU prescriptions but on the approval of the voters in a popular referendum. Since the beginning of the sovereign-debt crisis opinion polls show growing popular opposition to joining monetary union, so that the prospect of Swedish membership in EMU keeps receding into the future. According to a survey conducted in July 2010, 61 per cent of the Swedes were against joining monetary union; one year earlier the negative votes were only 44 per cent. One important reason for the growing opposition to the euro is the fact that Sweden, like Poland, has weathered the financial crisis rather well, also thanks to its independent monetary policy. The Swedish economy, which is heavily dependent on exports, has profited significantly from the weakness of the national currency, the Krone. Recently, Sweden had the lowest budget deficit of all EU member states and one of the highest rates of economic growth, providing additional evidence in support of Mr. Skrzypek's assessment of the advantages of an independent monetary policy.

It is quite possible that a number of Central and Eastern European countries may decide to follow Mr. Skrzypek's advice and join Sweden in the camp of the *de facto* opt-outs, regardless of the duty of membership in the euro zone imposed on them by the *acquis communautaire*. The Czech Republic and Hungary have already linked their acceptance of the common currency to approval by popular referendum or by a supermajority in the national parliament..Moreover, in a greatly enlarged and increasingly heterogeneous monetary union even the original members of the euro zone may conclude that the policies of the ECB no longer correspond to their national conditions as well as they did before the enlargement.

This is because the original members will more often than today be outliers, in terms of inflation and output, compared to the average that the ECB will have to focus on. As a consequence, some older members may realize that the calculus of the benefits and costs of monetary union has become less favourable<sup>12</sup>. In sum, while the whole philosophy of monetary union was based on the notion that all member states should accept the total harmonization of national monetary policies as a precondition of political union, the paradoxical result seems to be the final breakdown of the notion of one set of policies that apply to all member states.

Before concluding this paper, let me return to the discussion of policymaking and policy analysis started in section 1. There we considered in some detail the pre-decision stage, with particular attention to feasibility analysis. Now I intend to examine a crucially important part of post-decision analysis, namely policy evaluation. The

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<sup>12</sup> P. De Grauwe, *Economics of Monetary Union*, Oxford University Press, Oxford 2007, pp. 97–101.

purpose is, again, to see how much the practice of an efficient national government differs from the practice and assumptions prevailing at EU level.

## Policy evaluation at the national level

If feasibility analysis is arguably the most important element in the ex-ante stage of policy analysis, policy evaluation is today considered the major contribution of ex-post analysis. Evaluation distinguishes policy analysis from other (economic or legal) approaches to the study of public policy, even more clearly than feasibility analysis. It is performed by collecting, testing and interpreting information about the implementation and outcomes of existing policies and public programmes: whether they are accomplishing what was intended, and if not, how they can be improved or discontinued. One of the central questions of policy evaluation concerns the kind of evaluative criteria that are meaningful, fair, or politically acceptable in a given situation. Evaluative criteria vary with the role and position of the evaluator, and different evaluators tend to focus their attention on different aspects of the policy-making process.

General standards or criteria of performance like legality, legitimacy, economy, effectiveness, efficiency, or responsiveness to public needs are characteristically related to the distinctive roles of judges, politicians, budget officers, public accountants, opinion makers, and consumer of public services or their political representatives. This multiplicity of evaluative criteria reflects the complexity of policymaking in a pluralistic, democratic society. Debate among advocates of different criteria is often useful in reaching agreement, and permits a more sophisticated understanding of public policy than is possible from a single perspective. The expression “multiple evaluation”, used by professional evaluators, acknowledges the legitimacy of different criteria and perspectives, but also suggests the need to reach a level of understanding that is more than the sum of the separate evaluations. Multiple evaluation starts with two basic questions: “Evaluation by whom?” and “Evaluation of what?” The first question emphasizes the importance of accounting for different evaluative *roles*, while the second question directs our attention to the three basic *modes* of evaluation – inputs evaluation, outcomes evaluation, and process evaluation.

