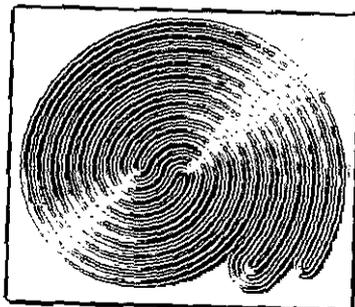


INSTITUTIONAL REFORM AND EXTERNAL ACTION  
OF THE EUROPEAN UNION : PORTUGUESE PRESIDENCY

LISBOA, 11-12 NOVEMBER 1999

IEEI



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**IEEI**

**Instituto de Estudos Estratégicos e Internacionais**

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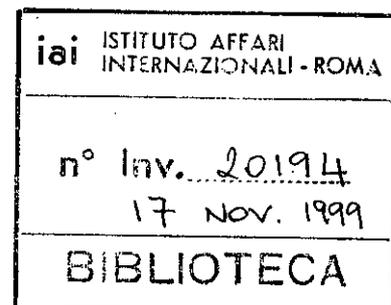
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**PORTUGUESE PRESIDENCY  
INSTITUTIONAL REFORM AND EXTERNAL ACTION  
OF THE EUROPEAN UNION**

Instituto de estudos estratégicos e internacionais (IEEI)

Lisboa, 11-12/XI/1999

- a. Programme
1. Sessão de abertura / José Calvet de Magalhães
  2. "The Portuguese presidency and the present European environment" / Andrew Duff
  3. "Old foundations and new rules for an enlarged European Union" (EUI policy paper RSC 97/1) / José I. Torreblanca
  4. "The evolving relationship between Europe and the United States" / Alfred van Staden
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  6. "La défense européenne après le Kosovo" / Nicole Gnesotto
  7. "The Euro influence on financial consolidation and regulation in the preparation for the accession to EU : the case of the Czech Republic" / Karel Zeman

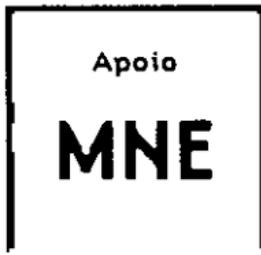


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# XVII CONFERÊNCIA Internacional Lisboa

Presidência Portuguesa  
Reforma Institucional  
e Acção Externa da  
União Europeia

11 e 12 de Novembro de 1999



## Sexta-feira, 12 de Novembro

09:30 **A Política Externa Europeia no pós-Amsterdão**

MODERADOR **MARIA DO ROSÁRIO MORAES VAZ**, IEEI, Lisboa

**GIANNI BONVICINI**, Director, IAI, Roma

**FERNANDO JORGE CARDOSO**, IEEI, Lisboa

**UWE SCHMALZ**, IEP, Bona

11:00 *Pausa para café*

11:30 **Contribuição dos Futuros Estados  
Membros para a PESC**

MODERADOR **CARLOS GASPAR**, Universidade Lusíada, Lisboa

**ANDRÁS BALOGH**, Director, HIIA, Budapeste

**ANTON BLEBER**, Universidade de Liubliana

15:00 **A Política de Defesa Europeia:  
Lições do Kosovo**

MODERADOR **ÁLVARO DE VASCONCELOS**

**NICOLE GNESOTTO**, Directora, ISS/UEO, Paris

**JOHN HOLMES**, Embaixador Britânico, Lisboa

**HANSPETER NEUHOLD**, Universidade de Viena

16:30 *Pausa para café*

16:45 **O Euro e a Regulação do Sistema Financeiro  
Internacional**

MODERADOR **ALEJANDRO LORCA**, Universidade Autónoma, Madrid

**VÍTOR CONSTÂNCIO**, BPI, Lisboa

**WOLFGANG WESSELS**, Presidente, TEPSA

**CONCLUSÕES**

**P**ortugal tem vindo a protagonizar, cada vez mais, os esforços da comunidade internacional no sentido de uma intervenção em prol da paz e do auxílio humanitário, levando, com o seu exemplo, alento e esperança aos povos martirizados por situações de conflito, como aconteceu nos casos da Bósnia, de Angola e de Moçambique.

É neste contexto que Portugal acolhe, uma vez mais, a Conferência Internacional de Lisboa do IEEI. A Câmara Municipal de Lisboa, ao patrocinar esta décima-sétima edição da conferência, sob o tema *Presidência Portuguesa: Reforma Institucional e Acção Externa da União Europeia*, vem reiterar a vocação da cidade de Lisboa para unir povos e culturas em torno do ideal da Paz.

**JOÃO SOARES**

PRESIDENTE DA CÂMARA MUNICIPAL DE LISBOA

**P**ela importância dos temas discutidos, pela sua actualidade, pelo número e pela qualidade dos participantes, estrangeiros e portugueses, a Conferência Internacional de Lisboa, que o IEEI organiza desde 1981, passou a constituir um importante acontecimento cultural levado a cabo na nossa capital.

Muitos dos mais importantes institutos e organismos das mais diversas partes do mundo têm enviado representantes seus a estas conferências, apresentando comunicações sobre relevantes questões internacionais e participando em debates que, além do seu valor científico, constituem por vezes valiosos contributos para a formulação das políticas públicas.

A Câmara Municipal de Lisboa tem concedido sempre o seu alto patrocínio a esta iniciativa, que tem igualmente sempre recebido, desde o princípio, o apoio dos sucessivos governos.

**JOSÉ CALVET DE MAGALHÃES**

PRESIDENTE DO INSTITUTO DE ESTUDOS ESTRATÉGICOS E INTERNACIONAIS

## Friday, 12 November

09:30 **European Foreign Policy After Amsterdam**

CHAIR **MARIA DO ROSÁRIO MORAES VAZ**, IEEI, *Lisbon*  
**GIANNI BONVICINI**, Director, IAI, *Rome*  
**FERNANDO JORGE CARDOSO**, IEEI, *Lisbon*  
**UWE SCHMALZ**, IEP, *Bonn*

11:00 *Coffee-break*

11:30 **Contributions of Future Member States to CFSP**

CHAIR **CARLOS GASPAR**, Lusíada University, *Lisbon*  
**ANDRÁS BALOGH**, Director, HIIA, *Budapest*  
**ANTON BLEBER**, University of Ljubljana

15:00 **European Defence Policy: Lessons from Kosovo**

CHAIR **ÁLVARO DE VASCONCELOS**  
**NICOLE GNESOTTO**, Director, WEU/ISS, *Paris*  
**JOHN HOLMES**, British Ambassador, *Lisbon*  
**HANSPETER NEUHOLD**, University of Vienna

16:30 *Coffee-break*

16:45 **The Euro and the Regulation of the International Financial System**

CHAIR **ALEJANDRO LORCA**, UAM, *Madrid*  
**VÍTOR CONSTÂNCIO**, BPI, *Lisbon*  
**WOLFGANG WESSELS**, Chairman, TEPSA

**SUMMING-UP**

No primeiro semestre do ano 2000 Portugal assumirá a presidência do Conselho de Ministros da União Europeia. A realidade europeia é hoje consideravelmente diferente de 1992, quando Portugal assumiu, pela primeira vez, a presidência da então Comunidade Europeia. A União tem hoje quinze Estados membros e prepara-se para um novo alargamento, o euro é um facto. No entanto, diversos temas são hoje tão actuais como o eram sete anos atrás: a reforma institucional da União Europeia e a construção de uma política externa e de segurança comum, activa e com capacidade de actuação efectiva na cena internacional. Estes são os temas centrais da XVII Conferência Internacional de Lisboa, organizada em colaboração com a Trans European Policy Studies Association, uma rede de institutos europeus que organiza, semestralmente, conferências nos países que vão assumir a presidência da União Europeia.

A XVII Conferência Internacional de Lisboa tem, assim, como objectivo analisar os temas preponderantes da actual agenda europeia. Desde logo, a reforma institucional, pois será tarefa da presidência portuguesa dar início a uma Conferência Intergovernamental sobre a reforma das instituições europeias. Igualmente central será a dimensão de política externa e de defesa. Para além da concretização dos novos instrumentos e da nova orgânica da PESC, no quadro do Tratado de Amsterdão, o Kosovo, a exemplo do que tinha sucedido em 1992 com a Bósnia, pôs mais uma vez em evidência as fragilidades da política externa europeia. Simultaneamente, a crise do Kosovo gerou um novo impulso para o reforço da dimensão de segurança e defesa da União, trazendo este tema para a ribalta do debate europeu.

Finalmente, a conferência abordará dois outros temas: as relações entre a União Europeia e os Estados Unidos da América, uma parceria com uma vasta agenda e nem sempre pacífica, e o papel que o euro poderá desempenhar na regulação do sistema financeiro internacional.

# Quinta-feira, 11 de Novembro

## 09:30 Sessão de Abertura

JOSÉ CALVET DE MAGALHÃES, Presidente, IEEI, Lisboa

JACQUES VANDAMME, TEPSA, Bruxelas

JOÃO SOARES, Presidente da Câmara Municipal de Lisboa

JAIME GAMA, Ministro dos Negócios Estrangeiros, Lisboa

## 10:30 *Pausa para café*

## 10:45 A Presidência Portuguesa e o Actual Contexto Europeu

FRANCISCO SEIXAS DA COSTA, Secretário de Estado dos Assuntos Europeus, Lisboa

ANDREW DUFF, Deputado ao Parlamento Europeu, ERDL; TEPSA rapporteur

## 11:45 O Alargamento e a Reforma Institucional

MODERADOR MARIA JOÃO SEABRA, IEEI, Lisboa

PHILIPPE SCHMITTER, Instituto Universitário Europeu, Florença

JACEK SARYUSZ-WOLSKI, Instituto Europeu, Lodz

## 15:00 As Relações Euro-Americanas

MODERADOR ÁLVARO DE VASCONCELOS, Director, IEEI, Lisboa

RICHARD MORNINGSTAR, Embaixador dos Estados Unidos junto da União Europeia

ALFRED VAN STADEN, Director, Clingendael, Haia

VÍTOR MARTINS, antigo Secretário de Estado dos Assuntos Europeus, Lisboa

## 16:30 *Pausa para café*

## 17:00 Reforma Institucional: Eficiência e Democracia

MODERADOR CHRISTIAN FRANCK, GEPE, Bruxelas

GUILHERME D'OLIVEIRA MARTINS, IEEI, Lisboa

JOSÉ LUÍS DA CRUZ VILAÇA, Comité de-Sábios para a reforma do sistema judicial comunitário, Lisboa

*Esta conferência é organizado pelo IEEI com o patrocínio da Câmara Municipal de Lisboa, e em cooperação com a Trans European Policy Studies Association. Tem o apoio do Ministério dos Negócios Estrangeiros.*

*A cada sessão de trabalho segue-se um debate. Linguas: português e inglês, com tradução simultânea para inglês.*

# Thursday, 11 November

## 09:30 Opening Session

JOSÉ CALVET DE MAGALHÃES, Chairman, IEEI, *Lisbon*

JACQUES VANDAMME, TEP SA, *Brussels*

JOÃO SOARES, Mayor of *Lisbon*

JAIME GAMA, Minister of Foreign Affairs, *Lisbon*

## 10:30 *Coffee-break*

## 10:45 The Portuguese Presidency and the Present European Environment

FRANCISCO SEIXAS DA COSTA, Secretary of State for European Affairs, *Lisbon*

ANDREW DUFF, MEP, Constitutional Affairs Spokesman of the European Liberal Democrats, TEP SA Rapporteur

## 11:45 Enlargement and Institutional Reform

CHAIR MARIA JOÃO SEABRA, IEEI, *Lisbon*

PHILIPPE SCHMITTER, European University Institute, *Florence*

JACEK SARYUSZ-WOLSKI, European Institute, *Lodz*

## 15:00 Euro-American Relations

CHAIR ÁLVARO DE VASCONCELOS, Director, IEEI; *Lisbon*

RICHARD MORNINGSTAR, US Ambassador to the European Union

ALFRED VAN STADEN, Director, Clingendael, *The Hague*

VÍTOR MARTINS, Former Secretary of State for European Affairs, *Lisbon*

## 16:30 *Coffee-break*

## 17:00 Institutional Reform: Efficiency and Democracy

CHAIR CHRISTIAN FRANCK, GEPE, *Brussels*

GUILHERME D'OLIVEIRA MARTINS, IEEI, *Lisbon*

JOSÉ LUÍS DA CRUZ VILAÇA, Comité des Sages for the Reform of the Community Judicial System, *Lisbon*

*The conference is organised by the IEEI under the high patronage of the Lisbon City Council, and in co-operation with the Trans European Policy Studies Association. It is sponsored by the Ministry of Foreign Affairs.*

*Working sessions followed by discussion. Conference languages: Portuguese and English, with simultaneous translation into English.*

# SEVENTEENTH INTERNATIONAL Lisbon Conference

Portuguese Presidency  
Institutional Reform  
and External Action of  
the European Union

11 - 12 November 1999

iai ISTITUTO AFFARI  
INTERNAZIONALI - ROMA

17 NOV. 1999

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Lisboa



Presidência Portuguesa  
Reforma Institucional e Acção Externa da União Europeia

Lisboa, 11 - 12 Novembro de 1999

**Sessão de Abertura**

José Calvet de Magalhães

Presidente, Instituto de Estudos Estratégicos e Internacionais

Portugal irá assumir, pela segunda vez, a presidência da União Europeia, no primeiro semestre do próximo ano 2000 – o último ano do presente século e do presente milénio. Os problemas que a presidência portuguesa terá de defrontar poderão ser da mais alta importância para o futuro desenvolvimento da União.

