Chapter 2

Facts, law, institutions and the budget

Chapter Contents

Introduction

The members of the European Union are economically and politically integrated to an extent that is historically unprecedented. In many ways, the EU is already more integrated than loosely federated nations such as Canada and Switzerland. This integration is maintained and advanced by a cocktail of economic, political, historical and legal forces shaped by European institutions, laws and policies. This chapter presents the background information on these institutional features that is essential to the study of European economic integration.

The chapter starts by detailing the extent of European economic integration, before turning to more institutional issues – EU organization, EU law, EU institutions and the legislative process. The chapter then presents basic facts on EU members (population, incomes and economic size), which are essential for understanding the subsequent topic – the EU budget.

2.1 Economic integration in the EU

The extent and nature of EU economic integration cannot be fully understood without reference to the founders' intentions. The post-war architects of Europe had radical goals in mind when they established the European Economic Community in 1958 with the Treaty of Rome (which was re-labelled the 'Treaty on the Functioning of the European Union' by the 2009 Lisbon Treaty).

The Treaty of Rome's main architect, Jean Monnet, headed an influential pan-European group called the Action Committee for the United States of Europe. Having failed with their plans for a European Political Community and a European Defence Community in the early 1950s, they switched to economic integration as the means of achieving their lofty goal (see Chapter 1 for details).

This insight is critical to understanding the basic outlines of European economic integration. The various elements of the Treaty of Rome were not subjected to a careful weighing of the economic and political costs and benefits. The idea was to fuse the six national economies into a unified economic area in a way that launched some kind of snowball effect, or ratchet effect. Economic integration, according to the founders' thinking, would launch a gradual process that would draw European citizens together in ways that went way beyond simple business interactions. As Europeans interacted more with one another at work, during study trips, and even on holiday, they would start to realize that Europe shared common values and aspirations, that they weren't that different after all.

This was the road to an 'ever-closer union', which in the 1940s and 1950s, was thought to lead all the way to political union (or 'finalité politique' in French) – the United States of Europe so to speak.[1] To put it bluntly, economic integration was the way to a politically unified Europe. In the 1940s, when radical thinking was mainstream, this was widely accepted as necessary to prevent another horrific war in Europe.

This section reviews economic integration in today's European Union, organizing the main features according to the logic of a unified economic area.

2.1.1 Treaty of Rome – fountainhead of EU economic integration

The Treaty of Rome is a far-reaching document. It is, in a sense, the bud whose leaves unfolded over 60 years into today's European Union. It laid out virtually every aspect of the economic integration that Europe has implemented right up to the 1992 Maastricht Treaty (which added the goal of a single currency to the economic integration plan). The Treaty of Rome is also easy to read. If you have never read a treaty, spend the 10 minutes it takes to read the first pages of the Treaty of Rome. At the very least, students should look at the three-page 'PART ONE – Principles' in the original version (available in many languages; the official version is on the website Europa.eu). To get readers started, Box 2.1 reproduces the first three articles.

[1] A clear statement of this can be found in the so-called Spaak Report, 'Rapport des chefs de délégation aux ministres des Affaires étrangères', Bruxelles, 21 avril 1956, the outcome of the experts group set up by the Messina Conference. See www.cvce.lu.

Box 2.1 Articles 1, 2 and 3 of the Treaty of Rome

ARTICLE 1. By this Treaty, the High Contracting Parties establish among themselves a EUROPEAN ECONOMIC COMMUNITY.

ARTICLE 2. The Community shall have as its task, by establishing a common market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it.

ARTICLE 3. For the purposes set out in Article 2, the activities of the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein:

(a) the elimination, as between Member States, of customs duties and of quantitative restrictions on the import and export of goods, and of all other measures having equivalent effect;
(b) the establishment of a common customs tariff and of a common commercial policy towards third countries;
(c) the abolition, as between Member States, of obstacles to freedom of movement for persons, services and capital;
(d) the adoption of a common policy in the sphere of agriculture;
(e) the adoption of a common policy in the sphere of transport;
(f) the institution of a system ensuring that competition in the common market is not distorted;
(g) the application of procedures by which the economic policies of Member States can be coordinated and disequilibria in their balances of payments remedied;
(h) the approximation of the laws of Member States to the extent required for the proper functioning of the common market;
(i) the creation of a European Social Fund in order to improve employment opportunities for workers and to contribute to the raising of their standard of living;
(j) the establishment of a European Investment Bank to facilitate the economic expansion of the Community by opening up fresh resources;
(k) the association of the overseas countries and territories in order to increase trade and to promote jointly economic and social development.

Note that the Treaty of Rome has been amended and renamed many times since the 1950s (see Box 2.2); the current name, Treaty on the Functioning of the European Union, is so dull that many writers continue to call it the Treaty of Rome.

2.1.2 How to create a unified economic area

The best way to understand European economic integration is to think about the founders' goal of an ever-closer union – keeping in mind their 1950s mind-set about the sort of economic integration that would lead to the finalité politique.

As mentioned, the intention of the Treaty of Rome was to create a unified economic area – an area within which all firms and consumers would have equal opportunities to sell or buy goods and services, and owners of labour and capital would be free to employ their resources in any economic activity anywhere within it.

Creating a unified economic area would, according to the founders' thinking, draw Europeans into ever-closer, ever-deeper economic exchanges (see Box 2.3 for the story of the Treaty's signing). These would, with time, lead Europeans to embrace ever-closer political cooperation and integration. As history shows, types of services, the service supplier and buyer have to be together in the same room. This means that either companies have to go to consumers, as in the case of a French bank setting up an office in Belgium, or consumers have to go to companies, as in the case of an Italian travelling to Paris for a medical operation. Moreover, since services often involve trust (think about medical or mass transit services), governments tend to regulate service fairly heavily. Many of the barriers to the free movement of service thus come from things like licences for bus drivers and dentists, or regulatory oversight of banks and insurance companies.

Even to this day, the tension between allowing EU members to take care of their own regulation of services has prevented truly free trade in services. As Britain is finding out in the case of financial services, rules that are meant to protect consumers and avoid banking crises can and will be used to discriminate against non-EU banks.

Labour and capital market integration

The Treaty of Rome instituted a common employment and investment area by abolishing barriers to the free movement of workers and capital. This includes a ban on any form of discrimination based on nationality regarding hiring, firing, pay and working conditions. The Treaty also explicitly allows workers to travel freely in search of work. Note that this was not intended to allow free movement of people, only workers. The Lisbon Treaty amplified this by requiring the free movement of people, not just workers. For example, it granted British retirees the right to live in Spain even when they were not employed locally. These are some of the freedoms that will almost surely be curtailed when the UK leaves the EU.

As for capital mobility, the Treaty focuses on two types of freedom. The first is the right of any Community firm to set up in another Member State. These 'rights of establishment' are essential to integration in sectors with high 'natural' trade barriers; for example, in sectors such as insurance and banking, where a physical presence in the local market is critical to doing business. The second type concerns financial capital and here the Treaty goes deep. It states that all restrictions on capital flows (e.g. cross-border investments in stocks and bonds, and direct investment in productive assets by multinationals) shall be abolished. It applies the same to current payments related to capital flows (e.g. the payment of interest and repatriation of profits).

The Treaty of Rome, very little capital-market liberalization was undertaken until the 1980s. The first reason was that most governments and economists suspected that free movement of capital could lead to a financial and banking crisis, so they were not in a hurry to free up capital movements. The second reason was that the Treaty of Rome provided an important loophole. It allowed capital market restrictions when capital movements create disturbances in the functioning of a Member State's capital market. Moreover, it did not set a timetable for this liberalization. Capital market liberalization only became a reality 30 years later with the Single European Act and the Maastricht Treaty (see Chapters 13 and 14 for the economics and politics that connected the free movement of capital and the adoption of the single currency).

Exchange rate and macroeconomic coordination

Fixed exchange rates were the norm when the Treaty of Rome was written, and throughout the late 1940s and 1950s nations occasionally found that their fixed exchange rate level induced their citizens to purchase a value of foreign products and assets that exceeded foreigners' purchases of domestic goods and assets. Such situations, known as balance-of-payments crises, historically led to many policies – such as tariffs, quotas and competitive devaluations – that would be disruptive in a unified economic area. To avoid such disruptions, the Treaty of Rome called for mechanisms for coordinating members' macroeconomic policies and for fixing balance-of-payments crises. This seed in the Treaty of Rome eventually sprouted into the euro, the Stability and Growth Pact, and the European Central Bank. See Chapters 17 and 18 for details.

Common policy in agriculture

From a logical point of view, it might seem that a unified economic area could treat trade in agricultural goods the same way as it treats trade in services and manufactured goods. From a political point of view, however, agriculture is very different politically, and the EU has explicitly recognized this right from the beginning.

In the 1950s, Europe's farm sector was far more important economically than it is today. In many European nations, a fifth or more of all workers were employed in the sector. Moreover, national policies in the sector were very important and very different across nations. In reaction to the great economic and social turmoil of the 1920s and 1930s, most European nations had adopted highly interventionist policies in agriculture. These typically involved price controls teamed with trade barriers. Moreover, in the 1950s, the competitiveness of the Six's farm sectors differed massively. French and Dutch farmers were far more competitive than German farmers. If the Six were to form a truly integrated economic area, trade in farm goods would have to be included. However, given sharp differences in farm competitiveness among the Six, free trade would have had massively negative effects on many farmers, although, as usual with free trade, the winners would have won more than the losers would have lost.

These simple facts prevented the writers of the Treaty of Rome from including more than the barest sketch of a common farm policy. They did, however, manage to agree on the goals, general principles and a two-year deadline for establishing the common policy. The Common Agricultural Policy came into effect in 1962 (see Chapter 9).

2.1.3 Omitted integration: social policy, taxes and intellectual property rights

The Treaty of Rome was enormously ambitious with respect to economic integration, but it was noticeably silent on two politically sensitive areas that might naturally be part of creating a unified economic area:

1. Harmonization of social policies (the set of rules that directly affects labour costs such as wage policies, working hours and conditions, and social benefits).
2. Harmonization of taxes.

Subsequent treaties have pushed social integration further but not anywhere near as deep as economic integration. Harmonization of taxes has advanced only slightly since the 1950s.

The Treaty also omitted something that jars with many Europeans today – the lack of integration of intellectual property rights, like copyrights for songs and books. It is this omission that allows websites like Amazon or iTunes to charge different prices for the same music in, for example, Germany and Italy. It is also why you cannot access some video content in one EU nation even when it was made in another.

The rest of this section considers the economic and political logic behind the social policy and tax omissions.

Social policy

Social harmonization is very difficult politically since even the original six members of the EEC held very different opinions on what types of social policy should be dictated by the government. France, for example, was much keener on the equal treatment of woman than was Italy. Since social policies very directly and very continuously touch citizens' lives, opinions are strongly held. In addition to social harmonization being significantly more difficult politically, there are economic arguments suggesting that it is not necessary.

Does European economic integration demand harmonization of social policies?