That different criteria are used by people in different roles simply reflects the various needs, interests, and concerns of different actors and stakeholders. So long as the judgements expressed from the perspective one particular role are not presented or misinterpreted as judgements relevant to or speaking for all possible roles, we have a healthy state of multiple evaluation. Difficulties begin to arise when the conclusions

of an evaluation done for use in a particular role are assumed to be equally relevant from the perspective of other roles with different evaluative criteria. Because roles and criteria are mismatched, the conclusions of the evaluation are almost inevitably found wanting. From the point of view of the present discussion, however, the distinction of evaluative modes is more important than the distinction of roles.

Analysts have found it useful to distinguish three general modes of evaluation. In the *outcome* mode, evaluation focuses on the actual results of a particular activity. In the *input* mode, the emphasis is on the resources, skills, and people engaged in that activity. Finally, in the *process* mode, attention shifts to the methods used to transform political, economic, and other inputs into outputs/outcomes. Procedural rules that govern participation in and administration of a particular programme are also relevant in this context.

I next consider each of these modes separately, but it should always be kept in mind that the modes are usually mingled in practical efforts to evaluate policies and programmes.

Evaluation by outcomes or results is commonly viewed as the obvious way to assess the value of any purposive activity. Goals and benchmarks are defined, results are produced, and the two are compared. In the case of an educational programme, for example, one would appraise the difference between pre- and post-tests, or between the experimental and the control group, on a number of different criteria. In health programmes, the outcomes are changes in incidence and prevalence rates; in manpower programmes, the outcomes are employment rates, and so on.

This mode of evaluation has strong intuitive appeal, and is about the only one in which citizens are interested. However, outcomes evaluation can be successfully performed only under rather stringent conditions. For example, it must be possible to measure with reasonable precision the level and quality of the desired performance. When these conditions cannot be satisfied in practice, other modes of evaluation must be used.

Evaluation by inputs focuses on the quantity and quality of the resources available to perform a certain task: number and technical quality of the staff, available information, level of funding, political support, etc. Unless a definite relationship between inputs and outcomes – a well-defined “production function” in the language of the economist – can be assumed, input variables are a poor proxy for the effectiveness of a given programme. But in some situations, input variables are all the information the evaluator has to work with – for example, when the problem is to estimate the likely results of a new project or to assess the feasibility of a new programme. Moreover, for purposes of control and public accounting, input variables are often strategically more important than outputs.

In some respects, process evaluation is the most subtle and informative mode of evaluation – it provides information that input and output measures are almost sure to miss. Even in commercial activities where outcomes can be easily quantified, prudent managers try to avoid too narrow a focus on results. They do so in the knowledge that the best outcome measures never capture more than a small fraction of the total range of performance that is important to the organization. For example, there is evidence that compensating teachers on the basis of their output, as measured by student test score gains, creates incentives for teachers to concentrate their time on students in the middle of the test score distribution, neglecting those at the top who would advance well on their own and those at the bottom whose test scores would not respond to small additional amounts of teacher time. Also, where the compensation of teachers depends on the number of students who acquire a set of narrowly defined skills (as, for example, under the payment-by-results plans used in England in the middle of the 19<sup>th</sup> century to compensate elementary school teachers), there is a tendency to narrow the curriculum to exclude all non-tested subjects – including some that are generally perceived to be important but are difficult to test.

As these examples suggest, a careful analysis of the activity to be evaluated is essential for the choice of the appropriate method of evaluation, since knowledge of the activity provides the best clue to the response that a particular mode of evaluation will elicit. Two parameters are crucial for determining the conditions under which different modes of evaluation are appropriate: measurability of the outcomes and knowledge of the process that generates the outcomes (for more details see Majone 1989, chapter 8, or chapter 10 of the 2004 Polish edition).

Finally, it should be pointed out that the above discussion of different roles and modes of evaluation bears directly on the problem of public accountability. In a democracy managers and producers of public services are expected to be accountable for their performance to those who consume their services and to those who pay for them, or to their political representatives. However, accountability cannot be enforced without standards of performance, even though there may be disagreement about the appropriate standards to be used in a specific situation. For example, accountability by results depends on outcomes evaluation, and we saw above that this mode of evaluation may involve serious technical and conceptual problems.