Dependendo das decisões que serão tomadas na próxima cimeira de Helsínquia, a presidência portuguesa terá, certamente, que prosseguir no processo de negociação das novas adesões dos países da Europa Central e Oriental que se candidataram à participação na União; ocupar-se do grave problema do desemprego nos seus diversos países membros; ocupar-se igualmente das relações da União com as várias regiões onde tem particulares interesses e, nomeadamente, com a África; e, acima de tudo, procurar dar concretização às medidas já adoptadas ou projectadas para pôr em prática uma efectiva política externa e de segurança comum com uma componente de defesa, adoptando as reformas institucionais que o alargamento e a concretização da PESC implicam.

A marcha um tanto arrastada da União para uma verdadeira e actuante integração política exige, de facto, uma aceleração do processo federativo, que já alcançou uma etapa decisiva com a instituição da moeda única, mas que necessita de novos passos em frente com a criação de uma estrutura e um processo decisório eficazes, dotando a União de uma configuração política própria, para poder estar em condições de exercer uma acção estratégica no presente sistema de relações internacionais.

Portugal – considerado um pequeno ou médio país membro – tem uma maior responsabilidade quanto ao impulso que poderá dar na resolução dos problemas fundamentais com que a União actualmente se defronta. Além da responsabilidade que lhe cabe como simples membro da União, pelo facto de pertencer ao grupo dos pequenos países membros, a sua contribuição significativa para a resolução desses problemas retirará argumentos àqueles que advogam que só os países membros mais importantes poderão fornecer o impulso necessário à maior integração política da União.

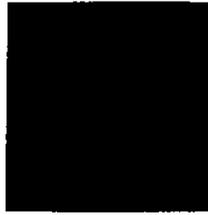
Entre as reformas institucionais mais importantes e exigentes conta-se a necessidade de alargar a lista das questões que poderão ser resolvidas por uma maioria qualificada. Na eventual revisão do sistema de ponderação de votos – sistema aliás, a meu ver, pouco feliz – deverá evitar-se que uma qualquer maioria de votos possa ser obtida com os votos conjuntos dos chamados países grandes; ou seja, para que uma maioria de votos seja válida, deverá ser necessário que inclua votos de um certo número dos pequenos países membros.

Finalmente, a presidência portuguesa fornecerá ao governo português a oportunidade de esclarecer melhor a opinião pública portuguesa sobre a verdadeira natureza da nossa participação no projecto europeu e as reais implicações da nossa qualidade de país membro da União Europeia. A adesão portuguesa ao Tratado de Roma não foi precedida por qualquer referendo popular ou debate de fundo na Assembleia da República. As razões então alegadas para a nossa adesão foram fundamentalmente a necessidade de consolidar o novo regime democrático instituído no país e a necessidade de obter apoio ao seu desenvolvimento económico e social. Foram razões perfeitamente válidas, facilmente compreendidas e aceites pela opinião pública portuguesa. O que não ficou porém claro, e ainda hoje não é inteiramente compreendido, mesmo em camadas mais informadas, é que,

com aquela adesão, o governo aceitou solene e livremente o projecto de integração política europeia subjacente ao Tratado de Roma, e que, para além das razões conjunturais e de interesse propriamente nacional apontadas, Portugal aceitou fazer parte de um sistema federativo de países europeus, com uma estrutura supranacional resultante de um processo consensual e evolutivo conduzido pelos respectivos membros. Essa estrutura já fez avanços consideráveis, como é o caso da criação de uma moeda única, e está em vias de atingir novas formas de integração política com a concretização da PESC e de uma defesa europeia. Isso implica que Portugal, como país que voluntariamente aderiu a essa construção, contraiu obrigações de solidariedade em relação à União que nem sempre são claramente apercebidas pela generalidade do povo português.

A futura presidência portuguesa da União permitirá, pois, que todas as implicações resultantes da participação portuguesa na construção consensual da federação europeia – qualquer que seja a forma definitiva que ela venha a assumir – sejam claramente expostas ao povo português.

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XVII

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Internacional

Lisboa



Portuguese Presidency  
Institutional Reform and External Action of the European Union

Lisbon, 11 - 12 November 1999

**The Portuguese Presidency and the present  
European environment**

Andrew Duff

MEP, Constitutional Affairs Spokesman of the European Liberal Democrats

Ladies and Gentlemen,

It is a great pleasure to be asked by the Instituto de Estudos Estratégicos e Internacionais to give the keynote contribution from TEPSA to this important pre-presidency conference.

It is 'pre-presidency' by about six weeks — give or take a few days for the Millennium celebrations (and a few more days for recovery from them).

These six weeks will not seem a very long time to the ministers and officials who have been working hard for many months to get the Portuguese machine into an advanced stage of preparedness. This time your preparations have been complicated by the recent general election. But at least you have been sensible enough to get the electoral campaign and the reorganisation of the government out of the way before you assume the Council presidency — and will thus avoid some of the domestic political problems that have beset so many recent terms of office of Council presidencies in other member states.

Portugal will take over from a very efficient and very well prepared presidency of Finland — possibly even over-prepared! The Helsinki European Council looks set to be, like Tampere, one of the more productive summits in recent times. You have a reformist European Commission now firmly in place; and (if I may say so) a rejuvenated European Parliament to be your interlocutor on the European scale.

It is the prime task of the Commission of Mr Prodi to set the work programme for the EU institutions not only for the next six months but also for the next five years. It is the job of the presidency to coordinate the Council's response to the Commission's initiatives, to help manage crises, and to share in the representation of the Union in world affairs. The presidency has a modest but vital role, and it is the passage from one presidency to another that allows TEPSA and its friends to confer upon the state of the Union, and to learn from the incoming presidency about its European priorities, anxieties and aspirations.

What, then, moves Portuguese European policy today? The main items of the EU's current agenda must include:

- the IGC and its two parallel exercises, the Charter of Fundamental Rights and the negotiations to settle Europe's arrangements in the field of defence;
- the Millennium Round of the World Trade Organisation;
- enlargement;
- the quest for a European social model;

- continued, and even spreading instability and danger in Eastern Europe.

There will certainly be other things that blow in suddenly from home and abroad to confuse and distract this presidency, as all presidencies, from its best-laid plans.

There may also be matters of special concern to Portugal, and we will learn about them during our stay in Lisbon. It is possible that, for each presidency in turn, the temptation is to try to put a national stamp on the work of the Union. In my experience, these national orientations — sometimes, even obsessions — usually fail.

For the outgoing Finnish presidency, the special priority was the so-called 'Northern Dimension'. The outcome here has not been especially or self-evidently fruitful, largely because of the inherent problematics of the Baltic region as well as the relative indifference of other member states to concentration on one region. But the Northern Dimension has required of the Finns much extra work and justification.

Portugal's equivalent would be the Mediterranean. Here, fortunately, the better prospects of peace in Palestine should at least allow some progress to be made. The Barcelona process may now escape from virtual imprisonment by the Middle East crisis.

### The IGC

Perhaps the greatest test of the presidency will be the conduct of the new Intergovernmental Conference (IGC) to change once again the foundation Treaties of the European Union. The role of the presidency cannot be underestimated at such conferences: a strong presidency can be very effective in forcing the pace of change; a weak Commission, by contrast can be completely marginalised in the process. The most successful IGCs have been run by presidencies who are not themselves significant *demandeurs* — a happy condition which, I think, will prevail for Portugal.

It is vital to recognise, and to keep in mind, that there is a link between improving the public policy that flows out of Brussels on the one hand and structural reform of the system of government of the Union on the other. Indeed, that is why we must endure another IGC: so that the citizen will see that European integration really is worth all the effort; that prosperity and security can be extended through greater solidarity between Europe's states and their peoples; and that the EU Treaty is the fundamental pact that forms the ties that bind.

I hope that Portugal therefore can be expected to be a strong proponent of the concept of EU citizenship, and that it will seek to progress the drafting of the new Charter of

Fundamental Rights so that the finished product, in December 2000, can be really meaningful — and, indeed, mandatory upon the EU institutions and member states in the implementation of EU law and policy. The Charter will need somehow to be written in to the revised Treaties. The IGC must leave a space for the enhanced citizenship rights, and the linkage between the drafting of the Charter and the negotiation of the IGC must be established and maintained.

Flowing directly from a decent Citizens' Charter is one of two key decisions — one radical and one conservative — of the IGC.

I refer to the need to widen the category of potential litigants before the European Court of Justice (ECJ). If the Charter is to be justiciable, every citizen must be granted direct right of access to the ECJ under a revised Article 173. Such a radical reform will ensure that the Luxembourg Court develops jurisprudence in civil liberties questions. Healthy competition with the Council of Europe's Court at Strasbourg will create circumstances in which the citizen can choose the best, quickest and cheapest form of litigation.

Conflict between the two Courts could be reduced if the EU as a whole were to adopt legal personality and sign up to the European Convention on Human Rights. As co-rapporteur of the Parliament on the Charter, I have to say, I favour such a dual track approach.

An ancillary but attractive consequence of the extended access to the ECJ would be that pressure groups and NGOs would have the incentive to scrutinise much more rigorously the delegated legislation coming out of the nexus of comitology because they would have the ability to seek judicial review if necessary. Speaking as an over-worked and under-paid European Parliamentarian, I can say how welcome this assistance to us would be.

A third category that should benefit from a widening class of privileged litigants in the ECJ must be member state (and in federal republics, regional) parliaments. This would allow national MPs to seek redress in Luxembourg on the grounds of *ultra vires*. For too long national parliaments have grumbled about European integration without doing much about it. Give national parliaments the power to challenge breaches of the principle of subsidiarity by the EU institutions, and they would have to put up or shut up.

My second key reform, and this a conservative one, is to entrench the constitutional elements of the Treaty in a first part of the Treaty that would be amendable in future only with extreme difficulty. Unanimity plus national ratification should continue to apply to those articles of the Treaty that state its values, set out its objectives, describe its decision-making procedures and establish citizens' rights. Included in this category of constitutional

articles would be those concerning the financial system of the Union, accession and secession, as well as the accretion of more competence by the EU institutions (Article 235).

A second part of the Treaty would contain the chapters concerning policy implementation, on transport and employment and so on. These articles would be amendable by a softer procedure, involving the European Parliament but without ponderous and protracted member state ratification.

It is important to recognise that in a Union of 25 member states Treaty amendment, even on small matters, will be very much more problematical than it is now. We have to build in more flexibility now if we are to avoid paralysis at some time in the future. That is why a reform of Article 48 at this IGC is essential.