This question has been the subject of an intense debate for decades. From the very beginning there were two schools of thought:

1. *The harmonize-before-liberalizing school.* This line of reasoning holds that international differences in wages and social conditions provide an 'unfair' advantage to countries with more laissez-faire social policies. The thinking here is easy to explain. If nations initially have very different social policies, then lowering trade barriers will give nations with low social standards an unbalanced advantage, assuming that exchange rates and wages do not adjust.
2. *The no-need-to-harmonize school.* This school argues that wages and social policies are reflections of productivity differences and social preferences – differences that wage and exchange rate adjustments will counter. This school of thought rejects calls for harmonization and notes that, in any case, social policies tend to converge as all nations get richer. The thinking here is that wages adjust to offset any systematic differences. For instance, if one nation requires that firms provide their workers with longer holidays than another, workers in the former will produce less in a year and will thus earn less. The competitiveness effect of the costly social regulation is offset by lower wages.

Tax policy

Like social policies, tax policy directly touches the lives of most citizens. This means that a nation's tax policy is the outcome of a hard-fought political compromise between broad groups of citizens, firms and labour unions, all of whom are well informed and fully engaged. Given this, EU leaders have always found it difficult politically to harmonize taxes, and this situation started with the Treaty of Rome, which made taxation a matter of national concern except for taxes that acted like subsidies or trade barriers.

The key compromise made here was that there would be no requirement to harmonize taxes that affected the economy very widely – say, income taxes or profit taxes. But there would be a requirement to harmonize taxes that affected a particular sector. The notion was that a tax that fell only on, say, paper-making, could lead to an unfair advantage that would not be offset by changes in the general wage rate or exchange rate.

2.2 EU structure pre- and post-Lisbon

The EU's institutional structure is highly complex. It is much harder to understand than the institutions in a single European country like Italy or Sweden. One important problem that makes this even more difficult is that many writings on the EU refer to the old structure – or explain the new structure with reference to the old structure. This unfortunately means that readers have to learn about both the old and new systems if they want to be able to follow today's discussion on European integration. Fortunately, they are not too different and understanding the motives behind the old structure makes it easier to understand the motives behind the new structure.

2.2.1 The EU's pre-Lisbon structure

Up to the 1992 Maastricht Treaty (formally its title was the Treaty on European Union, or TEU), things were simple. There was the European Economic Community (EEC) that mattered a lot and a couple of other Communities (Coal and Steel, and Euratom) that did not. The Maastricht Treaty took a big leap forward in economic integration with the monetary union, but it also pushed forward a broadening of European integration ambition. The members, however, were somewhat suspicious that this new broadening might get out of hand if the European Commission and European Court continued to push for an 'ever closer Europe'. To counter this, EU members insisted that the Maastricht Treaty put in place some 'fire breaks'.

More specifically, up to the 1992 Maastricht Treaty, most integration initiatives were subject to the Treaty of Rome's supranational decision-making procedures; for example, majority voting on EU laws which implied that any law passed had to be implemented by all members, even members who voted against it. Moreover, the European Court was the ultimate authority over disputes involving all such laws and the Court's rulings occasionally had the effect of boosting integration (see the Cassis de Dijon case in Chapter 4 for a famous example).

This supranationality created two related problems – an understanding of which provides a logical framework that makes sense of the unusual structure of the EU pre-Lisbon and helps build an understanding of why the Lisbon changes are important.

The first problem concerned the old schism between federalists and intergovernmentalists (see Chapter 1). On the one hand, some EU members – the 'vanguard' – wished to spread European integration to areas that were not covered in the original Treaties, such as harmonization of social policies and taxation. On the other hand, another group of members – call them the 'doubters' – worried that supranational decision-making procedures were producing an irresistible increase in the depth and breadth of European integration that forced their citizens to accept more integration than they wanted. Germany is an example of the vanguard and Britain was an example of the doubters.

The vanguard called this irresistible increase the 'Community method' while the doubters called it 'creeping competences' ('competence' is EU jargon for policy areas where EU-level policy takes the lead over Member States' national policies).

To the doubters, a particularly worrisome feature was the EU Court's ability to interpret the Treaty of Rome and subsequent amendments. The Treaty of Rome says that the EU can make laws in areas not mentioned in the Treaty, if the Court rules that doing so is necessary to attain Treaty objectives. The Treaty objectives, however, are extremely far-reaching; the first line of the Treaty of Rome's Preamble says that the members are 'determined to lay the foundations of an ever closer union among the peoples of Europe'.

Doubters worried that the Treaty's ambitious objectives combined with the Court's ability to sanction law-making in areas not explicitly mentioned in the Treaties opened the door to essentially unlimited transfers of national sovereignty to the EU level.

The second problem concerned integration that was taking place outside of the EU's structure due to differences between the vanguard and the doubters. The Schengen Accord – which is what allows passport-free travel among most EU members – is the classic example. While the free movement of people is an EU goal dating back to 1958, some members (e.g. Britain) held up progress towards passport-free travel. In 1985, five EU members signed an agreement ending controls on their internal frontiers. This was completely outside of the EU's structure and many observers feared that such ad hoc arrangements could undermine the unity of the Single Market and possibly foster tensions among EU members. A more recent example is the 2005 Prüm Treaty on police cooperation, which was signed outside the EU umbrella by seven EU members.

Both problems were addressed by the rather complex structure EU members set up with the Maastricht Treaty. The Lisbon Treaty has modified the Maastricht Treaty's architecture, but students will find it easier to understand today's situation by learning about the path of reform that got us here.

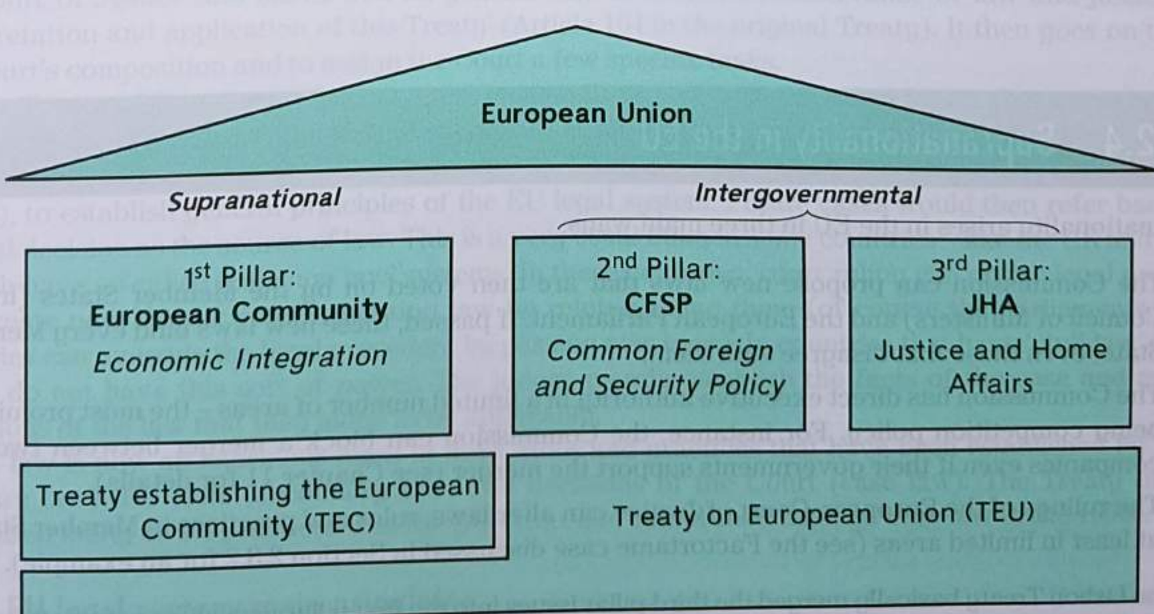
2.2.2 Maastricht and the three pillars as fire breaks

The Maastricht Treaty drew a clear line between supranational and intergovernmental policy areas by creating a 'three-pillar' organizational structure. The deep economic integration – basically the integration in the Treaty of Rome, Single European Act and the monetary union part of the Maastricht Treaty – was placed in the supranational 'first pillar'. The intergovernmental policies – foreign and defence matters (second pillar), and police, justice and other 'home affairs' (third pillar) – are under the European Union 'roof' but were not subject to supranationality in terms of decision making and EU Court rulings (see Figure 2.1).

The three-pillar structure solved the two problems mentioned above. The clear distinction between supranational and intergovernmental cooperation allowed initiatives like Schengen to be brought under the EU's wing without forcing every member to join. This greatly reduced the resistance of Britain and other doubters to further discussion of closer integration in areas ranging from police and foreign policy cooperation to closer cooperation on child custody in cases of divorce and recognition of professional qualifications.

The key, as far as the doubters were concerned, is that Maastricht put Member States clearly in control in second- and third-pillar areas. There was no possibility of the Court or Commission using their authority to force deeper integration on reluctant members in pursuit of the duties assigned to them by the Treaty of Rome.

Figure 2.1 The Maastricht Treaty (pre-Lisbon Treaty) three-pillar structure



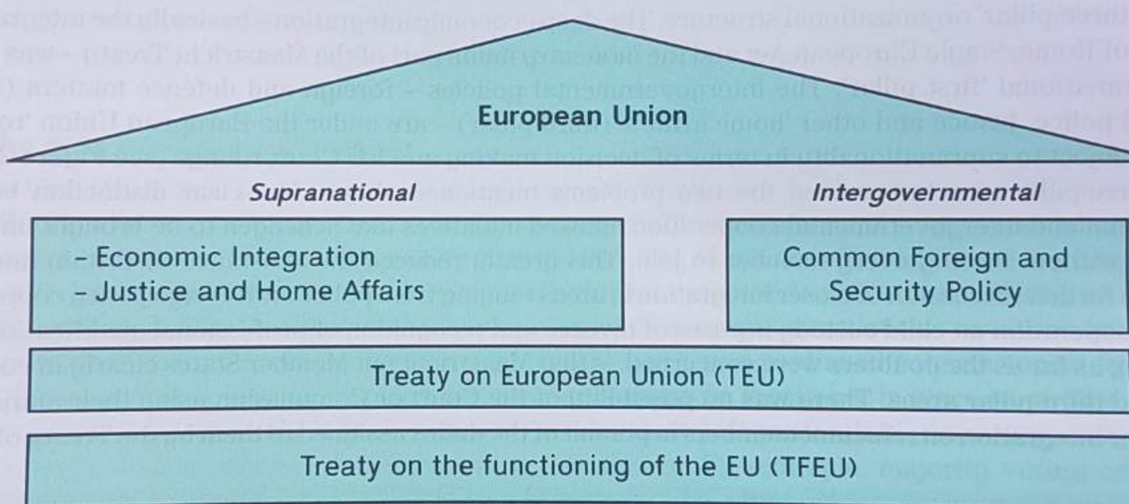
Note: The first pillar also includes the highly specialized European Atomic Energy Community; it is often called Euratom.

2.2.3 Post-Lisbon organization: two pillars in a single organization

One of the most radical things in the Lisbon Treaty is the de jure removal of the three-pillar structure. It was replaced by a two-pillar structure, as shown in Figure 2.2. It abolishes the European Community, replacing the term 'Community' with 'Union' throughout the TEU and TFEU (henceforth 'the amended Treaties' for short). Some writers refer to this as the removal of the pillar structure because there is now just one organization and it has what lawyers call 'legal personality' (it can sign agreements with nations and organizations).