Nevertheless, the idea of accountability by results has a strong intuitive appeal since it corresponds most closely to way in which voters assess public policies. Therefore, a democratic government cannot give up the idea of accountability by results, regardless of the problems involved in outcomes evaluation: after all, also the other modes of evaluation are in various ways problematic. Now, when we move from the national to the European level we discover that policy evaluation, if done at all, relies

primarily on the input and process modes. In the next section I argue that this may be changing because of the euro crisis.

## Policy evaluation in the EU: the aftermath of the euro crisis

What makes monetary union radically different from previous European policies is the fact that the problems are now, not only more serious but also much more evident than they were in earlier stages of European integration. Thus, the gap between the official rhetoric celebrating the economic achievements of European integration and the reality of poor economic and productivity growth since the 1980s<sup>13</sup> went largely unnoticed because most past EU policies were too remote from the daily problems of the people to seriously concern public opinion. Moreover, the complexity of policymaking at the European level meant that it was difficult for ordinary citizens, and sometimes even for the experts, to allocate responsibility for unsatisfactory outcomes as between “Brussels” and the national governments. This difficulty was aggravated by the fact that for half a century the public statements of European political leaders and EU policymakers were based almost exclusively on input or process criteria – level of institutionalization, scope of competences, scale of operations, size of membership, even volume of legislation – rather than in terms of actual results or net benefits for the citizens of the member states.

In the Commission’s White Book on *European Governance*, for example, the good governance principles are largely concerned, not with the ultimate decision/policy to be adopted, but with the way in which decisions are reached. It is not surprising, therefore, that the launch of the single currency in 1999, and the smooth introduction of euro notes and coins and phasing out of the national currencies in 2002, were taken as conclusive evidence of the success of one of the most risky projects of European integration. Two years after the introduction of the common currency a well-known monetary expert concluded: “The success of the launch of the euro is not only technical and economic, it is also and foremost political. The euro is now the most visible and practical symbol of the progress towards a political union in Europe”<sup>14</sup>. At about the same time, an American scholar who has written about European integration since the 1960s, judged that the introduction of the new common currency had been

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<sup>13</sup> G. Majone, *Europe As The Would-Be World Power: The EU At Fifty*, Cambridge University Press, Cambridge 2009, pp. 81–87.

<sup>14</sup> P. De Grauwe, *Challenges for Monetary Policy in Euroland*, in: *Governing EMU*, eds. F. Torres, A. Verdun, C. Zilioli, H. Zimmerman, European University Institute, Florence 2004, p. 363.



“a quiet success”. It appears that even distinguished scholars are not aware of the different implications of different evaluation criteria, as discussed previously.

The traditional reliance on process criteria made it possible to present European integration as a positive-sum game. In 2001 the Commission could ascribe to European integration fifty years of stability and economic prosperity, without much fear of contestation. After the euro crisis this kind of optimism is no longer possible. Now people realize that integration entails costs as well as benefits, and that a positive net balance of benefits over costs can no longer be taken for granted. This realistic assessment of the consequences of European integration is not only a new, but also an ominous development.

This new realism is likely to induce greater popular resistance to future transfers of powers to the European level, and a much stronger demand of accountability by results – precisely what is foreign to the political culture of total optimism of EU leaders and European institutions. Indeed, the basic reason why today public debate and hostile public reactions have replaced the permissive consensus of the past – when the integration project was seemingly taken for granted by European voters as part of the political landscape – is that monetary union put an end to the primacy of process over actual results. Unlike most policy decisions taken in Brussels, the decisions taken by the ECB are widely advertised, and their consequences – whether on home mortgages, on consumer credit, or on the availability of publicly-financed services – have a direct impact on the welfare of all inhabitants of the euro zone, indeed of the entire EU.

Thus, the most important, if unintended, consequence of monetary union may well be the injection of a good dose of realism in the discourse about European integration. The implications of this change are vast. A culture of total optimism cannot thrive in this new, sober atmosphere, while the integration process becomes increasingly politicized. Even before the present crisis, the quantum jump represented by monetary union had radically changed the piecemeal approach to integration advocated by Jean Monnet and by neo-functional scholar. Another consequence of the politicization of Europe is that political entrepreneurs now have the opportunity of differentiating themselves from other parties in terms of European issues, so that bargains struck in Brussels may now be contested at the national level.