The first part of this constitutionalisation process — the entrenchment — should serve to reassure those people who fear a creeping loss of national sovereignty to Europe. (I know there are some of these people even in Portugal.) The second part of the Treaty reform — introducing the more flexible method — should enliven the political debate at the EU level, offering the public the prospect of real choice, and stimulating the need for forceful representation within the institutions in Brussels and Strasbourg. Both parts of the reform would contribute to the development of the *parliamentary Europe* that I and my colleagues are keen to see.

We are discussing the IGC in more detail later in the conference, so I will say no more here. Apart from defence.

In defence policy we are on the brink of a brave new world. The old and fairly sterile campaign to establish a *European security and defence identity* is nearing its end, not because of interminable academic argument but because of the exercise of military power we saw above the skies and then on the ground in Bosnia-Herzegovina and Kosova. I have always seen Mr Milosevich as a throwback to the Second World War, Europe's last fascist dictator. It may be unfortunate that we had to go back fifty years later to the unfinished business of 1945 — but it has certainly spawned the radical review we needed of our mutual defence arrangements.

The IGC will have to draw the right conclusions from this experience, NATO's first at fighting a real war. The negotiations, led by the UK and France, yet continue, and there are still ambiguities in the position of both London and Paris. Portugal is no stranger to transatlantic relations, and as a loyal but small member of NATO it can contribute effectively as EU Council president-in-office to the resolution of these talks.

The TEPSA paper for this conference speaks of the European Union as being the 'natural organiser of a European security structure within NATO'. I think that is broadly right, although I would argue for a separate pillar under the Treaty — a European Defence Community — whose membership is wholly voluntary. This implies a clean break with the theory of Maastricht that sought to lump common foreign and security policy together with defence. In my opinion, that connection was as false as the now disproved but once popular notion that the Exchange Rate Mechanism of the European Monetary System would lead ineluctably to a single currency.

The fact is that some EU countries do not want the Article 5 guarantee of collective defence. Such reticence has to be respected. Others in an enlarged Union may want it in theory but might not effectively contribute to it in practice. Such incapacity has to be overcome.

All current and future member states of the EU, however, should be able to participate fully in the Petersberg tasks and the common approach to foreign policy that underpins them. CFSP, stripped of its defence connotations, should continue to make the transition towards the first pillar.

### **Special Lisbon European Council**

One of the least enviable tasks of the presidency is the special European Council in Lisbon on social policy matters. This will be marked by the efforts of Mr Blair to dissuade his partners from vain pursuit (as he would see it) of a single European social model and, instead, to embrace a new way towards social inclusion based on dynamic economic growth. The presidency will need to be very pragmatic, and even agile, in order to avoid a quarrel between the adherents of unreconstructed socialism and classical liberalism.

It would seem to me, as a witness to Portugal's structural reforms, and its enviable success at joining the euro, that it has much more to gain in letting Europe's different regions and varied tax regimes compete with each other rather than in forcing them to harmonise. If there is to be a model, let it be one where the internet is everywhere, where small firms are encouraged to take risks, where Europe's integrated capital markets has new opportunities to invest in infrastructure projects, where education and training is continually innovatory, and where the last remaining obstacles to the single market, especially in financial services, are removed. In these circumstances, Portugal's relative peripherality need not be a penalty: indeed, its lower labour costs will be turned to positive advantage.

And all Portugal's environmental sensibilities should be well to the fore in the negotiations about engines of growth, both in the domestic debate about a European 'third way', and also in the Millennium Round negotiations of the World Trade Organisation.

### **Welcome enlargement**

It would be natural for a small country on the Western periphery of the EU to have reservations about the huge enlargement in prospect far to the East. This would be a mistake, because Portugal has enjoyed a huge advancement since its accession to the Union, and it would be churlish to seek to deny comparable advantages to others whose GDP is even lower in respect of the EU average than was Portugal's in 1974.

The problem is that enlargement means a much larger range of issues to deal with as well as more numerous partners. It will not be easy to make a success of this enlargement without a greater degree of differentiation between existing members states. The prospect of 'reinforced cooperation' among a solid core around Germany and France raised anxieties for the then Portuguese government at Amsterdam. It may do so if raised again. But Portugal's long international experience — witnessed this year so painfully in the trauma of East Timor and in the more decorous withdrawal from Macao — should ensure that a broader set of issues will be brought to bear upon the Portuguese stance as it presides over the Council's drive towards the accession of new members.

Studied neutrality on Graeco-Turkish matters, while remaining a good member of NATO, should also ease your relationship with a Turkey that is willing to follow your example and to modernise itself on the basis of its European and democratic traditions.

Ladies and Gentlemen, the sails are set fair for this latest European voyage of Portugal, and the ship is in good trim. On behalf of the European Parliament and of the Trans European Policy Studies Association I wish you all good luck as you leave port.

*Brussels, 10/11/1999*

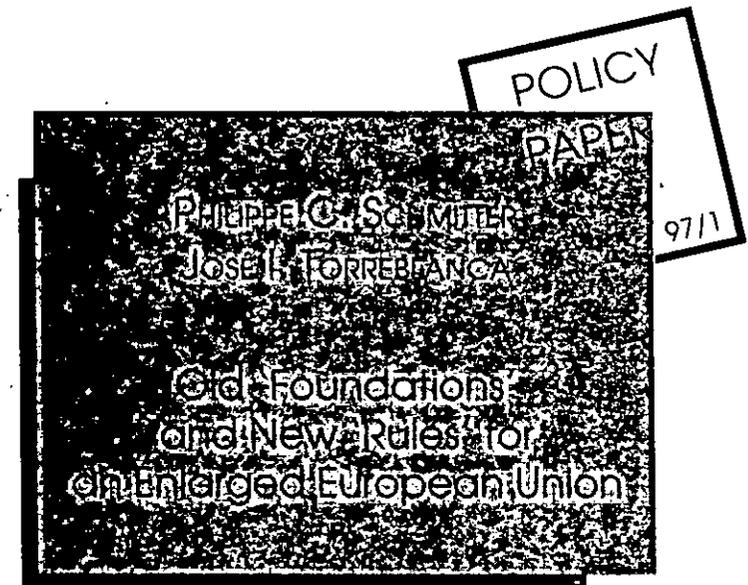
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**Old 'Foundations' and New 'Rules'  
for an Enlarged European Union**

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and

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[This is a draft manuscript of work-in-progress. However, you are encouraged to comment, circulate and cite it as much as you please, since we are very anxious to use it as a vehicle for stimulating debate on the subject of institutional reform in the EU. This essay will appear shortly in the working paper series of the Centro de Estudios Avanzados en Ciencias Sociales of the Fundación Juan March (Madrid) where it was originally written and presented, and in the working paper series of the Robert Schumann Centre of the Istituto Universitario Europeo (Florence) where it was subsequently discussed and revised. Eventually, it will appear as an appendix to a lengthier work by the senior author, tentatively entitled: How to Democratize the European Union and Why Bother, which should be finished by early 1998].

Please send any comments, criticisms or corrections by mail to Professor Philippe C. Schmitter, Dipartimento di Scienze Politiche e Sociali, Istituto Universitario Europeo, Badia Fiesolana, I-50016 San Domenico di Fiesole, Italia; by fax to ++39/55/46.85 201 or by email to: [schmitte@datacomm.iue.it](mailto:schmitte@datacomm.iue.it)

This essay presents a novel arrangement for the distribution of votes and the rules of decision-making in an enlarged European Union (EU).<sup>1</sup> It starts from the observation that if one merely transposes the present arrangement for the EU of 15 member states to prospective EUs with from 17 to 35 members, the result would be a very substantial distortion of one of the EU's most important "foundational principles," namely, its method for weighing the voting power of members according to their size of population. Under existing rules for qualified majority voting, it takes 62 out of 87 votes in the Council of Ministers -- needless to say, voting as a single body -- or 71% of the total to pass a measure and 26 votes out of 87 (30%) to veto one. This means that the five largest countries (Germany, France, the United Kingdom, Italy and Spain) can veto decisions, but cannot produce a qualified majority without help from either the five medium-size countries (Netherlands, Greece, Belgium, Hungary and Sweden) or the five smallest countries (Austria, Denmark, Finland, Ireland and Luxembourg).<sup>2</sup> Hence, the small and medium countries together cannot possibly form a qualified majority without the five largest ones, but they are able collectively to veto a decision. In other words, for the actual system to work effectively, cooperation is needed between all three size categories and, hence, the results are likely to be consensual.<sup>3</sup>

However, extending this system to a total of, say, twenty-seven members would violate the existing size principle in two important ways. First, the ten prospective newcomers from Central and Eastern Europe (CEECs) would alone have a veto possibility, based on an aggregate population of 105 millions or just 22% of the EU's total population. Second, it would become possible to form a qualified majority only by adding the largest countries and the medium-size ones -- not, as before, by adding the largest and either the medium or smallest ones. Any subsequent change in the direction of an absolute majority system would only further aggravate the problem by giving the medium and smallest countries, with only 26% of the population, a potential winning coalition over the seven largest countries with 74% of the EU's total population.

In contrast, a system that assigned votes in the Council of Ministers and seats in the European Parliament according to an uniform principle based in the square root of national populations has three advantages: (1) it would maintain the actual equilibrium and voting alternatives between the blocs of large, medium and small countries and, hence, presumably benefit from existing criterion of legitimation; (2) it would provide a predictable *ex ante* "assignment" of voting weights and parliamentary seats for prospective members in all possible future compositions of the EU; and (3) it should defuse the fear among existing member states that a voting bloc could emerge from the new members from Central and

Eastern Europe that might lead the EU into policy stalemate or a politics of sub-regional blackmail. We call this arrangement: **proportional proportionality**.

A second reform would go further toward ensuring a consensual decision-making system and, nevertheless, allow the expanding EU to be make commitments binding on all against the resistance of individual states -- even against the will of one of its largest members. An apposite device for doing this would involve dividing the votes in the Council of Ministers -- putatively, the EU's upper chamber -- into three *Colegii* according to the relative size of member states. All "constitutional" decisions involving important substantive reforms, rule changes or the admission of new members would have to receive the support of all three *colegii* -- instead of the present unanimity rule. Thus, no measure of major significance that was binding on all members could pass the Council unless at least a **simple majority of the weighted votes** of small, the medium and the large countries, voting separately according to proportional proportionality, approved it. For day-to-day matters, the present qualified majority or simple majority rules could be translated into the system of *Colegii*, but in a less demanding fashion. Normal directives or EU laws would be approved if they obtained a simple-weighted majority in at least two of the *Colegii*. In practice, this would mean that the (weighted) approval of *Colegio I* + *Colegio II* or *Colegio I* + *Colegio III* would suffice; whereas, the opposition of any two *Colegii* (including *Colegio II* + *Colegio III*) would amount to a veto. In the event of routine decisions currently governed by simple majority criteria, the same formula would apply, but only simple majorities would be required within each *Colegio* and for the Council as a whole. We call this a system of **concurrent majorities**.<sup>4</sup>

### The Present System

As we observed above, EU-15 works with a qualified majority voting procedure that requires 62 votes to be cast to reach a decision and 26 votes to veto a proposal. If we divide these fifteen member states -- *de facto* and not (yet) *de jure* -- into three *Colegii* of five members each based on their relative size, we get the distribution illustrated in Table I (in absolute terms) and in Table II (in relative terms).<sup>5</sup> *Colegio I* of the five largest states has 48 votes or 55%; *Colegio II* of the middle-size states has 24 votes or 28%; and *Colegio III* of the five smallest has 15 votes or 17% of the total 87 votes that can be cast. Any decision which receives a qualified majority in a *Colegio* automatically receives all of the weighted votes of that *Colegio*. Under such an arrangement, with the qualified majority established at 62 votes (71%), a positive decision can be reached either by adding the votes of *Colegii I* + *II* or *Colegii I* + *III*, but not by adding *Colegii*

II + III. However, any two Colegii can, if they vote in the same direction, veto a decision.

It is our assumption that the existing system is not merely an accidental product, but reflects an underlying principle that serves to legitimate decision-making among national states of very considerable diversity in their respective populations, geographical area and market power. We believe that this basic "size principle" should be conserved in the future as the EU incorporates new members.