However, the basic need that some members have for a fire break against deeper integration in second-pillar issues meant that Lisbon is best understood as merging the third pillar into the first. The new structure (Figure 2.2) essentially has two pillars – a supranational pillar and an intergovernmental pillar. It is therefore worth learning about the old three-pillar structure in some detail to understand which of today's EU policies are governed by supranationality (see Box 2.4 for the forms of supranationality in the EU) and which are governed by intergovernmentalism.

Figure 2.2 The post-Lisbon Treaty structure



Box 2.4 Supranationality in the EU

Supranationality arises in the EU in three main ways:

1. The Commission can propose new laws that are then voted on by the Member States (in the Council of Ministers) and the European Parliament. If passed, these new laws bind every Member State, even those that disagree with them.
2. The Commission has direct executive authority in a limited number of areas – the most prominent being competition policy. For instance, the Commission can block a merger between two EU companies even if their governments support the merger (see Chapter 11 for details).
3. The rulings of the European Court of Justice can alter laws, rules and practices in Member States, at least in limited areas (see the Factortame case discussed in Section 2.3.2 for an example).

The Lisbon Treaty basically merged the third-pillar issues into the first pillar with all its supranationality, although exceptions are included article by article so it is more difficult to draw the broad picture.

2.3 EU law

One of the most unusual and important things about the EU is its supranational legal system. This is a direct implication of the EU's unusual degree of economic integration. Implementing and maintaining a unified economic area requires a legal system of some kind since disputes over interpretation and conflicts among various laws are inevitable.

By the standards of every other international organization in the world, the European legal system is extremely supranational. For example, even the highest courts in EU Member States must defer to decisions by the EU's Court of Justice on matters concerning the interpretation of EU law. The EU is very much like a federal state in this respect. Just as the decisions of lower courts in France, Germany and Italy can be overturned by those nations' supreme courts, the EU's Court of Justice has the ultimate say on questions concerning European law.

Before the Lisbon Treaty, the deep, supranational aspects of EU law only applied to first-pillar issues, that is, where supranationality was the agreed principle. While the Lisbon Treaty removed the pillars, it did not remove the distinction between areas where the EU law's deep supranationality applies and areas where it does not. Now, however, the default option is that it applies to all areas except those areas explicitly excluded.

The topic of EU law is as intricate as it is fascinating. This section presents the barest outlines of the subject, focusing on the elements that are essential for understanding the decision-making process in particular and the economics of European integration more generally. Note that this section is largely based on the ebook by Claus-Dieter Borchandt, *The ABC of EU Law*, which is freely downloadable in over 20 languages from many sites including publications.europa.eu. It was most recently updated in late 2016.

2.3.1 'Sources' of EU law

The legal systems of most democratic nations are based on a constitution. The EU does not have a constitution, so where did these principles come from? As is true of so many things in the EU, a complete answer to this question would fill a book or two, but the short answer is easy: the Treaty of Rome created the Court and the Court created the legal system and its principles.

The Treaty of Rome commits Member States to a series of general economic and political goals, and it transfers important elements of national sovereignty to the European level in perpetuity. For example, after 1958 Member States no longer had the right to control their external trade policy and there was no legal way for them to quit, so this loss of sovereignty was permanent. As every reader of print or social media knows, leaving the EU became a legal option with the Lisbon Treaty's now-famous Article 50 – the legal vehicle that is guiding Brexit to this day.

The Treaty was not very specific when it came to setting up the legal system. The Treaty establishes the Court of Justice and states that its general task is to 'ensure observance of law and justice in the interpretation and application of this Treaty' (Article 164 in the original Treaty). It then goes on to define the Court's composition and to assign the Court a few specific tasks.

The Treaty of Rome was also not specific enough to deal with the many issues that came before the Court. The Court reacted to the lack of specificity in the Treaty by creating the Community's legal system via what is known as 'case law'. That is to say, the Court used its written decisions on a particular dispute ('case'), to establish general principles of the EU legal system. Future cases would then refer back to the original decision as the source of law. This is a very usual thing in some countries – like the UK and the USA – which have so-called 'common law' systems. In these countries, court ruling can create legal precedents that create new law, or refines existing law by reinterpreting them (of course the parliaments in these countries can overrule the legal precedent by passing new laws). In countries that have 'civil law' systems, courts do not have this sort of power. The judges merely establish the facts of the case and apply the provisions of the law that they judge to be applicable.

EC law is now an enormous mass of laws, rules and practices that have been established by Treaties (primary law), EU laws (secondary law) and decisions of the Court (case law). The Treaty of Lisbon formalized many of the practices that the EU Court had established through case law in the 1950s.

2.3.2 EU legal system: main principles

Since the EU legal system was not created by any single document, its principles were never officially proclaimed before the Lisbon Treaty. The 'principles' of EC law were thus general patterns that various jurists have discerned from the thousands of pages of primary, secondary and case law, and different jurists list different principles.

Three principles that are always mentioned are 'direct effect', 'primacy of EC law' and 'autonomy' of the EU legal system. These were first established in two landmark cases in 1963 and 1964 (see Box 2.5). These three have been explicitly confirmed in the Lisbon Treaty (see below for details).

Box 2.5 Two cases that established the EC legal system

The EC legal system was not explicitly established in any Treaty, so the Court used some early cases to establish three key principles. Since these principles arose in the course of real-world cases, it can be difficult to precisely distinguish among the three principles in the two cases.

***Van Gend & Loos v Netherlands*, 1963.** In this case, the Dutch company Van Gend & Loos brought an action against its own government for imposing an import duty on a chemical product from Germany which was higher than duties on an earlier shipment; the company claimed that this violated the Treaty of Rome's prohibition on tariff hikes on intra-EC trade. The Dutch court suspended the case and asked the EC Court to clarify. The EC Court ruled that the company could rely on provisions in the Treaties when arguing against the Dutch government before a Dutch court.

Plainly, this case has an element of direct effect and primacy. The Dutch government had one rule – the higher tariff rate – while the Treaty had another (no increase allowed). The EC Court said the Treaty provision trumped the national provision. Moreover, the EC Court said that the Dutch court should consider the Treaty directly rather than, for example, the Dutch Parliament's transposition of the Treaty's principles into Dutch law. In effect, the Court said that the Treaty was Dutch law as far as the Dutch court was to be concerned. This was new, since normally a national court can consider only national law when judging a case.

The European Court also took the opportunity to write down its thoughts on the fundamental nature of the EC legal system. In the *Van Gend & Loos v Netherlands* decision, it wrote: 'The Community constitutes a new legal order of international law for the benefit of which the States have limited their sovereign rights, albeit within limited fields, and the subjects of which comprise not only Member States but also their nationals.'

***Costa v ENEL*, 1964 decision by the Court of Justice.** The next year, the Court expanded its view of the EC legal system in a case involving a dispute over 1,925 lire – about one euro! In 1962, Italy nationalized its electricity grid and grouped it under the National Electricity Board (ENEL in Italian). Mr Flaminio Costa, a shareholder of one nationalized company, felt he had been unjustly deprived of his dividend and so refused to pay his electricity bill for 1,925 lira. The non-payment matter came before an arbitration court in Milan but since Mr Costa argued that the nationalization violated EC law, the Milan court asked the European Court to interpret various aspects of the Treaty of Rome.

The Court took the opportunity to go way beyond the question at hand. In its judgement, the Court stated the principle of autonomy and direct effect:

- 'By contrast with ordinary international treaties, the EEC Treaty has created its own legal system which . . . became an integral part of the legal systems of the Member States and which their courts are bound to apply.'
- 'Member States have limited their sovereign rights, albeit within limited fields, and have thus created a body of law which binds both their nationals and themselves.'

Relying on the logic of what the Treaty of Rome implied – at least implicitly – the Court established the principle of primacy.

- '[T]he law stemming from the Treaty, an independent source of law, could not, because of its special and original nature, be overridden by domestic legal provisions, however framed, without being deprived of its character as Community law and without the legal basis of the Community itself being called into question. The transfer by the States from their domestic legal system to the Community legal system of the rights and obligations arising under the Treaty carries with it a permanent limitation of their sovereign rights, against which a subsequent unilateral act incompatible with the concept of the Community cannot prevail.'

The Court's justification was that if EC law were not supreme, the objectives of the Treaty could not be met: 'The executive force of Community law cannot vary from one State to another in deference to subsequent domestic laws, without jeopardising the attainment of the objectives of the Treaty.'

'Direct effect'

'Direct effect' is simple to define – it means that Treaty provisions or other forms of EU law such as directives can create rights which EU citizens can rely upon when they go before their domestic courts. This is radical. It means that EC laws must be enforced by Member States' courts, just as if the law had been passed by the national parliament. A good example is the case of a Sabena air stewardess (as they called female flight attendants in the 1970s) who claimed that she was paid less and had to retire earlier than male flight attendants. Although this was not a violation of Belgian law at the time, the EC Court ruled in 1976 that the Treaty of Rome (which provides for equality of pay between the sexes) had the force of law in Belgium, or in legal terms, it had direct effect. The stewardess won the case.

The principle of direct effect is quite unique. For example, when New Zealand ratifies the Kyoto Protocol, it is agreeing to certain obligations, but New Zealand courts ignore these obligations unless they are implemented by a law passed by the New Zealand parliament. Even more unusual is that this 'direct effect' notion applies to EU laws passed by majority voting, such as directives. This means that, even if a Member State government votes against a particular law, that law automatically has the force of law, so its national courts must treat the EU law as if it were a national law. Importantly, there are complex conditions for a Treaty provision to have direct effect, so not everything in every Treaty is automatically enforceable in Member States.

The logical necessity of this principle is straightforward. If laws agreed in Brussels could be ignored in any Member State, the EU would fall into shambles. Each member would be tempted to implement only the EU laws it liked. This would, for example, make it impossible to create a single market or ensure the free movement of workers.

Primacy of EU law

This principle, which means that Community law has the final say, is not in the Treaty of Rome and indeed appears explicitly for the first time only in the rejected Constitutional Treaty (it is included in the Lisbon Treaty). It was, nonetheless, a principle that had been generally accepted by all EU members even before the Lisbon Treaty. It was repeatedly used to overturn Member State laws.

One classic example of this principle is the 1991 Factortame case, which confirmed the supremacy of EU law over UK law. The UK's Merchant Shipping Act of 1988 had the effect of forbidding a Spanish fishing company called Factortame from fishing in UK waters. Factortame asserted in UK courts that this violated EU law, and asked the UK court to suspend the Merchant Shipping Act until the EU Court could rule on the matter (this often takes a couple of years). Under UK law, no British court can suspend an Act of Parliament. The EU Court ruled that under EU law, which was supreme to UK law, a national court could suspend laws which contravened EU law. Subsequently, the highest UK court did strike down the Merchant Fishing Act.

The logical necessity of this principle is just as clear as that of direct effect. Simplifying for clarity's sake, 'direct effect' says that EU laws are automatically laws in every Member State. Primacy says that when EU law and national, regional or local laws conflict, the EU law is what must be enforced.

Autonomy

Most European nations have several layers of courts – local, regional and national. The lower courts, however, do not exist independently of the higher courts, and often the higher courts depend upon the lower courts (e.g. in some nations, the high court can rule only after the case has been tried at a lower level). The EU legal system, however, is entirely independent of the Member States' legal systems according to the principle of autonomy.