This particular consequence can already be observed in several member states. During the campaign for the Austrian national elections of September 2008, for example, both the social-democratic leader and the leaders of the two parties of the extreme right appealed to widespread anti-EU feelings in the population to steal votes from the pro-EU Volkspartei. New member states such as Hungary and the Czech Republic provide other examples of the use and abuse of European issues for

party-political purposes. This is an aspect of the politicization of Europe that deserves much more systematic analysis than it has received so far.

## The national governments between globalization and European integration

Since the onset of the financial crisis in 2007–2008, support for economic (particularly financial) globalization has declined dramatically, not only in Europe but also in the United States. For example, the proportion of respondents in an NBC/*Wall Street Journal* poll saying that globalization had been good for the U.S. economy fell dramatically from 42 per cent in June 2007 to 25 per cent in March 2008. The late Paul Samuelson, winner of the Nobel Prize for economics, warned that China's gains in globalization may well come at the expense of the United States, while Alan Blinder, a former U.S. Federal Reserve vice chairman, worried that international outsourcing may cause unprecedented dislocation for the American labour force. In England, Martin Wolf, a well-known *Financial Times* columnist and one of the most articulate advocates of globalization, expressed his disappointment with the way financial globalization has turned out. None of these experts is against globalization. They do not want to reverse globalization, but to create new institutions and compensation mechanisms – at home and internationally – that will render globalization more effective and sustainable. More or less explicitly, they all raise such questions as: Has globalization gone too far? Is global governance feasible? Is it desirable?<sup>15</sup>

Somewhat similar questions are being raised in Europe today, as a consequence of the crisis of monetary union and of the more general crisis of European governance: Has European integration gone too far? Is effective European governance feasible? Is it desirable? The urgency of such questions is emphasized by what Jean-Claude Piris, former head of the Legal Services of the EU Council of Ministers, has called the three-fold crisis of European integration: euro crisis, distrust of the citizens, and dysfunctional institutions<sup>16</sup>. In this concluding section I want to discuss the role of the national governments in the present critical juncture, in light of the many shortcomings of EU governance.

To do this it may be useful to go back to the beginnings of European integration. According to the federalists of the immediate post-World War II period, it was

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<sup>15</sup> D. Rodrik, *The Globalization Paradox*, Oxford University Press, Oxford 2011.

<sup>16</sup> J.-C. Piris, *It is Time for the Euro Area to Develop Further Closer Cooperation Among its Members*, "Jean Monnet Working Paper" 2011, no. 5, The NYU Institute on the Park, New York 2011.

impossible to rebuild a democratic, prosperous and powerful Europe starting with the nation states: only a strong federation could solve the great problems of the post-war period. The establishment of a federal super-state, the Italian federalist Altiero Spinelli argued, would have to precede the political and economic reconstruction of the national states, the former being the necessary foundation of the latter. The government of the future European federation was supposed to be responsible not to the national governments but directly to the peoples of the states of the federation. Indeed, since the construction of a European federal state should precede the reconstruction of the national governments, the federalist ideology would necessarily supersede the ideological divisions of the past.

Already by 1946, however, the prediction that Europe's nation states would all collapse, leaving the people free to design their political future on a clean slate, had been conclusively refuted. The federalists attributed the responsibility of this failure to the interest of the superpowers in preserving the old state structures – except in the case of Germany. The truth is that Spinelli – like many other intellectuals, then as now, underestimated both the amazing ability of European states to react to the catastrophes of the twentieth century, and the depth of popular attachment to the nation state. For federalists old and new, the European institutions would gradually replace the outdated national institutions. The new “Stability Treaty” is the most recent and striking demonstration of the tendency to reduce the autonomy of national governments in favour of supranational arrangements. Under the regime designed by the treaty, the first duty of each state in the euro zone is to secure a balanced budget. This balanced-budget norm is considered so central that it is to be set in a binding and permanent domestic law, preferably of a constitutional character. In addition, each state must set a medium-term budgetary objective (MTBO), which is to provide a realistic budgetary target and a plan to realize it. This will be assessed by the EU Council which can “invite” a state to adjust its programme if it is unhappy with it. For states that do not have a balanced budget – at present, the vast majority of member states – the assessment does not concern only their targets, the robustness of their planning and the quality of their reforms, but also the broader socio-economic context and the demands placed by this on the national governments.