Table I: The Present EU-15

		Pop.	Votes	Seats
I.	Germany	81.600.000	10	99
	United Kingdom	58.000.000	10	87
	France	58.000.000	10	87
	Italy	57.200.000	10	87
	Spain	39.600.000	8	64
II.	Netherlands	15.500.000	5	31
	Grece	10.500.000	5	25
	Belgium	10.100.000	5	25
	Portugal	9.800.000	5	25
	Sweden	8.800.000	4	22
III.	Austria	7.800.000	4	21
	Denmark	5.200.000	3	16
	Finland	5.100.000	3	16
	Ireland	3.600.000	3	15
	Luxembourg	400.000	2	6
	Total	371.200.000	87	626

Table II: Present relative weights

	Pop.	Votes	Seats
Colegio I	294.400.000 (79%)	48 (55%)	424 (68%)
Colegio II	54.700.000 (15%)	24 (28%)	128 (20%)
Colegio III	22.100.000 (6%)	15 (17%)	74 (12%)

The enlargement from EU-12 to EU-15 already produced several important crises. Great Britain bitterly resented any decrease in its potential veto power and envisaged a dangerous future in which "spendthrift" Southerners could outvote "abstemious" Northerners. Inversely, the Spanish government wanted to prevent the disappearance of the potential "Mediterranean Veto," according to which Spain (8 votes), plus France or Italy (10 votes each), plus Portugal or Greece (5 votes each), could reach the 23 votes necessary to veto any Council decision<sup>6</sup>. The so-called Ionannina compromise reflected the necessity to assure some countries that the decrease in their relative voting strength weight due to an eventual increase in membership would be taken into account, even if informally. In this particular compromise, it was decided that whenever any group of states representing 23 to 25 votes would oppose a decision to be taken by qualified majority, their negative opinion would be taken into account, even if these countries lacked to capacity (or will) to cast a formal veto, and the Council would try to find a satisfactory solution which could receive at least 65 votes (instead of the 62 necessary).<sup>7</sup>

Whether this particular solution will endure, the pattern of conflict behind it illustrates very well the problems that are bound to emerge with greater intensity in the future. Enlargement to the East (and, to a lesser extent, to the South with Malta and Cyprus) has to involve states with two characteristics that are most adverse to the present EU voting system: (1) either they are small in population and, hence, would have the net effect of increasing the already very considerable over-representation of small countries; or (2) they come from a geographically and culturally "compact" part of Europe and, hence, threaten to contribute further to the already considerable fear of regional bloc formation.<sup>8</sup> The emergence of Northern, Eastern and Southern or Mediterranean bloc voting could well unleash a broader uncertainty about where the "center of gravity" or "core area" of Europe really was -- and disrupt the current (implicit) consensus on Franco-German duopoly. The present system has, so far, proven to be tolerable, despite its gross disproportionality at the superior and inferior extremes of country size (see Table II: at present, 79% of the population has 55% of the votes), but it could be disrupted if overshadowed or displaced by regional solidarities.

### The Search for Alternatives

Actors seem aware of the potential serious destabilizing effect of maintaining and extending the present system to future configurations of the EU. It was one of the major preoccupations of decision-makers within the so-called "Reflection Group" that prepared the current Intergovernmental Conference

(IGC) on political reform. However, progress in this matter since the IGC first met in April of 1996 has been meager -- if non-existent -- due to the reluctance of member states to consider any alteration of their relative power under a new voting and decision-making system. A variety of formulae have been proposed without success, mainly because they have not been able to offer a system which is both effective and legitimate.

An examination of several alternative systems, all derived from Public Choice Theory, has recently been carried out by Torsten Peters.<sup>9</sup> The first one (the Shapley-Shubik Index) considers which country would be pivotal to the determination of winning coalitions, according to a given order of voting. The second (based on the Banzhaf Index) examines potential coalitions, instead of permutations, and attempts to find which countries can turn winning coalitions into losing coalitions by changing the direction of their vote. According to that system, larger countries can be pivotal more often than smaller ones. Finally, the third uses Holler's Index in an effort to correct what its author considers an overestimation of larger country capabilities inherent in the preceding two indexes and proposes a solution which results in a more equal distribution of weighted votes.

Peters then confronts the three indices with four different voting reform scenarios, while holding constant the number of states at fifteen. The results show clearly that any reform that reduces the number of votes necessary for a majority to be formed, will only marginally reduce the power of small states. Furthermore, if the requisite majority were reduced to a simple majority and, simultaneously, the number of countries required to form a majority is also decreased (to 9 or 8), the power of small states would even increase compared to the actual system.

In other words, the "common sense" solution to future enlargement, i.e. to reduce the number of votes and countries necessary to form winning majorities, would have precisely the opposite effect, if -- as will definitely be the case -- new members are predominantly small in size. In an EU with 27 members, decisions by simple majority would definitely be easier than by qualified majority, but they could be taken by member states representing only 26% of the EU's then total population (i.e. by 122.200.000 against 355.600.000 inhabitants). If, in reaction to this prospect, the 27 future members decide to maintain the present qualified majority system, the picture is not much more promising, since the Eastern European latecomers (Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia) with 41 votes out of 132 and a population of 22% would have a potential clear veto on all new measures<sup>10</sup>.

Table III: UE-27 with present system

	Countries	Votes
I.	Germany, U.K., France and Italy	10
	Spain and Poland	8
	Romania	6
II.	Netherlands, Greece, Czech Republic, Belgium, Hungary and Portugal	5
	Sweden, Bulgaria and Austria	4
III.	Slovakia, Denmark, Finland, Lithuania, Ireland and Latvia	3
	Slovenia, Estonia, Cyprus, Luxembourg and Malta	2

### A System with Concurrent Majorities and Proportional Proportionality

The combination of a decision-making arrangement based on three Colegii and the weighting of votes according to the square root of population appears (to us) to be an optimal solution that would keep the EU system working according to its present principles and allow it to adjust to any future configuration.<sup>11</sup> Let us see why.

We begin with the premise that any reform should respect *grosso modo* the actual system of relative weights between the larger, medium and smaller countries. We are looking for a device whereby the largest countries would still need the support of either the small- or the medium-size countries to obtain a binding majority. This is a system that guarantees the right to preeminence of the large countries while preventing them from "tyrannizing" the others. Also, since their concurrence is necessary, it makes it worthwhile for medium and small states to remain within the EU -- rather than to "free-ride" on its periphery. But the peculiarity of the system is that it also gives a fair, i.e. a proportionately proportionate, share of voting power to the medium and small states. Together, they cannot impose their will on the large countries, but together they can veto any proposal.

The obvious solution is to find a device or devices that could permanently insure the reproduction of such decision-making principles, no matter how many members the EU decides to admit in the future. An examination of the effect of weighing states' voting power according to the square root of their populations demonstrates the viability of such system in a Europe of 17, if and when the two small states of Malta and Cyprus are admitted; a Europe of 21, by adding the Visegrad Four; and a Europe of 27 that would include the ten Eastern European and Baltic states, but not the CIS, the Ukraine, Moldova, Croatia, Serbia-Montenegro, Macedonia, Albania or Moldova. It even works with a mega-Europe of 35 countries and 572 million inhabitants!

This can be accomplished by combining a qualified majoritarian system at the EU level with a qualified majority-bloc voting system at the level of the Colegii. The qualified majority rule would still hold globally because it would continue to be necessary for any directive to obtain 71 percent of the weighted votes for a proposal to become binding. Larger countries would still have to ally with either medium or small countries to obtain that 71%. Also in common with the present system, the medium and smaller countries could veto a proposal agreed to by the larger countries, if they voted together.

The basic difference is that voting in the Council would also take place *within* each of the three Colegii under a modified first-past-the-post system. Any coalition of countries whose weighted votes approved a directive/law within a Colegio would carry all the votes of that Colegio to the next stage.<sup>12</sup> As we shall see below in greater detail, this produces two net advantages. First, it would break up the possibility of forming dominant or veto blocs based on geographic or cultural regions, since the Northerners, Southerners and Easterners would be distributed among the three Colegii according to their relative size. By itself, this should suppress the fears derived from the typical instability of triadic systems which the prospect of three regional groups would surely unleash. Second, within each Colegio, the range of possible coalitions should be much more varied, permitting countries to align according to their particular preferences with regard to the policy issue at stake, rather than according to relatively fixed strategic calculations of relative power and status. For example, in EU-27, Colegio I would have seven countries. Germany plus the U.K, France and Italy would have an enabling majority, but Spain, Poland and Romania could also be in the winning coalition if they could convince any two of the four above to join them. In Colegio II with nine middle-size countries, any five countries could form the necessary majority, since they are so close to each other according to the size principle. Finally, in Colegio III with its eleven small members, the possible winning coalitions would range from any four of the largest to the five smallest plus at least two of the larger ones. The combinations are, thus, quite diverse -- one is tempted to say, **pluralistic** -- but relations between the Colegii should ensure a strong bias toward consensual solutions rather than the winner-take-all mentality of simple or even qualified majority systems in a single representative body.

To become a law or "directive" of the EU, a proposal would have to obtain a concurrent majority (CM) of 71% of the Council votes as a whole **and** a simple majority in at least two of the Colegii. For matters of constitutional importance, the criteria could be strengthened to include the requirement that a simple majority of the weighted votes in all three Colegii would be necessary.

The entire system rests on proportional proportionality (PP) derived from the square root of each country's population. We are assuming that this universalistic standard, while it deviates from the usual "one person, one vote" criteria applied in virtually all liberal democracies, would prove acceptable to the EU as a whole. In effect, what PP would ensure is that representation would be equal for similar **proportions** of the citizenry of different size political units. For example, ten percent of the population of Luxembourg (40,000 persons) would have approximately the same voting weight/number of seats as ten percent of the population of Germany (816,000 persons). Not only can this criterion be

defended normatively -- provided all agree that both Luxembourg and Germany deserve to persist in their present territorial/ demographic configuration -- but it is a more objective and easy to measure basis for differentiation than level of development, geographic location, religious conviction or any other cultural trait. Europeans have long lived in national societies of different size and this is predictably associated with varying intensities of feeling with regard to such things as language use, cultural preferences, institutional peculiarities, and so forth. If the larger countries refuse to recognize this proportionately fair criterion for over- and under-representation and insist on strictly numerical equality, any peaceful and voluntary effort to democratize the Euro-polity is bound to fail.

Table IV: EU 15 with PP & CM

		New Votes	Old Votes	New Seats	Old Seats
I.	Germany	12	10	88	99
	United Kingdom	10	10	74	87
	France	10	10	74	87
	Italy	10	10	73	87
	Spain	8	8	61	64
II.	Netherlands	5	5	38	31
	Greece	4	5	31	25
	Belgium	4	5	31	25
	Portugal	4	5	30	25
	Sweden	4	4	29	22
III.	Austria	4	4	27	21
	Denmark	3	3	22	16
	Finland	3	3	22	16
	Ireland	3	3	18	15
	Luxembourg	1	2	6	6
Total		85	87	624	626

If the proposed PP system were applied to the present EU-15 and the number of votes in the Council of Ministers remained unchanged at 87, the previous system maintains its basic features -- which is precisely the goal we have been seeking. Germany's votes would be increased to twelve (from 10) and Greece, Belgium, Portugal and Luxembourg would lose a single vote. A quick look at Table V shows how little variation in votes the new system would produce.<sup>13</sup> Thanks to the Colegio arrangement, it would still be necessary for one of the two smaller units to enter into a coalition with Colegio I for any measure to pass. Moreover, as we have discussed above, coalitions within each Colegio should be very fluid over time and across issues, given that any three of their five members can form a simple majority and obtain all the votes of that Colegio.<sup>14</sup> Now, let us see how the system would work when faced with three possible and successive enlargements.

### The Proposed System Applied to Future EU Enlargements

EU-17: Let us first speculate with what would happen should Malta and Cyprus enter the EU-15 as planned.<sup>15</sup> Under the present system, both countries, one with 400,000 and the other with 700,000 inhabitants, would be entitled to two votes in the Council. This would quite substantially alter the voting strength of the small member states since, by adding only slightly more than one million inhabitants to the Union (0.3%), it would increase their collective votes by 27%, i.e. from 15 to 19. Faced with that prospect, the fifteen could opt to do nothing. The sub-set of large countries could still not be overridden by a potential coalition of medium and smaller countries, and they would still need the votes of one or the other "size blocs." Needless to say, the (implicit) Southern or Mediterranean Veto would be strengthened to the delight of Spain and Italy and the dismay of Britain and the Scandinavians.