2.4 The 'Big-5' institutions

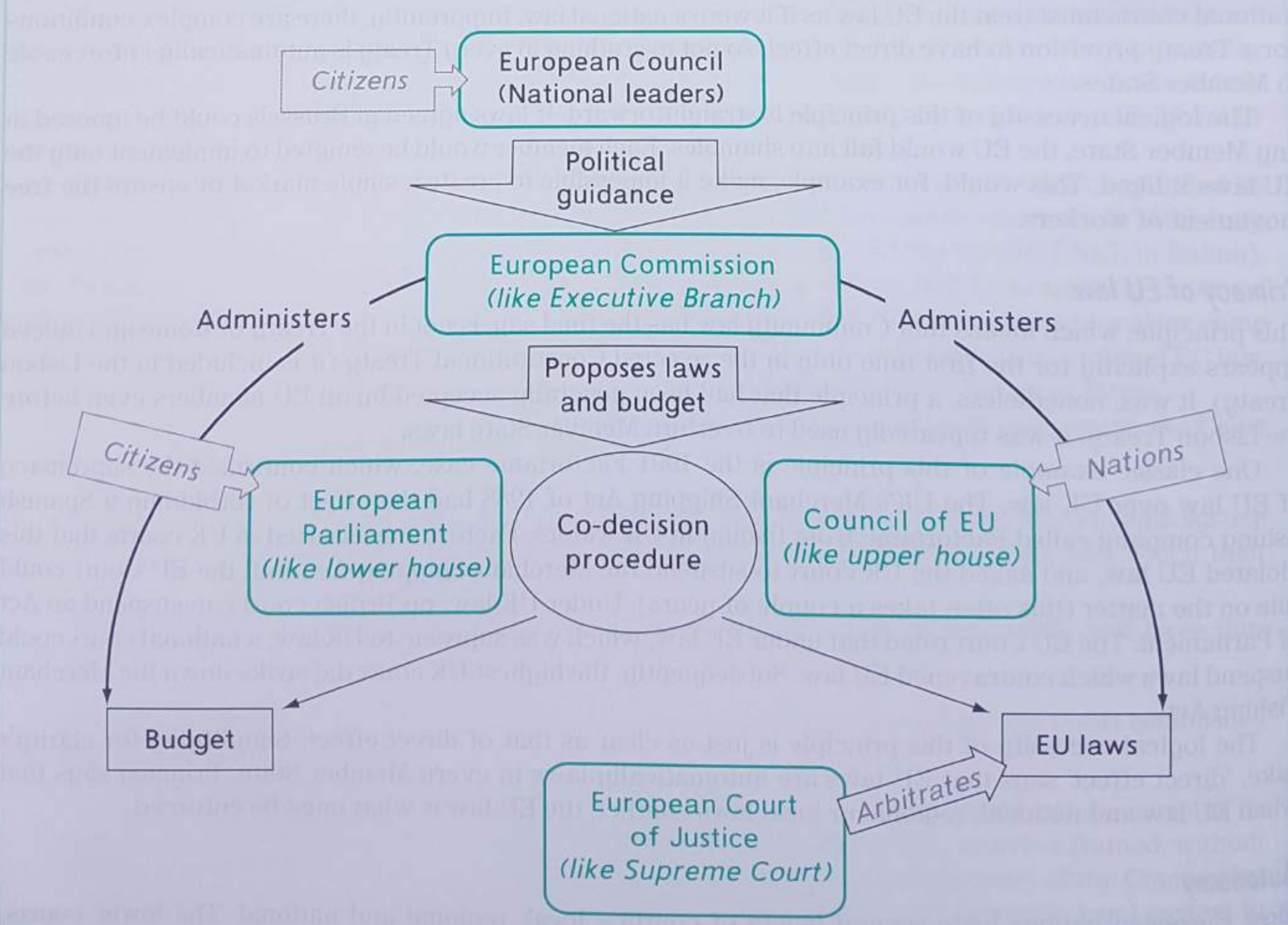
There are many EU agencies, bodies and committees, but one can achieve a very good understanding of how the EU works by knowing about the 'Big-5'. Somewhat confusingly, their names tend to be changed in each new treaty. Using the current names as defined in the Lisbon Treaty, these are:

1. the European Council (heads of state and governments);
2. the Council of the European Union (member nations' ministers), often called by its old name, the Council of Ministers;
3. the European Commission (appointed eurocrats);
4. the European Parliament (directly elected);
5. the EU Court (appointed judges).

On the other institutions, see Borchardt (2010). The European Central Bank and related institutions are now equally important, but they are intentionally separate from the Big-5. They are dealt with in Parts IV and V.

The relations between and basic roles of the Big-5 are summarized schematically in Figure 2.3.

Figure 2.3 Basics of EU institutional architecture



2.4.1 The European Council

The European Council comprises the EU's national leaders and as such is the highest political-level body in the EU. It provides political guidance to the EU as a whole, but especially to the European Commission. All EU major strategic choices are made by the European Council, sometimes in cooperation with the European Parliament. To facilitate cooperation with other EU bodies, the President of the European Commission, and the High Representative of the Union for Foreign Affairs and Security Policy attend the meetings but do not vote.

The European Council meets at least twice a year – and in recent years at least four times. The most important meetings come in June and December at the end of each six-month term of the Presidency of the EU. These June and December meetings are important, high-profile media events – the one aspect of the EU that almost every European citizen has seen on television.

Most important EU initiatives and policies are instigated by the European Council. For example, it provides broad guidelines for EU policy and thrashes out the final compromises necessary to conclude the most sensitive aspects of EU business, including reforms of the major EU policies, the EU's multi-year budget plan, treaty changes and the final terms of enlargements. This body is by far the most influential institution because its members are the leaders of their respective nations. Moreover, it usually takes decisions by consensus, so its decisions have the implicit backing of every EU national leader.

Following the Lisbon Treaty, the European Council is now chaired by a president selected by the Council itself, who serves a 2.5-year term.[2] The first President, Herman van Rompuy, served until November 2014. The current president, who will serve up till the end of 2019, is Donald Tusk. The President leads preparations for European Council meetings and ensures follow-through on its decisions. The President represents the EU at international summits in the area of foreign and security policy.

The 'Conclusions' and lack of legislative power

The most important decisions of each Presidency are contained in a document known as the 'Conclusions of the Presidency', which is published at the end of each European Council meeting. Students who want to track the EU's position on a particular topic – be it the need for a constitution or its position on Zimbabwe – will do well to start with the Conclusions (go to www.european-council.europa.eu).

One peculiarity of the EU is that the most powerful body by far – the European Council – has no formal role in EU law-making. The political decisions made by the European Council are translated into law following the standard legislative procedures (more on this below).

Confusingly, the European Council and the Council of the EU (what was called the Council of Ministers before Lisbon) are often both called 'the Council'. Moreover, neither of these Councils should be confused with the Council of Europe, which is an international organization set up in the 1940s and entirely unrelated to the EU.

2.4.2 The Council of the EU

The Council is the EU's main decision-making body. Its official name is the Council of the European Union (since the Lisbon Treaty) but it was called the Council of Ministers for most of the EU's history (and many people still use that name). Almost every piece of legislation is subject to its approval. The Council consists of one representative from each EU member. The national representatives must be authorized to commit their governments to Council decisions, so Council members are the government

[2] The President is selected on the basis of so-called qualified-majority voting (a system of weighted votes with large nations getting more weight). Chapter 3 describes this voting system in full. Before the Lisbon Treaty, the European Council was chaired by the head of the nation holding the Presidency of the EU. As the Presidency of the EU rotated every six months, and different members had different priorities, the European Council's effectiveness tended to be undermined. Specifically, this rotation made long-term planning and multi-year efforts difficult to organize and carry through.

ministers responsible for the relevant area – the finance ministers on budget issues, agriculture ministers on farm issues and so on.

The Council is where the Member States' governments assert their influence directly. Since all EU governments are elected (democracy is a must for membership) and the Council members represent their governments, the Council is the ultimate point of democratic control over the EU actions and law-making. Although the European Parliament is elected directly, very few Europeans know the name of their Member of the European Parliament (MEP). European voters do, however, know the name of their Prime Minister – and will hold him or her accountable if something goes seriously wrong in the EU.

The Council is responsible for certain supranational areas (see Figure 2.2). To meet these responsibilities, it has the power to:

- Pass European laws (jointly with the European Parliament; see Section 2.5). Most of the laws passed concern measures necessary to implement the Treaties or simply to keep the vital parts of the EU running smoothly (the internal market, the Common Agricultural Policy, etc.).
- Coordinate the general economic policies of the Member States in the context of the Economic and Monetary Union (EMU; see Chapter 16 for details).
- Pass final judgement on international agreements between the EU and other countries or international organizations (a power it shares with the European Parliament).
- Approve the EU's budget, jointly with the European Parliament.

In addition to these tasks linked to economic integration, the Council takes the decisions pertaining to Common Foreign and Security Policies (CFSPs). To the average European, these are some of the most visible actions of the Council.

Although the Council is a single institution, it follows the somewhat confusing practice of using different names to describe itself according to the matters being discussed. For example, when the Council addresses European and Monetary Union (EMU) matters it is called the Economic and Financial Affairs Council, or Ecofin to insiders. One particularly important group is the Eurogroup comprising the finance ministers of the Eurozone nations. It meets the day before the Ecofin meeting to discuss matters because only Eurozone nations vote on issues relating to the euro in Ecofin.

Decision-making rules

The Council has two main decision-making rules. On the most important issues – such as Treaty changes, the accession of new members and setting the multi-year budget plan – the Council must decide unanimously. However, on most issues, the Council decides on the basis of a form of majority voting called 'qualified majority voting' (QMV). These rules are extremely important for understanding how Europe works, so they are the subject of extensive analysis in Chapter 3.

Presidency of the EU

One EU Member State at a time holds the Presidency, with this office rotating every six months. The Presidency nation sets the EU basic agenda and chairs all the Council of Ministers meetings except those dealing with foreign affairs and security policy, which are chaired by the High Representative of the Union for Foreign Affairs and Security Policy (more on this position below).

The High Representative of the Union for Foreign Affairs and Security Policy

This is a new post created by the Lisbon Treaty. The High Representative of the Union for Foreign Affairs and Security Policy (High Representative for short) attends Council of EU meetings, European Council meetings and Commission meetings. The Lisbon Treaty also created the European External Action Service to assist the High Representative. This is a new organization; its roles and form are still evolving. Its most obvious manifestation is the EU Delegations (something like an embassy) in about 150 non-EU nations.

2.4.3 The Commission

The European Commission is best thought of as the executive branch of the EU, but with a twist. It is also charged with 'safeguarding' the Treaties. Indeed, since the EU's foundation, it has been a key driving force behind deeper and wider European integration – often pushing, pulling and prodding EU Member States towards the goal of an ever-closer union. The body, based in Brussels, has three main roles:

1 to propose legislation to the Council and Parliament;
2 to administer and implement EU policies;
3 to provide surveillance and enforcement of EU law in coordination with the EU Court.