Overall, the treaty and related European legislation introduce a system of “co-management” by member states and EU institutions – what the Stability Treaty calls a “budget and economic partnership” – to control and correct the economic, fiscal, and ultimately the welfare policies of euro zone members in serious financial difficulties. This process of co-management of the national economies (which some observers also call “co-government”) represents an unprecedented interference with national

sovereignty, at a moment when popular hostility towards the EU and its institutions has reached an intensity never experienced before. The result, according to a well-known specialist of European law is a system of mixed economic governance where “the atrophy of local democracy leads to a hollowing out of domestic processes so that these become little more than administrative containers”<sup>17</sup>.

Although 25 member states have signed the Stability Treaty, the driving force behind it has been Germany – a country which the euro crisis has placed in the difficult and unpleasant role of a reluctant hegemon. It remains to be seen how strictly national governments will be willing to enforce such restrictive and unpopular conditions. Recent evidence justifies some doubts. Already at the end of January 2011 the German chancellor had been working on plans for an “economic government” of the euro zone. The first step in the new strategy to further integrate the EU on economic issues was to be the “Pact for Competitiveness” – a long term plan intended to provide a permanent solution for the ongoing euro crisis.

The Pact would have required all member states of the euro zone to adhere to sound fiscal *and* social policies, including a limit on pensions to reflect demographic developments, and modest wage increases that would no longer be adapted automatically to rising prices. However, biting criticism of the Pact came from across the EU: from long-time members of the Union and new member states, small and large countries, debt-ridden southern countries and fiscally virtuous northern countries, even from the head of the European Commission.

As we know, monetary union was introduced against the advice of the vast majority of experts who considered it to be, at best, a premature move. Today it is generally admitted that monetary union was a political, not an economic, project: among other things, it was supposed to make irreversible the movement towards the political union of Europe. In fact, Europe has never been politically as divided as at present. In this atmosphere of political dissension, economic crisis, and even open revolt, the Stability Treaty foresees a massive transfer of economic, political, and social competences from the national to the EU level.

The problem is that in the absence of popular support for such radical changes of the governance structure, co-management or co-government between national administrations and European institutions could well result in an overall loss of effectiveness at national level without compensating gains at EU level. The consequences could be disastrous from both the normative (democratic legitimacy) and the economic point of view. Time restrictions allow me to consider only some of

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<sup>17</sup> D. Chalmers, *The European Redistributive State and a European Law of Struggle*, “European Law Journal” 2012, vol. 18, no. 5, p. 693.

the economic consequences of the loss of policymaking autonomy of the national governments.

To begin with, there is the potential loss of what Michael Porter has called the competitive advantage of nations – see the citations at the beginning of the present paper. According to this well-known management expert and professor at the Harvard Business School, neither globalization nor European integration have reduced the central role of the national state in economic development and innovation. Porter starts from the observation that the leaders in particular industries and segments of industries tend to be concentrated in a few nations and sustain competitive advantage for many decades. This competitive advantage is created and sustained in a highly localized (national or even regional) process:

Differences in national economic structures, values, cultures, institutions, and histories contribute profoundly to competitive success... While globalization of competition might appear to make the nation less important, instead it seems to make it more so. With fewer impediments to trade to shelter uncompetitive domestic firms and industries, the home nation takes on growing significance because it is the source of the skills and technology that underpin competitive advantage... The home base [for successful global competitors] is the nation in which the essential competitive advantages of the enterprise are created and sustained. It is where a firm's strategy is set and the core product and process technology (broadly defined) are created and maintained<sup>18</sup>.