Table V: EU-15 -Present and Proposed Votes and Seats by Colegio-

	New Votes	Old Votes	New Seats	Old Seats
Colegio I	50 (59%)	48 (55%)	370 (59%)	424 (68%)
Colegio II	21 (25%)	24 (28%)	159 (26%)	128 (20%)
Colegio III	14 (16%)	15 (17%)	95 (15%)	74 (12%)

Table VI: UE-17 with PP and CM

	Population	Votes	Seats
I. Germany	81.600.000	14	96
United Kingdom	58.000.000	12	81
France	58.000.000	12	81
Italy	57.200.000	11	80
Spain	39.600.000	10	67
II. Netherlands	15.500.000	6	42
Greece	10.500.000	5	34
Belgium	10.100.000	5	34
Portugal	9.800.000	5	33
Sweden	8.800.000	5	32
Austria	7.800.000	4	30
III. Denmark	5.200.000	3	24
Finland	5.100.000	3	24
Ireland	3.600.000	3	20
Cyprus	700.000	1	9
Luxembourg	400.000	1	7
Malta	400.000	1	7
Total	372.300.000	101	701

If PP were applied to EU-17, winning majorities could be formed without including as many of the larger countries. The twelve medium and small-size members would have 42% -- if they voted together -- and the five large ones would have the remaining 58% votes in the Council.<sup>16</sup> Of course, according to the rules of the Council of Ministers, it would still be highly unlikely that its members would pass anything that could negatively affect the group as a whole and, on constitutional issues, this group would still have a veto. The strongest argument in favor of introducing the reform already for EU-17 is that it would serve to familiarize members with their new voting weights and allow them to begin experimenting with the formation of coalitions within each of the Colegii. Moreover, this would set a precedent under relatively easy conditions for negotiation since the immediate impact would be so negligible. A very important and contentious issue that is bound to plague much more complex enlargements in the future would have been resolved in a way that is universal, predictable and defensible in terms of democratic theory. Each potential member state would know before it entered into negotiations what its weighted vote would be and where it would fit within the decision-making procedures as a whole. The "shadow of the future" will have been clarified considerably, if not dissipated altogether -- and the conflicts surrounding eventual inclusion and exclusion should (hopefully) turn to other, more substantive, matters.

If the IGC on institutional reform were to adopt PP and CM, they might also choose a further simplification of EU rules. For example, they might set the number of weighted votes in the Council of Ministers at a fixed sum -- say, one hundred -- and make it even easier for everyone to calculate the possible impact of any enlargement.<sup>17</sup> This way, all eventual changes in membership would result in a (predictable) redistribution of weighted votes among the pre-existing members, as well as the assignment of new "quotas" to those just entering. Under the Colegii system, countries would be assigned to one of the three sub-groups according to the size of their respective populations.<sup>18</sup> If it was felt to be desirable to keep the Colegii more-or-less equal in terms of the number of members, specific countries could even be promoted from medium to large or small to medium status, although in so elevating themselves they would lose some of their proportional clout. Perhaps, one could allow them the choice of remaining a relatively large fish in a small pond or becoming a small fish in a larger pond! In any case, all of the fish -- no matter how small -- would get at least one vote.<sup>19</sup>

For EU-17, the results of PP and CM would be as follows, according to Table VI: (1) The "big guys" in Colegio I would have 58% of the votes and any three among them could win or veto a decision; (2) In Colegi II, with 29% of the total votes, the potential winning or vetoing coalitions seem indeterminant:

Austria plus any three of the others or the Netherlands allied with any two among Greece, Belgium, Portugal or Ireland; (4) Colegio III would only have 12% of Council votes and a considerable variety of potential combinations: the smallest three plus any two among Denmark, Finland or Ireland could veto, as could either of these three "big small countries" by joining the three smallest ones (Cyprus, Luxembourg or Malta). The overall principle is protected, however. If would still take a majority in Colegio I plus either Colegio II or III to win, and the combination of Colegio II and III can still veto.

**EU-21:** Now, the institutions of the EU are being put to a stiffer test, that of incorporating the so-called "Visegrad Four", i.e. the Czech Republic, Hungary, Poland and Slovakia.<sup>20</sup>

Table VII: UE-21 with PP and CM

	Population	Votes	Seats
I. Germany	81.600.000	11	78
United Kingdom	58.800.000	10	66
France	57.800.000	9	66
Italy	57.200.000	9	65
Spain	39.600.000	8	54
Poland	38.400.000	8	54
II. Netherlands	15.500.000	5	34
Greece	10.500.000	4	28
Czech Republic	10.300.000	4	28
Belgium	10.100.000	4	28
Hungary	10.100.000	4	28
Portugal	9.800.000	4	27
Sweden	8.800.000	4	26
III. Austria	7.800.000	3	24
Slovakia	5.400.000	3	20
Denmark	5.200.000	3	20
Finland	5.100.000	3	20
Ireland	3.600.000	2	16
Cyprus	700.000	1	7
Luxembourg	400.000	1	5
Malta	400.000	1	5
<b>Total</b>	<b>437.100.000</b>	<b>101</b>	<b>699</b>

The basic rule of qualified majority would still hold, since Colegio I (with Poland as its sixth "Great European Power") would have 54% of the total votes, Colegio II (now joined by the Czech Republic and Hungary) would have 29%, and Colegio III (with incoming Slovakia and descending Austria) 17%. Thus, the small and medium countries could veto but not decide; whereas, the largest countries would still need one of the two small Colegios to reach the necessary majority. Also, coalitions within each Colegio would be potentially quite varied - at least without reference to any specific substantive issue.<sup>21</sup> In Colegio I, the potential threat of a majority bloc composed exclusively of Mediterranean countries (France + Italy + Spain) is dissipated. Either the smallest four or the biggest three among the Great Powers can form a winning coalition. In Colegio II, the picture has become even more varied: out of seven countries, any four could produce a majority and the only stable alliance one might imagine would involve its four older members (Greece, Netherlands, Portugal and Belgium). This is not very likely given their behavior in the EU to date. In Colegio III, the biggest four countries could dominate, but so also could the smallest three if they could convince any three of the five remaining ones. Thus, the system of relative weights within Colegios plus the "first-past-the post" bloc voting provision assigned to each Colegio should guarantee respect for the one of the foundations of the present EU system, despite a major change in the number of players. There are still the internal checks and balances between different countries grouped by size, but no greater a propensity for stalemate or blackmail by hardcore recalcitrants.

**EU- 27:** Now let us see what happens to the properties of the EU system when PP and CM are applied to what many regard as its most likely final configuration -- at some indefinite moment in the Twenty-First Century. Besides the Visegrad Four, two Southeastern European countries (Bulgaria and Romania) and the three Baltic states (plus Slovenia in the very near future) have all signed association agreements with the EU. No doubt, their inferior economic conditions (not to mention the problematic consolidation of democracy in several of these countries) might defer their entry for some time; nevertheless, the EU's formal stance is that they will all become members.

Table VIII: UE-27 with PP and CM

		Population	Votes	Seats
I.	Germany	81.600.000	10	67
	United Kingdom	58.000.000	8	56
	France	58.000.000	8	56
	Italy	57.200.000	8	56
	Spain	39.600.000	7	47
	Poland	38.400.000	7	46
	Romania	22.800.000	5	35
II.	Netherlands	15.500.000	4	29
	Greece	10.500.000	3	24
	Czech Republic	10.300.000	3	24
	Belgium	10.100.000	3	23
	Hungary	10.100.000	3	23
	Portugal	9.800.000	3	23
	Sweden	8.800.000	3	22
	Bulgaria	8.800.000	3	22
	Austria	7.800.000	3	21
	III.	Slovakia	5.400.000	2
Denmark		5.200.000	2	17
Finland		5.100.000	2	17
Lithuania		3.700.000	2	14
Ireland		3.600.000	2	14
Latvia		2.600.000	2	12
Slovenia		1.900.000	1	10
Estonia		1.500.000	1	9
Cyprus		700.000	1	6
Luxembourg		400.000	1	5
Malta		400.000	1	5
Total	477.800.000	98	700	

And this is where and when the decision-making problems will surely become especially acute, unless the existing rules are changed. If not, as we have discussed above, the new "Eastern Bloc" of ten countries (out of 27) would be so over-represented that collectively they could veto all initiatives within the Council (while only having 22% of the EU-27's total population). This is presumably the menacing "shadow of the future" that all existing members have an interest in avoiding.

And the proposed combination of PP and CM would do just that -- without resorting to any explicitly discriminatory treatment. Especially if it could be implemented early enough, its effects should be perceived as generic and fair. It would tend to impede the formation of any geographically or culturally based "sub-regional" veto, just as it would continue to encourage the larger countries to take into account the preferences of their medium and small "partners."

In EU-27 with PP and CM, Colegio I joined by Romania would have a weight of 54%; Colegio II, now with Bulgaria in its ranks, would have 29% and Colegio III with four new members (the Baltic Republics + Slovenia) would have 17%. With the qualified majority remaining at 71% and the prospective veto at 30%, all of the checks and balances discussed above would continue to function. Within each Colegio, a considerable variety of winning and vetoing combinations have become possible -- and, moreover, they do not cluster by either level of development or geo-cultural region. In Colegio I, a coalition of Germany plus the next three "bigees" or one formed by the smallest three plus any two of the four largest countries would be able to pass directives and win all of its 53 votes. In Colegio II, any five of the nine countries composing it could produce a simple majority and obtain its 15 votes. In Colegio III, the necessary majority would be 9 out of 17 votes. Its five Eastern and Baltic members would have to attract either Denmark, Finland, Ireland, Cyprus, Luxembourg or Malta to their ranks in order to produce a majority -- and even then they would still have to join with a majority in either Colegio I or Colegio II to enact their preferred measures. Most likely, the pattern of voting in Colegio III with its more numerous (and one must add very heterogenous in terms of level of development) membership should be quite varied with possible majorities coming from any four of its two-vote members plus one of its five one-vote governments, while all of the five smallest countries in that Colegio would need at least two of the larger ones to reach an effective majority.

EU-35: We are now pushing the envelope of possible "Europes." And no one questions that the issue of such a "mega-enlargement" lies far in the future. EU-35 would include all countries that, for one reason or another and with one degree of seriousness or another, have expressed or might express in the future a

desire to enter the European Union. These prospective members include: Turkey, the Federal Republic of Yugoslavia (Serbia and Montenegro), Switzerland, Croatia, Norway, Macedonia, Albania and Iceland.<sup>22</sup>

Table IX: EU-35 with PP and CM

		Population	Votes	Seats	
I.	Germany	81.600.000	8	54	
	Turkey	61.900.000	7	47	
	United Kingdom	58.000.000	7	46	
	France	58.000.000	7	46	
	Italy	57.200.000	6	45	
	Spain	39.600.000	5	38	
	Poland	38.400.000	5	37	
	Romania	22.800.000	4	29	
II.	Netherlands	15.500.000	3	24	
	Yugoslavia	10.800.000	3	20	
	Greece	10.500.000	3	19	
	Czech Republic	10.300.000	3	19	
	Belgium	10.100.000	3	19	
	Hungary	10.100.000	3	19	
	Portugal	9.800.000	3	19	
	Bulgaria	8.800.000	3	18	
	Sweden	8.800.000	3	18	
	III.	Austria	7.800.000	2	17
		Switzerland	7.200.000	2	16
Slovakia		5.400.000	2	14	
Denmark		5.200.000	2	14	
Finland		5.100.000	2	14	
Croatia		4.500.000	2	13	
Norway		4.300.000	2	12	
Lithuania		3.700.000	2	12	
Ireland		3.600.000	2	11	
Albania		3.400.000	2	11	
Latvia		2.600.000	1	10	
Macedonia		2.200.000	1	9	
Slovenia		1.900.000	1	8	
Estonia		1.500.000	1	7	
Cyprus		700.000	1	5	
Luxembourg		400.000	1	4	
Malta	400.000	1	4		
Iceland	300.000	1	3		
Total		572.400.000	104	701	

Table IX shows that the application of PP and CM to a putative Euro-polity of this enormous scale -- 572 million inhabitants according to present figures! -- would not produce radically different potential political outcomes, even if one could question whether any mechanism of democratic representation and accountability could function effectively for such a demographically numerous and culturally varied population. To demonstrate that EU-35 is possible is not the same thing as arguing that it would be desirable.