As part of its third role, it is responsible for ensuring that the Treaties are implemented and enforced.

The Commission also represents the EU at some international negotiations, such as those relating to World Trade Organization (WTO) trade talks. The Commission's negotiating stances at such meetings are closely monitored by EU members.

Commissioners and the Commission's composition

The European Commission is made up of one Commissioner from each EU member.[3] This includes the President and two Vice-Presidents. The current Commission President, Jean-Claude Juncker (a former Prime Minister of Luxembourg), was selected in 2014 to replace the outgoing President, José Manuel Barroso (a former Prime Minister of Portugal). Commissioners, including the President of the Commission, are appointed all together and serve for five years.

The appointments are made just after European Parliamentary elections and take effect in the January of the following year. The current Commission's term ends in 2019. Commissioners are effectively chosen by their own national governments, but the choices are subject to political agreement by other members and the President of the Commission. The Commission as a whole and the Commission President individually must also be approved by the European Parliament.

Each politically appointed Commissioner is in charge of a specific area of EU policy. In particular, each runs what can be thought of as the EU equivalent of a national ministry. These 'ministries', called Directorates-General, or DGs in EU jargon, employ a relatively modest number of international civil servants.

The Commission as a whole employs about 32,000 people, which is fewer than those who work for the city of Vienna. Just as in national ministries, Commission officials tend to provide most of the expertise necessary to administer and analyse the EU's vastly complex network of policies since the Commissioners themselves are typically generalists.

Commissioners are not supposed to act as national representatives. They are forbidden from accepting or seeking instruction from their country's government. In practice, Commissioners are generally quite independent of their home governments, but since they have typically held high political office in their home nations, they are naturally sensitive to issues that are of particular concern back home. This ensures that all decisive national sensitivities are heard in Commission deliberations. You can find the Commissioner from your own nation at ec.europa.eu/index_en.htm – along with all the others and their respective areas of responsibility.

The Commission has a great deal of independence in practice and often takes views that differ substantially from those of the Member States, the Council and the Parliament. However, it is ultimately answerable to the European Parliament since the Parliament can dismiss the Commission as a whole by adopting a motion of censure. Although this has never happened, a censure motion was almost passed in 2005. In 1999 a similar near-censure triggered a sequence of events that ended in mass resignation of the Commission led by President Jacques Santer.

Legislative powers

The Commission's main law-making duty is to prepare proposals for new EU legislation. These range from a new directive on minimum elevator safety standards to the reform of the Common Agricultural Policy (CAP). Neither the Council nor the Parliament can adopt legislation until the Commission presents its proposals, except under extraordinary procedures. This monopoly on the 'right to initiate' makes the Commission the gatekeeper of

[3] The original intention of the Lisbon Treaty was to reduce the number of Commissioners to less than the number of Member States, but a political promise made by EU leaders to Ireland annuls that goal, so there will be one Commissioner per member for the foreseeable future.

EU integration. It also allows the Commission occasionally to become the driving force behind deeper or broader integration. This was especially true under the two Delors Commissions that served from 1985 to 1994 and pushed forward the Single European Act and the Maastricht Treaty.

Commission proposals are usually based on general guidelines established by the Council of Ministers, the European Council, the Parliament or the Treaties. A proposal is prepared by the relevant Directorate-General in collaboration with other DGs concerned. In exercising this power of initiative, the Commission consults a very broad range of EU actors, including national governments, the European Parliament, national administrations, professional groups and trade union organizations. This complex consultation process is known in EU jargon as 'comitology'.

Executive powers

The Commission is the executive in all of the EU's endeavours, but its power is most obvious in competition policy. Chapter 11 explains in more detail how the Commission has the power to block mergers, to fine corporations for unfair practices and to insist that EU members remove or modify subsidies to their firms. The Commission also has substantial latitude in administering the Common Agricultural Policy, including the right to impose fines on members that violate CAP rules.

One of the key responsibilities of the Commission is to manage the EU budget, subject to supervision by a specialized institution called the EU Court of Auditors. For example, while the Council and Parliament decided the programme-by-programme allocation of funds in the EU's current multi-year budget (Financial Perspective in EU jargon), the Commission basically decides the year-by-year indicative allocation of Structural Funds across members.

Decision making

The Commission decides, in principle, on the basis of a simple majority. The 'in principle' proviso is necessary because the Commission makes almost all of its decision 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 Commission decision that fails to attract the support of a very substantial majority of the Commissioners will almost surely fail in the Council and/or Parliament.

2.4.4 The European Parliament

The Parliament has two main tasks: sharing legislative powers with the Council of Ministers and the Commission; and overseeing all EU institutions, but especially the Commission. The Parliament, on its own initiative, has also begun to act as the 'conscience' of the EU, for example condemning various nations for human rights violations via non-binding resolutions.

The Lisbon Treaty boosted the power of the Parliament substantially, making it equal to the Council on most types of EU legislation. Especially noteworthy are the Parliament's new powers over the budget (in particular, agricultural spending where previously the Parliament had little say, and some Justice and Home Affairs issues). The European Parliament also gets an increased role in Treaty revision, an increased role in the selection of senior EU leaders and a right of refusal for most international agreements, including trade agreements.

In 2014, the European Parliament significantly stretched its power by effectively usurping the European Council's right to nominate the next President of the European Commission. Under the Lisbon Treaty, the European Council nominates the Commission President and the Parliament accepts or rejects this nomination. The Lisbon Treaty, however, included some vague language about the European Council taking account of the outcome of the European Parliamentary elections. Parliament proceeded to announce 'lead candidates' at the head of each major party and indicated that the Council should appoint the lead candidate from the party that won the most votes. In the 2014 elections, the centre-right party won about 29 per cent of the vote. However, as the voter turnout was just 43 per cent, the centre-right received votes from something like 12 per cent of the eligible EU voters (29 per cent of 43 per cent). Despite this meagre showing, the centre-right group claimed that their victory meant that the European Council should nominate their lead candidate, Jean-Claude Junckers. Britain strongly opposed both the procedure in general and the candidate in particular, but Junckers was appointed and will be the Commission President until the end of 2019.

Organization

The European Parliament (EP) has about 750 members, who are directly elected by EU citizens in special elections organized in each Member State every five years (most recently in May 2014). The number of Members of European Parliament (MEPs) per nation varies with population, but the number of MEPs per million EU citizens is much higher for small nations than for large. For example, in the 2014–19 Parliament, Luxembourg has six MEPs and Germany has 96, despite the fact that Germany's population is about 160 times that of Luxembourg.

The latest elections saw continued dominance of the centre-right and centre-left parties, the EPP and S&D, respectively (see Table 2.1). There was, however, a significant increase in the explicitly anti-European integration candidates elected (see Chapter 1 for discussion). The number of anti-EU MEPs rose in 16 of the 28 EU Member States, with the number doubling in Greece, Poland, Austria, Finland and Denmark. Even Germany elected seven anti-EU MEPs. In all, the strongly Eurosceptic parties won about 15 per cent of seats. It is a very diverse group and was unable to form an effective bloc. A number of these parties banded together in the 'Europe of Freedom and Direct Democracy' grouping.

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

Turnout in European Parliamentary elections has fallen steadily, from 62 per cent since the first election in 1979 to 43 per cent in 2014. This is quite low compared to the turnout for national government elections.

MEPs are supposed to represent their local constituencies, but the Parliament's organization has evolved along classic European political lines rather than along national lines (for details, see Noury and Roland, 2002). The European Parliament election campaigns are generally run by each nation's main political parties and MEPs are generally associated with a particular national political party. Although this means that over a hundred parties are represented in the Parliament, fragmentation is avoided because many of these parties have formed political groups. As in most EU Member States, two main political groups – the centre-left and the centre-right – account for two-thirds of the seats and tend to dominate the Parliament's activity. The centre-left grouping in the European Parliament is called the Party of European Socialists, the centre-right group is called the European People's Party.

National delegations of MEPs do not sit together. As in most parliaments, the European Parliament's physical, left-to-right seating arrangement reflects the left-to-right ideology of the MEPs. These party groups have their own internal structure, including chairs, secretariats, staffs and 'whips' who keep track of attendance and voting behaviour. The political groups receive budgets from the Parliament. Details on the size and national composition of the European Parliament can be found on http://www.elections2014.eu/en.

Location

The Parliament is not located in Brussels, the centre of EU decision making, but in Strasbourg owing to France's dogged insistence (the Parliament's predecessor in the European Coal and Steel Community, the

Common Assembly, was located in Strasbourg since it was near to the heart of the coal and steel sectors). Equally determined insistence by Luxembourg has kept the Parliament's secretariat in Luxembourg. Since Brussels is where most of the political action occurs, and is also the location of most of the institutions that the Parliament is supposed to supervise, the Parliament also has offices in Brussels (this is where the various Parliamentary committees meet).

The staffs of the Parliament's political groups work in Brussels. It is not clear how much this geographic dispersion hinders the Parliament's effectiveness, but the time and money wasted on shipping documents and people among three locations occasionally produces negative media attention.

2.4.5 Court of Justice

In the EU, as in every other organization in the world, laws and decisions are open to interpretation and this frequently leads to disputes that cannot be settled by negotiation. The role of the Court of Justice (often known by its pre-Lisbon Treaty name, the European Court of Justice, or the 'EU Court') is to settle these disputes, especially disputes between Member States, between the EU and Member States, between EU institutions, and between individuals and the EU. As discussed above, the EU Court is the highest authority on the application of EU law.[4]

As a result of this power, the Court has had a major impact on European integration. For example, its ruling in the 1970s on non-tariff barriers triggered a sequence of events that eventually led to the Single European Act (see Chapter 4 for details). The Court has also been important in defining the relations between the Member States and the EU, and in the legal protection of individuals (EU citizens can take cases directly to the EU Court without going through their governments).

The Court, which is located in Luxembourg, consists of one judge from each Member State. Judges are appointed by common accord of the Member States' governments and serve for six years. The Court also has eight 'advocates-general' whose job is to help the judges by constructing 'reasoned submissions' that suggest what conclusions the judges might make. The Court reaches its decisions by majority voting. The Court of First Instance was set up in the late 1980s to help the EU Court with its ever-growing workload.

2.5 Legislative processes

The European Commission has a near-monopoly on initiating the EU decision-making process. That is to say, it is in charge of writing proposed legislation, although it naturally consults widely when doing so. More importantly, this right of initiative affords the Commission a good deal of power over which new legislation is considered. For example, if France and Germany want a particular EU law to be passed, they have to first convince the Commission that it would be a good idea.

Once developed, the Commission's proposal is sent to the Council for approval. Most EU legislation also requires the European Parliament's approval, although the exact procedure depends upon the issue concerned. (The Treaties specify which procedure must be used in which areas.)

The main procedure is called the 'ordinary legislative procedure'. The Parliament and the Council have equal power in terms of approval/rejection and amendment.[5] The details of the ordinary legislative procedure are highly complex (see Box 2.6) but simple in concept. The Commission writes a proposed law and before it can be enacted (i.e., become law) both the Parliament and the Council have to approve it. But the Parliament and the Council can amend the proposed law, so the process works in sequence (so there is only one version of the proposal at any one time). This can lead to a couple of rounds of revisions. In any case, both bodies have to agree the same version if the proposal is to be enacted. The Council

4 The Lisbon Treaty lumps three EU courts (the Court of Justice, the General Court and the Civil Service Tribunal) under the label Court of Justice of the European Union; the first one is by far the most important.