These propositions are supported by an impressive amount of statistical and descriptive material showing how a nation provides an environment in which its firms in a particular industry are able to improve and innovate faster than foreign rivals. The sample includes ten important trading nations—from Japan, Singapore and Korea to the United States, Germany, Italy, and Switzerland – and over 100 industries. The theoretical core of Porter's approach is a critique of the static (neo-classic) view of competition in which a nation's factors of production are fixed and firms deploy such factors in industries where they will produce the greatest return. In actual competition, Porter points out, the essential character is innovation and change. "Instead of simply maximizing within fixed constraints, the question is how firms can gain competitive advantage from changing the constraints"<sup>19</sup>. In the first section of this paper I argued that this was the correct strategy also for governments facing technological, economic, or political constraints. To expand the range of feasible choice, however, both firms and governments must enjoy a considerable freedom of action.

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<sup>18</sup> M.E. Porter, *The Competitive Advantage of Nations*, The Free Press, New York 1990.

<sup>19</sup> *Ibidem*, p. 21.

More recent research provides additional support for the thesis that economic development is possible only by preserving or even strengthening the policymaking autonomy of the national governments. As Dani Rodrik (an economist teaching at Harvard's Kennedy School of Government) writes: "Markets are most developed and most effective in generating wealth when they are backed by solid governmental institutions. *Markets and states are complements*, not substitutes, as simplistic economic accounts would have it"<sup>20</sup>. Analysing a huge set of economic data from both advanced and developing countries Rodrik found a strong positive correlation between a country's exposure to international trade and the size of its government. In other words, "governments had grown the largest in those economies that were most exposed to international markets"<sup>21</sup>.

For example, countries heavily engaged in international trade, like Sweden or the Netherlands, devote the highest proportion of their resources to the public sector – between 55 and 60 per cent of GDP. How to explain this rather counterintuitive finding? Rodrik considers many possible explanations and, in the end, concludes that the evidence points strongly toward the social insurance motive: "People demand compensation against risk when their economies are more exposed to international economic forces; and governments respond by erecting broader safety nets... If you want markets to expand, you need governments to do the same"<sup>22</sup>.

In the decades following the Great Depression of the 1930s, industrial states have erected a wide array of social protections – unemployment compensation and other labour markets interventions, health insurance, family support, etc. – that mitigate demand for cruder forms of protection such as sheltering the economy behind high tariff walls, as was done during the Great Depression. This is the reason why today protectionism can be kept under control, in America as in Europe.

The paradox is that while the European Union does not have either the financial resources or the legal powers to provide similar compensations against the risks of globalization, at the same time it pretends to limit the autonomy of the member states by imposing increasingly stringent constraints on national policy making. From the very beginning of European integration the emphasis has been on the "harmonization" of the laws and policies of the member states rather than on a healthy competition between different national approaches to problem solving. As a consequence, inter-jurisdictional competition has played no role in the integration process. Indeed, a well-known expert of European law like Stephen Weatherill maintains that competition

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<sup>20</sup> D. Rodrik, *The Globalization Paradox*, Oxford University Press, Oxford 2011, p. 16.

<sup>21</sup> *Ibidem*, p. 17.

<sup>22</sup> *Ibidem*, p. 18.

among national regulators is incompatible with the notion of undistorted competition in the internal European market. Hence the UK – the member state which has most consistently defended the benefits of inter-state competition – has been accused of subordinating individual rights and social protection to a free-market philosophy incompatible with the basic aspirations of the European Community/Union: “Competition between regulators on this perspective is simply incompatible with the EC’s historical mission”<sup>23</sup>. Widespread opposition to inter-jurisdictional competition explains why the principle of mutual recognition has played a much more limited role in the integration process than had originally been expected<sup>24</sup>.

This deep-rooted opposition to inter-state competition has been criticized by the Canadian economist André Breton, author of an important book on *Competitive Governments*. Breton notes that in the EU inter-country competition has been virtually suppressed through excessive policy harmonization. Assessing the situation before the euro crisis, he writes:

I believe that the European Union is quite stable but that the stability has been acquired by the virtual suppression of intercountry competition through excessive policy harmonization.... To prevent the occurrence of instability, competition is minimized through the excessive harmonization of a substantial fraction of social, economic, and other policies... If one compares the degree of harmonization in Europe with that in Canada, the United States, and other federations, one is impressed by the extent to which it is greater in Europe than in the federations”<sup>25</sup>.