The increase in number of countries belonging to Colegio III by five does not alter substantially the situation with respect to EU-27 as described above. Colegio I would get just one new member (Turkey), but only diminish its proportion of the total Council votes from 54% to 47%. Again, it would only be able to reach a qualified majority with the help of winning majorities among the medium or small states in either Colegio II or Colegio III. The former would have 26% of the votes (as opposed to 28% in EU-27) with 17% of the expanded European population. The latter would now have a total of 28 of the 104 votes in the Council, up from 17 of 98 in EU's previous configuration. Moreover, its 27% would correspond to 60 million Europeans, while Colegio II with almost 95 million would have one less vote. Despite this anomaly, by making voting concurrent among the three Colegios, its effect is nullified. As before, the PP & CM system works to prevent the larger states from being placed in a minority and to ensure that the medium and smaller states will not be marginalized or ignored. Those eight "Great European Powers" with 73% of the total population would have to be content with 47% percent of the voting power, while the rest of weighted votes would be almost equally distributed between the nine medium and the eighteen small states.

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Until proven wrong, we are convinced that the combination of proportional proportionality and concurrent majority offers the best solution for allocating weighted votes and for making binding decisions in the Council of Ministers of a continuously enlarging European Union. Its basic principles are consistent with those already in use and defensible in terms of democratic theory; its calculations are simple, predictable and open-ended; its procedures should promote flexibility and consensual decision-making; its results are likely to be sufficiently fair and other-regarding to encourage those who are outside the EU to join it and those who are inside the EU to remain within it.

## Some Reflections on the European Parliament

The critical (and democratically concerned) reader will surely have noticed that we have given scant attention to the European Parliament (EP) in this discussion of possible reforms in the rules of decision-making and voting. The observant reader, however, will have noticed that in each of the tables we have displayed the effect of applying PP to the distribution of seats in that body. In these tables, he or she can readily see how various future enlargements of the EU might be translated into changes in the distribution of seats for Members of the European Parliament (MEPs) if the method of weighing according to the square root of the country's total population were applied and if the eventual reformers were sensible enough to limit the total size of the EP to 700 MEPs. We see no reason why, if the principle of proportionate proportionality is acceptable for distributing votes in the Council of Ministers, it should not be used for same purpose in the Parliament. A quick perusal of the results it produces from EU-15 all the way to EU-35 would show that -- as intended -- it overrepresents the smallest countries in particular, but it does not radically alter the present system. Perhaps its major difficulty would have to be faced initially since such "biggies" as Germany (88 from 99), the United Kingdom (74 from 87), France (74 from 87) and Italy (73 from 87) would have to face a considerable reduction in their number of seats. It should be noted, however, that these large delegations could still be expected to wield a considerable amount of informal influence *via* party channels and that, in any case, the EP is not designed to represent "national" populations as such, but individual citizens.

What would not be appropriate would be to transfer the system of concurrent majorities to the European Parliament. The main purpose of the EP is to insert within the political process of the EU a different "partisan" mode of representation, one that can potentially moderate and counteract the effects of representation according to national states. In the EP, it is the individual citizen that is being (indirectly) brought into the process through the internal divisions of each country's party system and (eventually) through the formation of partisan alliances along transnational lines of cleavage and solidarity. Representatives in the EP are not expected to vote along national lines and it would make no sense to force them to do so through the concurrent majority system.

We can only think of two instances in which its division into three Colegii might make some sense: (1) if the EP were granted the power to force the resignation of individual Commissioners and if these Commissioners were nominated according the Colegii system, then it would seem proper that only the MEPs from the countries in the Colegio that initially proposed the candidate should have a definitive voice in determining whether that Commissioner should

remain in his/her position; (2) if it were felt that, for very significant decisions such as major rules changes or the admission of new members, the existing "Collegial" guarantees inbedded in the Council of Ministers were insufficient to ensure legitimacy before mass publics, then it might advisable to require that these decisions be approved by a concurrent majority of MEPs grouped by country size in the three Colegii.

Otherwise, the procedures of the European Parliament should be as close as possible to those of a "normal" national parliament with its self-elected leadership, its party caucuses, its standing committees, its majoritarian decision-making, and so forth. Admittedly, this will demand some major reforms in the future, especially with regard to the nature and uniformity of its electoral system, but to discuss them here would take us far beyond the intent of this short article.<sup>23</sup>

February 1997

\* ENDNOTES \*

<sup>1</sup> Actually, as Schmitter was reminded when he presented these ideas at a seminar of the *Cellule de Prospective* in Bruxelles, the arrangement it proposes is not really so novel. One participant came up afterward and remarked: "You know what you have done? You have re-invented the Holy Roman Empire!" Subject to further research on the matter, the accusation might not be as damaging as it sounds. After all, the HRE lasted for quite awhile, was a genuinely European creation, and probably made a net positive contribution to the integration of the European State System. Admittedly, it was not so good at preventing wars (and may even have encouraged a few), was consistently dominated by its larger members, and it had a strong reputation for corruption -- but no arrangement is perfect!

<sup>2</sup> The Treaty (Art. 148) establishes the qualified majority at 62 votes whenever a Commission proposal is involved and 62 votes representing at least ten member states in the rest of the cases. The clear intention is to avoid "government by size," i.e. that the largest eight member states acting together would be able to make rules binding all fifteen.

<sup>3</sup> It should be noted that this "hidden" rule operates whether or not the actual voting patterns vary according to the size of country. They are, so to speak, embedded in the context of voting in the EU's Council of Ministers and presumed to affect the behavior of member states by anticipation and habit, i.e. they "structure" actor preferences in advance. In any case, since Council voting is "opaque," there is no systematic and reliable way of verifying present behavior and, hence, of predicting how the change of rules we propose will affect future behavior -- which is not to say that those who have been directly involved will not be able to estimate their effect.

For a comprehensive assessment of how the Council operates, see Fiona Hayes-Renshaw and Helen Wallace, "Executive power in the European Union: the functions and limits of the Council of Ministers," *Journal of European Public Policy*, Vol. 2, No. 4 (December 1995), pp. 559-582. They estimate that contentious issues actually leading to formal voting by ministers -- whether by unanimity or qualified majority -- only amount to 10 to 15% of the total. The rest is settled consensually by senior officials at one level or another (p. 562). They also conclude that they could find "no systematic cleavage between smaller and larger members" (p. 577) -- which does not, we believe, argue against the utility of the Colegii system we propose. Our purpose is to preclude and preempt conflict among different sized countries, not to mirror or institutionalize this line of cleavage.

For the conclusion that all previous enlargements have enhanced the relative voting power of smaller EU members, see Madelaine O. Hosli, "Admission of European Free Trade Association states to the European Community: effects on voting power in the European Community Council of Ministers," *International Organization*, Vol. 47, No. 4 (Autuman 1993), p. 631.

<sup>4</sup> Unfortunately, the origins of this concept go back to an effort to structure the decision-making system of the United States in such a way as to ensure the perpetuation of slavery. Not exactly an auspicious start! John C. Calhoun, *A Disquisition on Government* (New York: Peter Smith, 1943), originally published in 1853.

<sup>5</sup> Population figures for all the Tables have been extracted from 1996 *Keesing's World Record of Events*, which uses United Nations data.

<sup>6</sup> Prior to the Nordic enlargement, qualified majority stood at 54 votes and veto at 23 with a total number of votes of 76. Spain argued that Norway, Finland, Sweden and Denmark, with only 23 million inhabitants, would have 13 votes at the Council; whereas, Spain would count on only 8 votes having a population of 39 million. With the support of the United

Kingdom, it fought unsuccessfully for new veto rights be awarded according to population criteria -- more specifically, whenever coalitions of two big and one small country representing 100 million inhabitants opposed a particular decision. Not coincidentally, Spain plus France or Italy plus Greece or Portugal made up that figure (see *El País* 2 March 1994, p.4).

<sup>7</sup> Council Decision of 19 March 1994, amended on 1 January 1995. See *Official Journal of the European Communities*, No. C 105 of 13 April 1994 and No. C 1 of 1 January 1995.

<sup>8</sup> As we observed above (FN 2), the issue is not whether the Eastern (or, for that matter, the Mediterranean or the Northern) countries "really" form a voting bloc, but whether they might be anticipated to do so on specific issues or at some specific moment in the future.

Moreover, the present system offers some perverse incentives. For example, the former Czechoslovak Federal Republic would have received five votes in the Council; whereas, the Czech and the Slovak Republics now that they have "velvetly divorced" might receive eight votes between them in EU-27. By submerging them within the weighted voting of the Colegii system these differential advantages would become less significant -- but not be eliminated altogether.

<sup>9</sup> Torsten Peters, "Voting Power after the Enlargement and Options for Decision Making in the European Union," paper presented at the *ECPR Joint Session of Workshops*, Oslo, April 1995. For further discussion of these competing indices of "voting power," see Geoffrey Garrett and George Tsebelis, "An Institutional Critique of Intergovernmentalism," *International Organization*, Vol. 50, No. 2 (Spring 1996), pp. 269-299 and Madelaine Holsti, "Coalitions and Power: Effects of QMV on the Council of the EU," *Journal of Common Market Studies*, Vol. 34, No. 2 (June 1996), pp. 255-274. As dazzling and "scientific" as these may seem, they are only as good as their initial premises -- which, to us, do not seem realistic. Much more promising is the approach taken by Kirman and Widgrén which attempts to put some substantive content into the simulations: "European economic decision-making policy: progress or paralysis?" *Economic Policy*, No. 21 (October 1995), pp. 423-460. For a knowledgeable critique of rational choice simplifications applied to Council voting, see the article cited in FN 2 by Fiona Hayes-Renshaw and Helen Wallace.

<sup>10</sup> Table III shows the authors' estimated weights. For another estimation, which excludes Malta and Cyprus, see Richard E. Baldwin, *Towards an Integrated Europe* (London: CEPR, 1992), pp. 186-187. Baldwin gives the ten CEECs 47 votes in an EU-25 of 134 votes. The differences seem to be due to the population figures used. For example, if Bulgaria were to reach a population of 9 million, it would obtain one more vote in the Council. Also, Baldwin is systematically more generous than we are in assigning votes to the three Baltic Republics.

<sup>11</sup> One might refer to this as "the Lampedusa Ploy" in honor of the author of *Il Gattopardo* who advised his fellow conservative Sicilians that "if things are going to remain the same around here, they are going to have to change." The trick for the EU, faced with enlargement, will be how to change its decision-making rules so that the present principle of equilibrium by size remains unchanged.

<sup>12</sup> It should be noted that there would be no necessity for the Colegii to meet formally and separately in order to tally the vote, although it would not be surprising if a certain amount of informal caucusing took place among large, medium and small countries. It also goes without saying that nothing in this scheme would prevent larger and medium-size countries from seeking to influence the voting of their smaller brethren in Colegii II & III. What the device does do, however, is to guarantee the relative bargaining power of the smaller countries in these informal log-rolls and trade-offs.

<sup>13</sup> Votes and seats have been rounded up in all tables. This explains why there are only 85 votes and 624 seats in Table IV and why, in the following tables, the totals do not always add

up to 100 (for votes) or 700 (for seats). Also, in the Council of Ministers, when the very smallest countries would be mathematically entitled to less than one half a vote, their weights have been increased to one.

<sup>14</sup> Except for the case of Luxembourg, whose diminutive size would naturally limit its coalition possibilities.