5 Before Lisbon, the Council had more power as there were several important areas in which Parliament was only 'consulted' or was ignored altogether. The areas over which Parliament gained power include immigration, criminal judicial cooperation, police cooperation, and trade and agricultural policy.

Box 2.6 The ordinary legislative procedure in detail

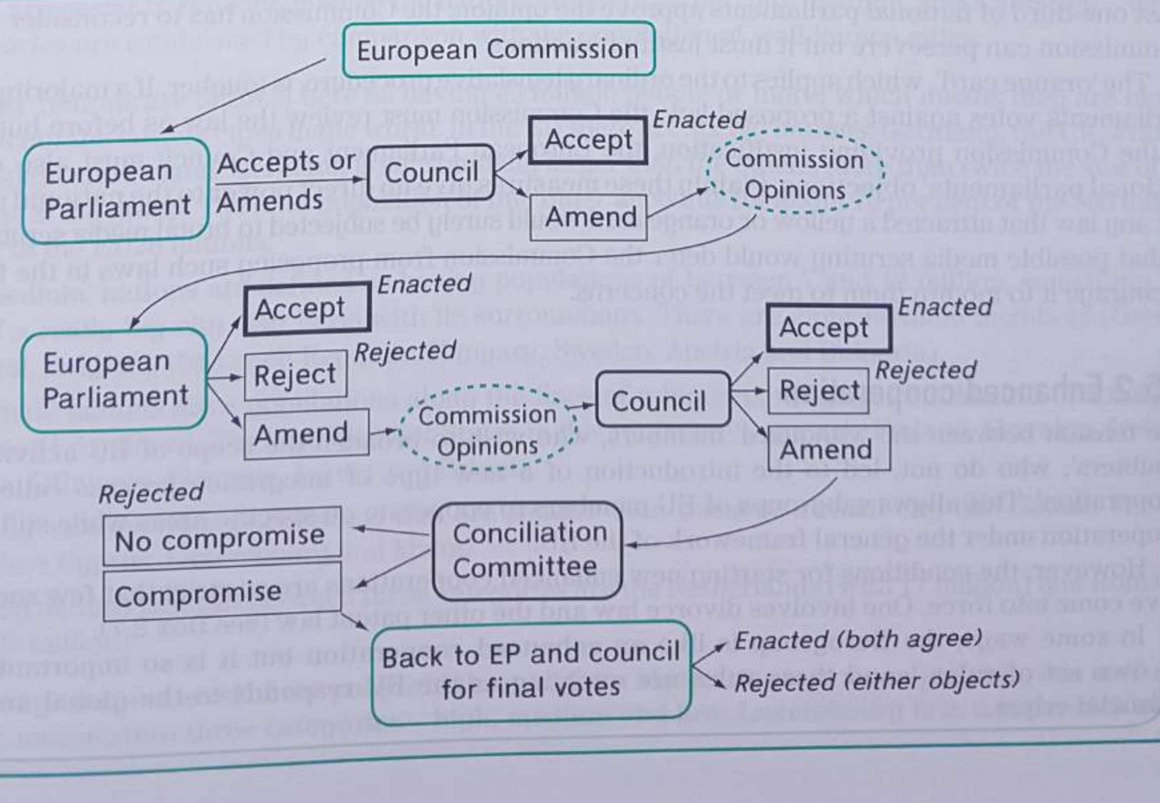
An elaborate consultation process between the Commission and other relevant EU bodies, business groups, labour unions, other civil society groups and in some cases foreign governments and international organizations is the first step. The Commission then drafts a proposed law and sends it to the European Parliament. The Parliament gets to act first; it either accepts the proposal or amends it. The proposal is updated to include any parliamentary amendment and sent to the Council. The Council approves the Parliament's position or suggests amendments. If the Council approves, the law (as amended by the Parliament) is adopted. If the Council amends it, the law is sent back to the Commission, which then approves or disapproves of the amendments.

The European Parliament then has three months to react (this is called the Second Reading). It can either accept the Council's amendments, provide further amendments of its own or reject the Council's amendments. In the first case, the law with the Council amendments becomes law (this also happens if the Parliament fails to act within three months). In the last case, the law is rejected and the process is stopped. In the middle case, another round is needed.

The amended law again goes to Commission (to get its opinions of the amended proposal) and then on to the Council. The Council has three options: accept, reject or amend. The outcome in the 'accept' or 'reject' cases are, as would be expected, either enactment (since both bodies approved the same proposal) or rejection of the proposal (see Figure 2.4). To avoid indefinite back-and-forth amendments, if the Council amends the proposal at this stage, the whole thing goes to a Conciliation Committee, which tries to hash out a compromise that both sides can agree to. If it manages such a compromise, it goes back to both the Parliament and the Council for a final yes-or-no vote; no further amendments are possible. The Conciliation Committee has six weeks to reach agreement; beyond that time period, the law is rejected and the process stopped.

The exact voting rules are complex but basically the Parliament acts on the basis of a simple majority (50 per cent of the MEPs voting) and the Council acts on the basis of a weighted voting scheme called 'qualified majority' (see Chapter 3 for details). The Commission's voice is also influential since the Council must act unanimously to accept an amendment that the Commission disapproves.

Figure 2.4 Ordinary legislative procedure



acts on the basis of a weight-majority system and the Parliament on the basis of a simple majority of MEPs voting.

There are also a couple of legislative procedures that rarely arise (see Box 2.6). The other 'special legislative procedures' foreseen in the Lisbon Treaty are re-labellings of existing procedures that were created to reduce the power of the Parliament on matters that are especially sensitive (mostly on grounds of national sovereignty). These are:

- *Consultation procedure.* Here, the Council can adopt legislation based on a proposal by the European Commission after merely consulting the European Parliament. Consultation is still used for legislation concerning internal market exemptions and competition law.
- *Consent procedure.* This procedure (which used to be called the assent procedure) allows the Council to adopt legislation (proposed by the Commission) after obtaining the consent of Parliament. In this way, Parliament can reject the law but it cannot formally propose amendments. The procedure applies to things like the admission or withdrawal of members.

Readers may find it useful to consultant the very good infographics at the European Parliament's site, http://www.europarl.europa.eu/about-parliament/en.

2.5.1 National parliaments

Member States' parliaments are not part of the EU institutional superstructure, but the Lisbon Treaty gives them a heightened role in guarding against competence creep, that is, the EU overstepping its authority and legislating in areas where it should not. For example, if a sufficient number of national parliaments are convinced that a legislative initiative would better be taken at a local, regional or national level, the Commission either has to withdraw it or clearly justify why it does not believe that the initiative is in breach of the principle of subsidiarity.

While national parliaments are mentioned in several places, the clearest examples are in the creation of what are known as 'yellow and orange cards'. These give national parliaments the right to express concerns on subsidiarity directly to the institution that initiated the proposed legislation. Under the 'yellow card' procedure, any parliament can, within two months of the release of a draft law, submit an opinion that the law violates the principle of subsidiarity. This triggers a voting system among national parliaments. If at least one-third of national parliaments approve the opinion, the Commission has to reconsider the law. The Commission can persevere but it must justify its actions.

The 'orange card', which applies to the ordinary legislative procedure, is tougher. If a majority of available parliaments votes against a proposed law, the Commission must review the law as before but, in addition to the Commission providing justification, the European Parliament and Council must also consider the national parliaments' objections. Plainly these measures give no direct power to the national parliaments, but any law that attracted a yellow or orange card would surely be subjected to brutal media scrutiny. The idea is that possible media scrutiny would deter the Commission from proposing such laws in the first place or encourage it to modify them to meet the concerns.

2.5.2 Enhanced cooperation

The tension between the 'vanguard' members, who wish to broaden the scope of EU activities, and the 'doubters', who do not, led to the introduction of a new type of integration process called 'enhanced cooperation'. This allows subgroups of EU members to cooperate on specific areas while still keeping the cooperation under the general framework of the EU.

However, the conditions for starting new enhanced cooperations are so strict that few such initiatives have come into force. One involves divorce law and the other patent law (see Box 2.7).

In some ways, the Eurogroup is like an enhanced cooperation but it is so important that it has its own set of rules – and these rules are evolving as the EU responds to the global and Eurozone financial crises.

Box 2.7 Divorce and the first enhanced cooperation

Divorce is never an easy thing, but it can get nightmarishly complicated with a mixed nationality couple with children. Even within the EU, divorce laws vary widely – from the no-fault, automatic policy of secular Sweden to devotedly Catholic Malta's lack of recognition of divorce – and it is not always clear which laws should apply.

The EU tried to simplify things and avoid spouses engaging in a trying and costly search for the 'best' set of divorce laws by agreeing a regulation (known as Rome III) that would specify which laws apply. The absolute refusal of Sweden and Malta to agree to the regulation (which must be agreed unanimously since such legal cooperation is a third-pillar issue) induced a subset of nations to proceed by requesting an enhanced cooperation on the matter. The group included Austria, France, Greece, Hungary, Italy, Luxembourg, Romania, Slovenia and Spain from the beginning; Germany, Belgium, Portugal and Lithuania are considering joining the initiative.

2.6 Some important facts

EU nations are very different, one from another. This simple fact is the source of a large share of the EU's problems and this makes it important to understand the differences. This section covers the facts on population, income and economic size. Readers can easily update the figures themselves using freely downloadable and well-organized data from the Eurostat website, http://ec.europa.eu/eurostat/.

2.6.1 Population and income

Before Brexit, there were about 510 million EU citizens, a figure that is substantially larger than the corresponding US and Japanese figures, but substantially smaller than those of China and India. After Brexit, the EU population will be about 66 million lower, but that still makes it much larger than the USA and much smaller than China.

The EU28 nations vary enormously in terms of population, as the upper panel of Figure 2.5 shows. The differences are easier to remember when the nations are grouped into big, medium, small and tiny – where these categories are established by comparison with the population of well-known cities:

- The 'big' nations are defined here as having 35 million people or more, which means they are bigger than all but the largest cities in the world. In the EU there are six big nations: Germany, the UK, France, Italy, Spain and Poland. Germany is substantially larger than the others, more than twice the size of the smallest in the group. The total population of the 'Big-6' accounts for about 70 per cent of the 500 million people in the EU28 nations.
- The 'medium' nations are defined as having populations of between 7 and 12 million, something like that of a really big city, say Paris with its surroundings. There are eight medium members (Greece, Portugal, Belgium, the Czech Republic, Hungary, Sweden, Austria and Bulgaria).
- The 'small' nations have populations along the lines of a big city, ranging from Madrid (5.4 million) to Lyons (1.6 million). The nine Member States in this range are Denmark, Finland, Slovakia, Ireland, Croatia, Lithuania, Slovenia, Latvia and Estonia.
- The 'tiny' nations have populations that are smaller than those of a small city like Genoa. The list comprises Cyprus, Luxembourg and Malta.
- The only nations that fall between these categories are the Netherlands (with 17 million) and Romania (with 20 million).