According to Breton, part of the opposition to the idea that governments, national and international agencies, or vertical and horizontal networks, should compete among themselves derives from the widespread notion that competition is incompatible with, even antithetical to, cooperation. He cogently argues that this perception is mistaken. Cooperation and competition can and generally do coexist, so that the presence of one is no indication of the absence of the other. In particular, the observation of cooperation and coordination does not per se disprove that the underlying determining force may be competition.

If one thinks of competition not as the *state* of affairs neoclassical theory calls “perfect competition”, but as an *activity* – à la Schumpeter, Hayek, and other Austrian economists who developed the model of *entrepreneurial competition* – then it becomes plain that “the entrepreneurial innovation that sets the competitive process in motion, the imitation that follows, and the Creative Destruction that they generate

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<sup>23</sup> S. Weatherill, *Law and Integration in the European Union*, Clarendon Press, Oxford 1995, p. 180.

<sup>24</sup> G. Majone, *Europe As The Would-Be World Power: The EU At Fifty*, Cambridge University Press, Cambridge 2009, pp. 117–124.

<sup>25</sup> A. Breton, *Competitive Governments*, Cambridge University Press, Cambridge 1996, pp. 275–276.



are not inconsistent with cooperative behaviour and the coordination of activities” (ibid.: 33). Given the appropriate competitive stimuli, “political entrepreneurs” (innovative policymakers), like their business counterparts, will consult with colleagues at home and abroad, collaborate with them on certain projects, harmonize various activities, and in the extreme case integrate some operations – all actions corresponding to what is generally meant by cooperation and coordination.

Let me conclude. Sixty years is not a long period in the life of a state, or even of a major public institution. The European Union is still a young political system and it is therefore quite understandable that it should be incomplete in many of its elements, and also that it should be prone to mistakes. Moreover, it is a highly composite and inhomogeneous system that must satisfy a number of different, sometimes conflicting, demands. If the notion of optimality (“first best”) is hardly applicable to national policymaking, as was argued in a previous section, it is almost meaningless in the context of EU policymaking.

*Feasibility*, however, is a necessary condition at all levels of governance – indeed, in all types of human activity. A national government may be reluctant to examine too closely the feasibility of a pet project, but the political opposition will not miss the opportunity to accuse the government of being incompetent. Unfortunately, the government-opposition dialectic simply does not exist in the EU. This condition should enhance the role of feasibility analysis at the European level. However, the absence of any concern about feasibility is one of the most striking, and worrisome, features of European governance. Also worrisome is the near-absence of policy evaluation using outcome rather than process criteria. Indeed, the institutions of the EU are themselves in a serious crisis. According to Jean-Claude Piris who knows those institutions very well, the Commission has become weaker since the 1990s for a number of factors, including its composition and pressures from the European Parliament (EP) and from the largest member states. In fact, the powers of the EP have been expanded treaty after treaty, but the results have not been as positive as expected, so that Piris writes of a “relative failure” of the EP--as shown, for instance, by the steady decrease of voters’ participation in European elections<sup>26</sup>.

As a relatively new governance system, the EU is entitled to make mistakes. What can be reasonably asked, however, is that after the experience of the euro crisis, the strategy of *fait accompli* – moving ahead, regardless of longer-term consequences – should be definitely abandoned. This means that integration should advance only to the extent permitted by the prevailing economic, political, and institutional

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<sup>26</sup> J.-C. Piris, *op.cit.*, pp. 8–15.

conditions. It is all too obvious that the decision to proceed with monetary union did not satisfy even minimally such conditions. As long as the EU remains a complex, incomplete, and unpopular system of governance, it is everybody's interest to maintain the essential autonomy of the national governments and their administrations. The strength of Europe, its capacity to meet the challenges of globalization, reside in its diversity, not in harmonization; in its competitive governments, not in a super-state conceived as a more or less traditional state "writ large".

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