<sup>15</sup> Negotiations were scheduled to start six months after the conclusion of the 1996 IGC on institutional reform. However, the IGC will surely finish well into 1997, which would carry the opening of negotiations into January 1998 at the earliest. Moreover, the recent national elections in Malta seem to have resulted in the withdrawal of its application for membership. The Cypriot bid has long been stalled over the splitting of the island into Turkish and Greek parts, and a recent recrudescence of violent conflict would seem to have prolonged any serious consideration of entry. Nevertheless and however unlikely its eventuality now seems, we have gone ahead simulated the impact of their joint entry into the EU.

<sup>16</sup> Due to the rounding up of figures, Austria would maintain its 4 votes. However, given that in future enlargements, Austria would be corrected to 3 votes and sent down to Colegio III, we propose: (1) to maintain it in Colegio II but decrease its weight to 3; (2) sent it down to Colegio III while maintaining its weight at 4, or (3) maintain its 4 votes and let it stay in Colegio II, but raise the veto threshold to 31%. Any of these three modifications would void the possibility that Colegio II alone would be able to veto EU legislation.

<sup>17</sup> They might also choose to limit the total number of seats in the European Parliament to, say, 700 in order to facilitate discussion and internal procedures. For a similar suggestion, see Mathias Dewatripont *et al.*, Flexible Integration: Towards a More Effective and Democratic Europe (London: CEPR, 1995), p. 172. It should be pointed out that the authors of this collective report were predominantly economists and their concern was much more with effectiveness than democracy.

<sup>18</sup> Actually, it would be more democratic to assign votes, seats and Colegio membership according to the size of their respective citizenries. For most members, this would not change much since the criteria for eligibility for citizenship in Europe are rather standard these days, but it would have the effect of penalizing those countries that discriminate against "denizens" and have in their midst a substantial proportion of residents who are not eligible to vote or stand for office. Countries such as Luxembourg and Switzerland with their mercenary proletariats of "guest-workers" and those such as the Baltic Republics that discriminate against resident Russians, Ukrainians and Belorussians would be especially affected -- and for a good democratic reason.

<sup>19</sup> It might eventually be necessary to modify this rule if the mini-states of Europe became serious about joining the EU. Just imagine the effect of Andorra, Monaco, San Marino, the Vatican, the Isle of Man, the Farøes Islands and Liechtenstein on Colegio III!

<sup>20</sup> Though no exact dates have been given for entry, these four countries are often assumed to be in the best position for early entrance. Since December 1994 Essen's European Council, all the Central and Eastern European Countries (CEECs) enjoying association agreements with the European Union are placed on a 'pre-accession' path consisting of a 'structured dialogue' with the EU, a free trade area and legal convergence. At the Madrid Meeting of the European Council (December 1995), it was agreed that the 15 would try to make CEECs' entry negotiations coincide with those dealing with Malta and Cyprus. Thus, the start date would be equal for all and the accession date will depend on economic criteria. The general principles agreed upon at the European Council were: (1) non-discrimination; (2) early date for political entry; and (3) long-transitional periods (see: Commission of the European

Communities. European Council -Madrid 15 & 16 December 1995- Presidency Conclusions, Brussels, 16 December 1995, SI 95 1000).

<sup>21</sup> For an imaginative effort at simulating how different structurally determined preferences might affect voting on external trade and budgetary issues in an enlarged EU, see the article by Alan Kirman and Mika Widgrén cited in FN 8.

<sup>22</sup> Bosnia-Herzegovina has not been included due to the difficulty in determining the population and area that might define that polity in the future. Belorussia, the Ukraine, Moldova, Russia and the other former republics and units of the USSR have been considered "beyond the pale" of all possible future Europes. Recently, the heads of six "center-right" or "Peoples" parties (Belgium, Germany, Ireland, Italy, Luxembourg and Spain) announced that Turkey would never be admitted to the EU. Financial Times (5 March 1997), p. 2.

<sup>23</sup> Several proposals in this sense have been advanced in a longer manuscript of which this is an appendix. There, the senior author argues that the formula of concurrent majorities can also be applied to two other contentious areas of EU decision-making: (1) the **selection of Commissioners** (by giving each Colegio collectively the right to nominate 1/3 of them); and (2) the **composition of the Presidency** of the Council of Ministers (by establishing a three person collective executive for a fixed term with each of the chief executives chosen by one of the Colegio).

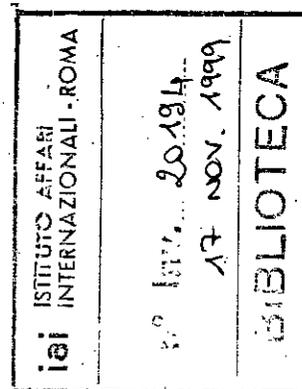


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**THE EVOLVING RELATIONSHIP BETWEEN  
EUROPE AND THE UNITED STATES**

Alfred van Staden

Director, Netherlands Institute of International Relations

'Clingendael'

At present, the three main dimensions of the transatlantic relationship are: a. security, b. trade and c. monetary affairs. There are clear cross-linkages between the related policy fields, on the understanding that the reduced need for Europe to rely on military protection by the United States since the collapse of the Soviet empire has increased the likelihood of the outbreak of conflicts in the non-security sectors. European countries are inclined to assert their interests more vigorously than in the past, whereas well-organised domestic interests in the US leave the current American administration little room to sacrifice short-term national interests. On the other hand, new opportunities have arisen to transform the mutual relationship into a more equal partnership. But it remains to be seen whether the window will be closed.

Until recently, Europe was only at par with the US in the domain of trade relations. By speaking with one voice it was able to convert its position as the world's largest trading bloc into effective negotiating strength vis-à-vis the US. There was American hegemony (or leadership) both on security and money. The realisation of the EMU and the introduction of a common European currency are now offering the prospect of establishing a bipolar monetary order with about equal responsibility for Europeans and Americans. As Europe becomes not only a commercial but also a monetary big power, its military dependency on the US will increasingly be seen as both an anachronism and an embarrassment. The search for a more independent role for the Europeans in the Atlantic Alliance gained fresh impetus by recent European decision-making on defence. Theoretically at least, the way has been paved for a much higher European security profile than in the past.

#### *a. Security*

For many years European states and the United States have been trying to define a new transatlantic bargain that reconciled Europe's desire for playing a more important geopolitical role (commensurate to its economic strength) with its enduring reliance on US military capabilities. The Treaty of Maastricht (effective 1993) underlined the need for developing a European Security and Defence Identity (ESDI) but failed to give a clear definition. The Western European Union was designated as "the defence component of the European Union and as means to strengthen the European pillar of the Atlantic Alliance". The Treaty of Amsterdam (which was agreed upon in 1997) gave some substance to the European Union's common defence policy by including the so-called

Petersberg tasks to the treaty provisions, *ie.*, "humanitarian and rescue tasks, peacekeeping tasks and tasks of combat forces in crisis management, including peacemaking".

For a long time, American reactions were dominated by fears of erosion of NATO and particularly of a European caucus to emerge within the Alliance. It was felt that, as a result of the development of a European defence policy, the process of building a consensus would shift from NATO to EU. EU members were under suspicion to present common positions to the U.S. and other allies, which were not open to further negotiation. Nevertheless, by adopting the concept of Combined Joint Task Forces (Berlin 1996) the US agreed that, when it chose not to become involved in an operation, it would approve of NATO supporting European operations under the political responsibility of WEU. It also agreed to provide critical military assets (strategic lift, intelligence and surveillance) for these operations. This agreement was reaffirmed three years later at NATO's summit in Washington (April 1999). The New Strategic Concept endorsed the further development of ESDI within NATO because it would enable all European allies to make a more coherent and effective contribution to the missions and activities of the Alliance as an expression of shared responsibilities... " The decision to make NATO assets and capabilities available for WEU-led operations would be taken on a case by case basis and by consensus.

A major development was the reversal of Britain's long-standing reluctance to seriously consider defence co-operation in the EU. The December 1998 joint declaration of the British Prime Minister Blair and French President Chirac in St. Malo was particularly significant. The two leaders agreed that the EU "must have the capacity for autonomous action, backed up by credible military forces..."

The declaration was therefore significant because it left open the possibility of European military action outside the framework of NATO.

At the Cologne meeting of the European Council (June 1999) the other EU member states concurred with the joint British and French position on defence, thus making the commitment to create a capacity for autonomous action part of agreed EU policies. European leaders, more specifically, identified the need for "a capacity for analysis of situations, sources of intelligence, and a capability for relevant strategic planning". On the same occasion, also preparations were made "for the inclusion of those functions of WEU which will be necessary for the EU to fulfil its a new responsibilities in the area of the Petersberg tasks". The abrogation of WEU was anticipated by the end of the year 2000.

The Cologne decisions have been hailed as an important breakthrough in Europe's quest for defence co-operation but did the Europeans really pass the Rubicon? It is much too early to say. The readiness of especially the larger European nations to pool their sovereignty on defence has not been tested yet. Despite their agreement in St. Malo, France and Great Britain still believe to have military options of their own while their differences on the appropriate role to be played by the U.S. in Europe have not disappeared either. There is also in this context the relevance of the neo-realist argument about considerations of relative power as a major impediment to international co-operation. In view of the strictly intergovernmental nature of any conceivable form of European defence participating countries have reason to ask about the distribution of gains. Which countries will be brought in positions of leadership and, concomitantly, which countries will enjoy more prestige than others will?

What's more, as the Kosovo war demonstrated, European countries lack vital capabilities to sustain longer-distance military campaigns beyond the size of humanitarian operations and classical peacekeeping. It is, therefore, imperative for them to get more deployable troops for the euro, not by duplicating the command structures and headquarters of NATO but by removing the duplications among the armed forces of European countries. Building "common force elements" could increase Europe's military strength. Obvious candidates are strategic lift, air surveillance, communication facilities and IT systems for logistical support.

As for the U.S., it hard to avoid the impression that Washington wants the best of two worlds: Europe is urged to take up a larger share of the common Atlantic defence burden and to assume greater international responsibility in security matters but at the same time the US tries to maintain political control (if not dominance) in NATO. From the European perspective, the US must show more flexibility so as to allow for wider French participation in the military organisation of the Alliance.

EU-led military operations would require the creation of a European sub-structure that can be extracted from NATO's overall, command structure.

#### *b. Trade*

Trade relations between both sides of the Atlantic have been dominated recently by noisy quarrels over bananas, tomatoes, soybeans, genetically modified food, hormone-treated beef, and airplane 'hush kits'. Official discourse, then, was very much focused on a range of

narrow, highly technical sectional interests. At the latest EU-US summit (Bonn, June 1999), the Atlantic partners decided to establish an early warning system in order to combat tensions arising from trade disputes. The mechanism was intended "to improve the capacity of each side to take the other side's interests into account at an early stage when formulating policy, legislative, or regulatory decisions, without thereby limiting each side's existing decision-making autonomy". This institutional device may turn out to be useful but the present state of the relationship demands for more substantive initiatives. One reason for this is the threat of a protectionist backlash in the US as a consequence of the yawning trade deficit. The US administration has become increasingly subject to pressures exerted by domestic industries, notably steel and agriculture, complaining of unfair pricing by foreign competitors and urging the government to restrict imports. The issue poses a political dilemma to the administration, which is not in the mood to alienate its constituents but which, at the same time, is neither eager to antagonise its trade partners by erecting new trade barriers. Another, more general reason for concern lies in the fact that the movement towards trade liberalisation has lost its momentum since no significant trade liberalisation is under way anywhere in the world. Whilst the European Union was very much preoccupied with internal reform because of further enlargement towards Central and Eastern Europe, it shook off its rather inward-looking attitude by proposing a Millennium Round of negotiations at the World Trade Organisation (WTO). Last July the European Commission set out its proposals for the agenda of the new round of global talks to be launched in Seattle (November 1999). Considering a comprehensive round to be the best mechanism for breaking down the remaining barriers to trade, the Commission stressed the need to achieve greater market access by reducing tariffs and non-tariff barriers and improving market access in the services sector. It also emphasised the importance of developing new rules governing trade and investment, trade and competition, and rules aimed at facilitating trade. To date (early September), the US failed to respond to the European suggestions by offering detailed proposals of its own.