The average income level of the people in these nations also varies enormously. Again, it is useful to classify the nations into three categories – high, medium and low. Luxembourg is in a super-rich class

Figure 2.5 Population and income per capita (PPS), 2017

Source: Based on data from Eurostat.eu.

by itself; Luxembourgers are more than twice as rich as the French. One explanation for this is that Luxembourg is, economically speaking, a medium-sized city and incomes in cities tend to be quite high.

The high-income category – defined as incomes above the EU28 average (about €30,000 in 2017) – includes 11 of the 28 nations. In the medium-income category – defined somewhat arbitrarily as incomes between €30,000 and €25,000 – there are six nations. These are two 'old' members (Italy and Spain) and four new members (Malta, Czech Republic, Slovenia and Cyprus). Low-income nations, defined as those with per-capita incomes of less than €25,000, are Lithuania, Estonia, Portugal, Slovakia, Poland, Hungary, Greece, Latvia, Romania, Croatia and Bulgaria.

2.6.2 Size of EU economies

The size distribution of European economies is also very uneven, measuring economic size with total GDP. Just six nations, the 'Big-5' (Germany, the UK, France, Italy and Spain) and the Netherlands, account for about 75 per cent of the GDP of the whole EU. The other nations are small, tiny or minuscule, using the following definitions:

- 'Small' is an economy that accounts for between 1 and 3 per cent of the EU27's output.
  This includes Sweden, Poland, Belgium, Austria, Ireland, Denmark, Finland, Portugal, the Czech Republic, Romania and Greece.
- 'Tiny' is one that accounts for less than 1 per cent of the total.
  These nations are Hungary, Slovakia, Luxembourg, Bulgaria, Croatia, Slovenia and Lithuania.
- Minuscule is one that accounts for less than two-tenths of 1 per cent.
  The countries in this category are Latvia, Estonia, Malta and Cyprus.

2.7 The budget

The EU budget is the source of a great deal of both solidarity and tension among EU members, so it is important to understand the basics. It is also an issue that will increasingly dominate EU public discourse as the renewal of the seven-year budget plan (the so-called Multi-annual Financing Framework, MFF) comes up in 2020. Political fights concerning the MFF 2021–2027 will probably last right up to December 2020. Note that this is when the UK will stop making contributions to the EU budget (according to information available when this book went to press).

To organize the presentation of the budget, this section looks at four questions in order. What is the money spent on? Where does it come from? Who gets the most on net? How does the budget process work?

2.7.1 Expenditure

Total EU spending for 2017 was about €160 billion. While this sounds like a lot to most people, it is really fairly small. The total economic income generated in all EU28 taken together is about €16 trillion, so the budget spending is about 1 per cent of total income, or about €310 per EU28 citizen. The first priority here is to study how this money is spent. We look first at spending by area and then spending by EU member.

Expenditure by area

As with so many things in Europe, understanding EU spending in all its detail would take a lifetime, but understanding the basics takes just a few minutes. Starting at the broadest level, the EU spends its money on farming, poor regions and other things. These categories, however, attract a great deal of criticism, especially – as we shall see in Chapter 9 – that much of the agriculture money is given to large landowners.

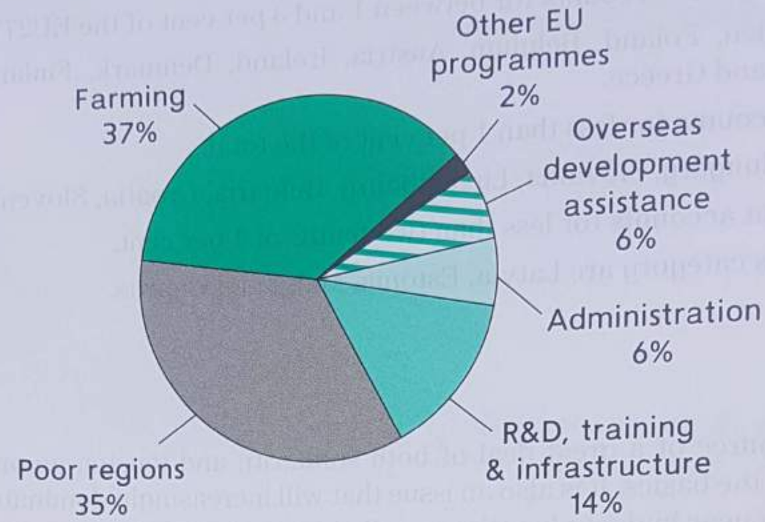
The official names of all main spending categories are not very clear for the very simple reason that they were changed to make them sound more positive. For example, the EU spends two-fifths of the budget on payments to farmers despite the sector's meagre contribution to EU growth, income and employment. To make this sound more in line with a forward-looking, dynamic EU, these expenditures were labelled 'Sustainable Growth: Natural Resources'. To clarify, we use plain English and focus only on the biggest areas (see Figure 2.6), which are farming (37 per cent) and poor regions (35 per cent). The rest is split among many different uses – the biggest being R&D and Training (14 per cent), Overseas Development Assistance (6 per cent) and Administration (6 per cent).

Spending on agriculture and poor regions is so important that we have written separate chapters dealing with each, so we do not go into further detail here (see Chapter 9 on agriculture and Chapter 10 on poor regions).

Historical development of EU spending by area

The EU's spending priorities and level of spending have changed dramatically since its inception in 1958. The EU budget grew rapidly, but started at a very low level (just 8/100ths of 1 per cent of the EEC6's GDP). EU spending was negligible until the late 1960s, amounting to less than €10 per EU citizen. This changed as the cost of the Common Agricultural Policy (CAP) started to rise rapidly in the 1960s and spending on poor regions – called 'Cohesion' spending in EU parlance – started to rise in the 1980s. From the early 1970s to the early 1990s,

Figure 2.6 The EU's 2014 budget



Source: Based on data from ec.europa.eu/budget/

the budget grew steadily as a fraction of EU GDP, starting from about 0.8 per cent and rising to 1.2 per cent in 1993. Since the 1994 enlargement, the budget as a share of GDP has remained quite stable at about 1 per cent.

From the mid-1960s, CAP spending began to dominate the budget. For almost a decade, farm spending regularly took 80 per cent or more of total expenditures; at its peak in 1970, it made up 92 per cent of the budget! From the date of the first enlargement, 1973, Cohesion spending began to grow in importance, pushing down Agriculture's share in the process. Indeed, the sum of the shares of these two big-ticket items has remained remarkably steady, ranging between 80 and 85 per cent of the budget. In a very real sense, we can think of Cohesion spending as steadily crowding out CAP spending over the past three decades.

2.7.2 Expenditure by type by member

By far the most important benefit gained from EU membership is economic integration. By comparison, the financial transfers involved in EU spending are minor. Remember that the whole budget is only about 1 per cent of EU GDP and the net contributions (payments to the EU minus payments from the EU) are never greater than one-tenth of 1 per cent. Be this as it may, many people are interested to see which members receive the largest shares of EU spending. Many EU disputes, after all, are over budget matters.

The amount and type of EU spending vary quite a lot across members (see Figure 2.7). Italy and Spain are the top recipients, with most of their money coming from EU payments to farmers and poor regions. There are a few other noteworthy patterns:

- Farming receipts are important for members with relatively large farm sectors like Denmark and Ireland.
- Spending on poor regions is more important for the poorer Member States such as the central and eastern European members.
- Almost all of Luxembourg's and Belgium's receipts come from administrative spending, that is, the EU institutions that are located there.
- The UK has remarkably low receipts for its size; Belgium, with a sixth of Britain's population, gets the same total.

Readers may find it instructive to download the data themselves and search for abnormalities in their own nation's receipts.

Figure 2.7 EU spending by member and type, 2012

Note: Cyprus CY, Malta MT, Slovenia SI, Estonia EE, Latvia LV, Croatia HR, Denmark DK, Lithuania LT, Finland FI, Sweden SE, Luxembourg LU, Austria AT, Ireland IE, Netherlands NL, Bulgaria BG, Slovak Republic SK, Portugal PT, Hungary HU, Czech Republic CZ, Greece EL, United Kingdom UK, Belgium BE, Romania RO, Germany DE, Poland PL, France FR, Italy IT and Spain ES.

Source: Based on data compiled by the authors from ec.europa.eu/budget/

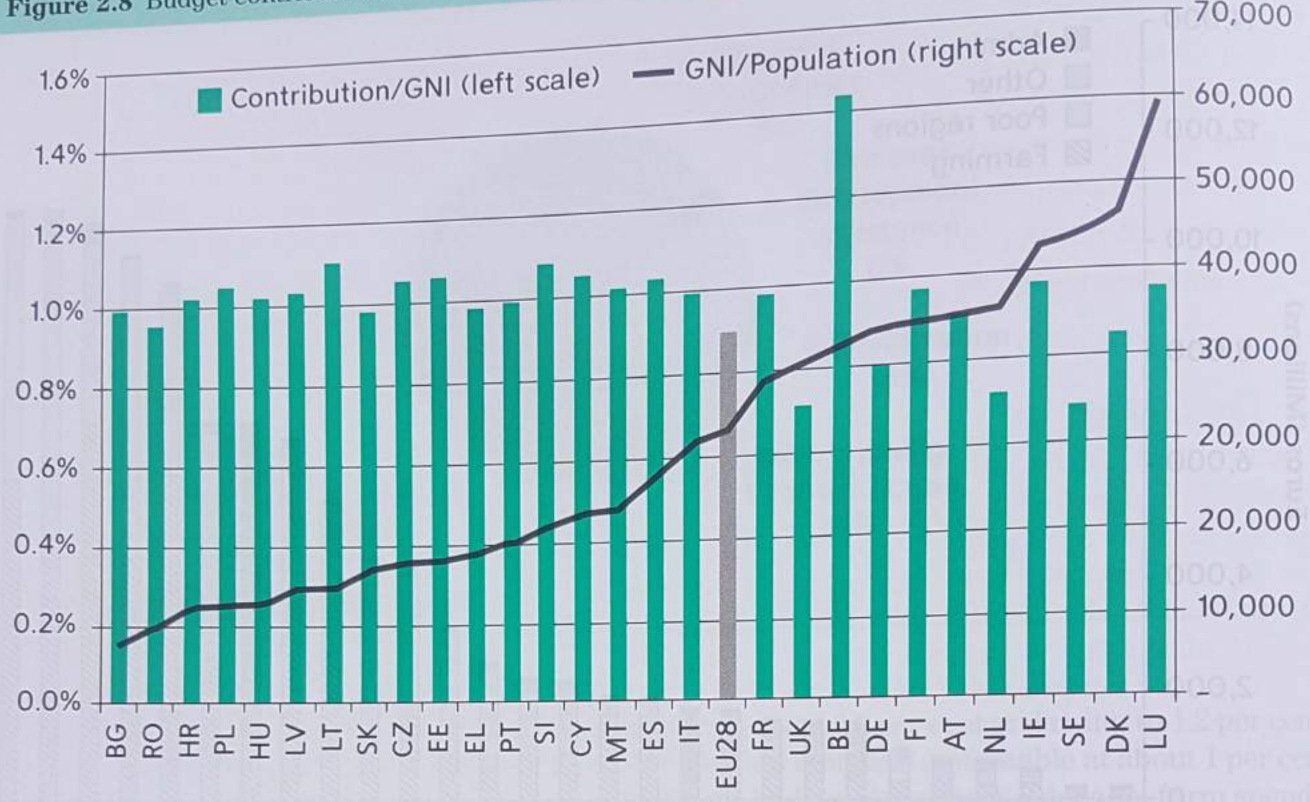
2.7.3 Revenue

The EU's budget must, by law, be balanced every year. All of the spending discussed above must be financed each year by revenues collected from EU members or carried over from previous years. The system is designed so that each EU member pays a bit less than 1 per cent of their GDP (see Figure 2.8). Some observers find this anomalous since taxation in most nations, especially in Europe, is progressive; that is, the tax rate that an individual pays rises with his or her income level. Belgium's contribution seems extraordinarily high but this is mostly an illusion. When goods come into the EU, they are charged a tariff. The EU nation that is the point of entry hands over this tariff revenue to the EU, but it still counts in the national contribution. Belgium's Antwerp port is a major gateway for world goods going to nations on the Rhine river, so many of the goods coming into Antwerp are actually going to other nations, but Belgium gets credit for handing over the money to the EU budget office.

Today, there are four main sources of revenue, which are known collectively as 'own resources' in EU jargon. Two of the four have long been used, and indeed in the early days of the Union they were sufficient to finance all payments. These so-called traditional own resources are:

- Tariff revenue stemming from the Common External Tariff (CET). Although trade within the EU is tariff-free, tariffs are imposed on imports from non-member nations. This money accrues to the EU rather than to any particular member.

Figure 2.8 Budget contribution as share of national income, 2016



Note: See Figure 2.7 for the country abbreviations.

Source: Based on data from the DG budget website, ec.europa.eu/budget/

- 'Agricultural levies' are tariffs on agricultural goods that are imported from non-members. Conceptually, these are the same as the previous category (they are both taxes on imports from third nations) but are viewed as distinct since the levies are not formally part of the CET. Historically, the level of these tariffs has fluctuated widely according to market conditions (they were part of the CAP's price support mechanism; see Chapter 9).

The importance of these two revenue items has fallen over the years to the point where they are no longer major items (together, they make up only one-seventh of the revenue needs). This reduced importance stems from the way that the level of the EU's external tariff, the CET, has been steadily lowered in the course of WTO rounds (e.g. the 1986–94 Uruguay Round). Moreover, EU enlargement and the signing of free trade agreements with non-members means that a very large fraction of EU imports from non-members is duty free. The level of the agricultural levies has also been reduced in the context of CAP reform. The third and fourth types of own resources provide most of the money. They are:

- 'VAT resource'. As is often the case when it comes to tax matters, the reality is quite complex, but it is best thought of as a 1 per cent value added tax. The importance of this resource has declined and is set to decline further.
- GNP-based. This revenue is a tax based on the GNP of EU members. It is used to top up any revenue shortfall and thus ensures that the EU never runs a deficit.

The other revenue sources are relatively unimportant.

To illustrate the interaction of contributions and receipts, it is useful to look at one very particular case – that of the UK – especially since the UK's contribution to the EU budget played a big role in the pre-referendum debate on Brexit.

Box 2.8 The UK budget contribution: net, gross and the rebate

The UK's budget contribution played a big role in the arguments made by the Leave campaign (those wanting to leave the EU). Most famously, the Leave campaign had a big red London bus with a sign on its side that read: 'We send the EU £350 million per week. . . .' This was widely acknowledged to be misleading, but what is the true figure?

Up until Brexit happens, the UK's payment to the EU and receipts from the EU are based on the general rules discussed above. As mentioned, the complex rules mean that each Member State pays about 1 per cent of its GDP to the EU, and receives money based on the general EU spending priorities. According to the general rules, the UK's total contribution (i.e., its 'gross' contribution) should have been about £19 billion in 2016, but that is not how much the UK paid, due to a peculiar arrangement called the 'UK Rebate'.

The UK Rebate was created in 1984 when then Prime Minister Margaret Thatcher objected to the fact that the UK was the largest net contributor even though it was far from the richest member. This large net payment was structural, arising from long-standing contribution and payment priorities. National contributions to the EU budget were (and still are) essentially based on the size of the member's economy, while the member's receipts are based on the number and size of farms and poor regions (about 80 per cent of EU spending goes to poor regions and farm owners). Because the UK has few eligible poor regions and its farming sector is relatively small, the UK ended up as a net contributor, which means it paid in more than it received. Instead of negotiating changes in the spending rules to ensure that the UK got more money (as other members have done), Thatcher insisted that the EU return some of the money in cash so as to reduce the UK's net payment.

The exact rebate arrangement in force today is complex, but the intent is to reduce the UK's net payment to about one-third the size it would be without the rebate. Importantly, each year's rebate is based on the previous year's figures, so the UK never makes the full contribution to the EU budget; it makes a contribution that is the full contribution minus the calculated rebate. For example in 2016, the normal rules would have had the UK pay £18.9 billion to the EU, but the rebate was £5.0 billion, so the UK Treasury only paid £13.9 billion to the EU in 2016. This is the 'gross' contribution and it amounts to about £267 million per week, not £350 million. EU spending in the UK amounted to £5.6 billion, so the UK's 'net' contribution was £8.1 billion which is about £155 million per week. In euros, the UK's net contribution amounted to about €10 billion at 2016 exchange rates.

Source: The information is drawn largely from Begg (2016), and the UK's Office of National Statistics website, https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/articles/theukcontributiontotheeubudget/2017-10-31.

2.7.4 Budget process

The budget is decided and controlled jointly by the European Parliament, the Council and the Commission. To avoid delays and problems, the EU's annual budget is guided by a medium-term agreement on spending priorities called the 'Multiannual Financial Framework', as mentioned above. The current framework sets out broad spending guidelines for the annual budgets from 2014 to 2020 (you can download it from ec.europa.eu/budget/).

The procedure for drawing up the annual budget (as laid down in the Treaties) calls for the Commission to prepare a preliminary draft budget. The Commission's draft is presented to the Council for amendments and adoption. Once it has passed the Council, the budget goes to the European Parliament, which has some power to amend it. After two readings in the Council and the Parliament, it is the European Parliament that adopts the final budget. For more information, see ec.europa.eu/budget/.

2.8 Summary

This chapter covered seven very different topics.

Economic integration

The economic integration in the EU was designed to create a unified economic area in which firms and consumers located anywhere within it would have equal opportunities to sell or buy goods throughout the area, and where owners of labour and capital would be free to employ their resources in any economic activity anywhere in the area. Such integration is implemented via the 'four freedoms' – the free movements of goods, services, people and capital.

EU organization

The organization of the EU changed after the 2009 Lisbon Treaty from a three-pillar to a two-pillar system. The first pillar (supranational decision making and the authority of supranational institutions such as the Commission and European Court) encompasses economic integration and some areas of Home and Justice Affairs. The other pillar includes areas in which EU integration proceeds on an intergovernmental basis, such as the Common Foreign and Security Policy. The treaties governing these areas are the Treaty on European Union (TEU) and the Treaty on the Functioning of the EU (TFEU).

Law

The EU is unique in that it has a supranational system of law. That is, on matters pertaining to the European Community, EU law and the European Court take precedence over Member States' laws and courts. The key principles covered were 'direct effect', 'primacy' and 'autonomy'.

Institutions and legislative procedures

While there are many EU institutions, only five really matter for most things. These are the European Council, the Council of Ministers, the Commission, the Parliament and the Court.

These five institutions work in concert to govern the EU and to pursue deeper and wider European economic integration. Under the main legislative procedure, now called the 'ordinary legislative procedure', the Commission proposes draft laws which have to be approved by the Council of Ministers and the European Parliament before taking effect. The three bodies work in sequence to ensure there is only one version of a proposed law at any one time. Most EU legislation has to be turned into national law by each Member State's parliament.

Facts

A dominant feature of the EU members is their diversity in size and income levels.

Budget

The EU budget is rather small, representing only 1 per cent of the EU's GDP. It is spent mainly on a set of agricultural programmes known as the Common Agricultural Policy (roughly 40 per cent of the budget) and on poor regions in the EU (roughly a third of the budget). The budget is funded through four different mechanisms but the result is that each EU member pays roughly 1 per cent of its GDP to the Commission, regardless of its income level.

Self-assessment questions

1 Draw a diagram like Figure 2.5 which includes the role of the national Parliaments.
2 Go online to find details on the EU budget and find what share of the budget is spent on the EU's fishery policies, the EU's ERASMUS programme, the EU's space programme.
3 Draw a diagram that shows how the power of the European Parliament expanded from 1959 to the Lisbon Treaty.

4 Develop an easy way of remembering the names of all EU28 members (e.g., when there were only 15 members, one way to remember was that there are four big ones, four small ones, four poor ones and three new ones).

5 Explain why the authority of the EU Court was such an issue in the Brexit negotiations.

6 List the main sources of EU revenue and the main spending priorities. Explain how each of these has developed over time. (Hint: you can find some very nice charts and data sources on this internet.)

7 Explain why it is important for the coherence of the Single Market that the European Court's rulings cannot be appealed in Member States' courts.

8 Make a table recording the major changes to each of the Big-5 institutions implied by the Lisbon Treaty.

References and further reading

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Further reading: the aficionado's corner

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For more economic statistics on Europe, see the most recent issue of the *Eurostat Yearbook*. This is well organized and provides directly comparable figures for all EU members. Eurostat, which used to charge for data, now allows free downloads of most data series. Much of the same information can be found in the Statistical Appendix to the Commission publication, *European Economy*. The OECD also provides an excellent statistical overview in its 'OECD in figures'. You can download the latest issue free of charge from www.oecd.org.

On EU law, an excellent source is *The ABC of EU Law* by **Klaus-Dieter Borchandt** (2018); this eBook can be freely downloaded. It is still the best freely downloadable text and has been fully updated to reflect changes instituted by the 2009 Lisbon Treaty: https://publications.europa.eu/en/publication-detail/-/publication/5d4f8cde-de25-11e7-a506-01aa75ed71a1.

Another well-written and succinct source is 'The European Union Today', published by the UK's House of Lords and written by **Maxine Hill and Matthew Purvis** (11 June 2010). Go to http://www.parliament.uk/business/publications/research/briefing-papers/LLN-2012-003/the-european-union-today.

Two other good sources of further information on the budget and a discussion of the many options and conflicts are:

Bruegel (a Brussels-based think-tank on European economic issues): http://www.bruegel.org/publications/publication-detail/publication/760-the-long-term-eu-budget-size-or-flexibility/.

Notre Europe (a think-tank established by Jacques Delors): http://www.eng.notre-europe.eu/011015-97-European-Budget.html.

Useful websites

The European Parliament's factsheets provide excellent, up-to-date, authoritative and succinct coverage of EU law, institutions, decision-making procedures and the budget process. It is a really great place to start when you are trying to figure out how or why or what the EU does in any area ranging from marine conservation to banking union: http://www.europarl.europa.eu/aboutparliament/en /displayFtu.html.

The most exhaustive (but also exhausting) source for information on EU law is the Commission's excellent website: http://europa.eu/legislation_summaries/.