To counter looming protectionism as well as to overcome anti-globalisation sentiments in many political quarters, it is essential that the US and the EU reach agreement about some strategy to achieve the goal of greater market access to countries that still place large restraints on imports. In their bilateral relations the two sides are well advised to conclude mutual recognition agreements for consumer safety, labour and environmental standards, in order to prevent regulations from acting as non-tariff barriers to transatlantic trade and investment.

*c. finance*

Sharp fluctuations in the official exchange rates of the major currencies have been one of the basic characteristics of the international monetary system since the early 1970s when President Nixon was forced to float the dollar. Although the establishment of formal exchange rate regimes is a source of controversy among economists, there is general agreement among them that monetary stability is a precondition for a steady growth of international trade. Indeed, currency fluctuations often are not rational adjustments to changing competitive conditions but consequences of speculative and erratic financial flows. The launch of the euro raised expectations about transatlantic efforts aimed at the avoidance of destabilising currency gyrations, at least between the two Atlantic monetary blocs. However, German suggestions, supported by other Euroland countries, to establish monetary target zones or to consider similar arrangements fell on deaf American ears. As a result of a mixture of ideological motives and fear of higher interest rates, the US preferred to leave the euro-dollar rate to market forces.

Should mutually benign neglect govern US-European monetary relations in the future? Probably not. It is true that, so far, predictions about a radical upsurge of the euro against the dollar and a radical portfolio diversification from dollars into euros have not materialised. The explanation for this can be sought in the "economic fundamentals", i.e., the diverging economic developments of Europe (stagnation in Germany and other European countries) and of the US (uninterrupted economic expansion). But as European economies are bouncing back and as the European Central Bank succeeds in establishing its credibility a broad swing in the dollar-euro exchange rate may be anticipated in the years ahead. The decline of the dollar is all the more likely in view of America's increasing trade deficits. Its value has already sunk against the yen. The foreseen swing in the dollar-euro exchange rate would be neither in Europe's interest nor in the American. An excessive appreciation of the euro is bound to hurt Europe's competitiveness and to raise unemployment levels already considered much too high. On the other hand, a sharp fall of the dollar would certainly help to redress the trade deficit with Europe but at the same time most likely produce inflationary pressures. So logic and mutual interest compel the US and the EU to accept a clear commitment to pre-empt radical movements in their exchange rate and to prevent monetary turbulence in the international financial system as a whole.

### *Conclusion*

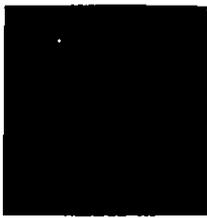
As long as the US and Europe give priority to following their domestic agendas it is not very likely that the official rhetoric of equal partnership will be turned into reality. Both in Europe and perhaps even more so in the US the sense of urgency, notably in the field of trade and finance, seems to be lacking to move policies beyond sheer incrementalism. Bureaucratic compartmentalisation and inertia pose formidable obstacles to developing a comprehensive strategy linking the main dimensions of the Atlantic relationship together. Such a strategy would also be required in view of European and American relations with the countries belonging to zones of conflict and turmoil outside the Atlantic area. A tacit division of labour seems to be growing: Europe takes care of 'soft power' issues like foreign aid and humanitarian assistance whilst the US is mainly in the business of 'hard power' with the use of military force. A division of labour along these lines can hardly be a cause for self-congratulation; on the contrary, it will most certainly stir up new acrimonious debates about transatlantic burden-sharing. The current official paralysis can only be broken by strong political leadership rooted in a clear recognition of the fact that only through close co-operation on various areas Europe and the US will be able to master the challenges of the new millennium.

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**EUROPEAN FOREIGN AND SECURITY  
POLICY AFTER AMSTERDAM**

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*Draft Outline*

## *1. From vicious to virtuous circle in the field of Common Foreign and Security Policy (CFSP): a short historical overview.*

– the long-lasting struggle to move from a purely declaratory European Political Co-operation (EPC) to a common foreign policy with a capacity for action, and some effective instruments at its disposal. The experience of using economic tools (economic sanctions, essentially) in some crisis situations (Falklands, Iran, etc.) led to successive decisions aimed at reinforcing the credibility of EPC, meant to be a policy capable of moving beyond the stage of pure intergovernmental co-operation among national foreign policies:

a) the inclusion in the Single European Act (SEA) of the concept of “political consistency” (art. 30.5), that is, co-ordination between diplomatic and economic activities;

b) the attempt made with Maastricht to move also toward what one might call “institutional consistency”, that is the linkage between CFSP and EC decision-making systems (e.g., art 228a on economic sanctions);

c) the gradual addition, since Maastricht, of a few limited instruments of action in the field of security and defence, namely the Petersberg Tasks (introduced into the Treaty framework in Amsterdam).

– this progressive move to a more consistent CFSP was largely due to the changing geostrategic scenario of the post-cold war period and to the completion of Economic Monetary Union, which was bound to force parallel progress in other fields of co-operation, such as CFSP.

## *2. The way to a consistent CFSP.*

There are three basic principles by which to judge the consistency and credibility of a CFSP: efficiency, effectiveness and legitimacy.

- the principle of efficiency has largely to do with a smooth decision-making system. Voting rules, permanent bodies, external representation, budget and reinforced co-operation (when necessary) have traditionally been indicated as key elements to improve the performance of CFSP. The Maastricht Treaty has pointed the way (a partial process of "communitarisation" for some institutional aspects of CFSP) and in Amsterdam an attempt was made to correct or complete some of the missing rules and mechanisms, namely by creating the High Representative and the PPEWU and introducing a full-fledged common budget, direct recourse to majority voting for joint actions, constructive abstention, etc.

- the principle of effectiveness is represented by the practical results of CFSP activities on the world stage. A degree of imbalances in terms of effectiveness in the external projection of the Union can still be witnessed. The dimension of foreign economic policy is well developed through the processes of enlargement, super-association and association agreements, custom unions, etc. The foreign policy dimension proper is scoring some successes in the field of stability pacts, political dialogue with third countries and declaratory policies, but still lacks the capability (and credibility) to act in the area of conflict prevention and conflict resolution. An improvement could derive from an effective presence of the High Representative, a skilful performance by the PPEWU, extensive use of the new Troika (Presidency, High Representative and Commission) and a larger common budget. However, the current voting rules and the failure to introduce reinforced co-operation might work as elements of functional weakness to a more effective CFSP.

- legitimacy concerns not only the role to be attributed to the European Parliament (which might increase in practice), but also the relationship between CFSP and national foreign policies. In this field it is particularly difficult to draw a clear-cut line between national sovereignty and the need for a common CFSP. Common strategies and guidelines, which are the responsibility of the European Council, should indicate clearly and in detail the areas of common sovereignty and exclusive action for the Union. The use of constructive abstention has to be interpreted in the broader sense,

allowing a majority of countries to fix a higher degree of shared sovereignty and to act in the name of the Union.

*3. The still missing dimension: defence policy as a necessary completion of a common CFSP.*

- a shared, common opinion is presently emerging inside the Union on the need to deepen the currently still limited policy of co-operation in the field of defence. In this regard the most important news is represented by the acceptance of the EU as the legal and political framework in which to locate the future defence policy of Europe. The St. Malò Declaration, the Final Communiqué of Washington, the Cologne European Council, the French "plan d'action" and the preparatory documents for Helsinki, all confirm that European defence is a responsibility to be borne by the EU.

- The political acceleration of the debate on a Common Defence Policy (CDP) is making some of the provisions of the Amsterdam Treaty obsolete. The Cologne European Council has already started to make some institutional suggestions for the merging of the WEU into the EU and for the decision to absorb it into the Second Pillar (CFSP). If, for example, "reinforced co-operation" (see next points) will reemerge as a key mechanism for the completion of the merging of the two Treaties (particularly with reference to art 5 of WEU Treaty), the next Paris IGC might be obliged extend its agenda.

- The creation of a common defence capability has to address, among other things, a necessary process of practical convergence both in the economic and military sectors in order to eliminate duplications, the wasting of resources and conflicting defence doctrines. Macro-defence convergence criteria should be fixed and a phased plan (as in the EMU experience) approved, with a strict deadline for the year 2010 for a full-fledged common defence.

- convergence criteria in the defence field will have to be accompanied by an institutional development involving the creation of *ad hoc* agencies (such as a

European Chiefs of Staff and a Common Military Command), the assigning of the political management of defence policies to the CFSP High Representative (with the planned creation of the Cops), the reinstatement of a mechanism of reinforced co-operation in the Second Pillar, the definition of the meaning of art. 5 of the present WEU Treaty in the context of the Union, the role to be attributed to different categories of member states (fully or partially involved in the common defence policy), etc.

#### *4. Towards a more effective CFSP?*

- A great deal of institutional progress has been made in the CFSP field. Since its inception, EPC has moved through various stages of progressively increasing decision-making complexity. The treaties of Maastricht and Amsterdam have introduced a number of elements of "institutional consistency", which have made a certain degree of "communitarisation" of CFSP mechanisms rather evident;

- nevertheless intergovernmental ideology and practice is still there. It must be remembered that the real "initiating" organ - the one which gives impulse to CFSP - is, in the final analysis, the European Council. The Treaties of Maastricht and Amsterdam officially recognise this reality and it is in this way that the decision-making activity derives its legitimacy. To some extent, even foreign economic activity (in the communitarian field) originates in the European Council (e.g., enlargement policy);

- moreover, the decision to include defence policy in the EU framework in the near future will fuel the intergovernmental method, distancing it, at least in the beginning, from the communitarian decision-making system.

- the real question is not whether the ideological tendency is toward supranationalism or intergovernmentalism, but whether the CFSP is effective. Probably the force of events, as has happened in the past, will lead to greater efficiency in the institutional field and therefore effectiveness in policy management.

*5. The real challenge for the Portuguese Presidency will be:*

a) to implement the new rules of Amsterdam with a clear view of the need for a progressively greater "institutional consistency" among the three pillars; key will be the practical solution which will be adopted for the role of the High Representative and his relationship both with the Presidency and the Commission. The new Troika should be given a focal task in initiating, implementing and monitoring CFSP activities. The Cops might take the place of the old Political Committee, but it should work in co-operation with the Coreper, in order to assure consistency. Military affairs might progressively be linked, through the Cops, not just to foreign but also to economic policies decisions (defence industries).

b) to adopt the principle of effectiveness as a basic objective for CFSP; use of the common budget, transformation of PPEWU into a real policy planning unit, ad hoc external missions largely delegated to the High Representative, use of the Troika for co-ordination purposes, etc.

c) to test the "efficiency" of the new voting rules for EU joint actions in the post-war Kosovo;

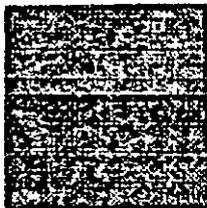
d) to start a process of greater institutional revision (beyond the limits of art.17 of the Amsterdam Treaty) in the defence field in the light of a new IGC, to be held in the second half of the year 2000.

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**La défense européenne après le Kosovo**

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## **La défense européenne après le Kosovo**

Nicole Gnesotto,

17<sup>e</sup> Conférence internationale de Lisbonne, 11-12 novembre 1999

IEEI/TEPSA

### **Introduction**

- 1999 est une année charnière sur le plan politique (euro, Saint-Malo, Cologne ) et au regard des crises réelles (Kosovo)
- Le Kosovo a « boosté » les Européens, prise de conscience des lacunes et des erreurs enregistrées lors de la crise bosniaque
- Les évolutions politiques en Europe sont sérieuses, structurelles et non accidentelles. Exemple de trois pays : une Grande Bretagne plus européenne, une France moins anti-OTAN, une Allemagne plus sensible aux intérêts nationaux. Pour la première fois, les convergences politiques entre ces trois pays sont réelles et les compromis possibles sur l'Europe de la défense.
- Rappel des acquis de Cologne

La dynamique européenne demeure excellente, les avancées sont possibles pour Helsinki. Certes, la défense ne sera pas un objet de négociation pour la prochaine CIG. Mais si des réformes sont agréées sur le plan institutionnel, il faudra à terme les enregistrer dans le TUE.

### **Quelles sont les questions qui restent à résoudre ?**

#### **1) L'articulation entre la volonté politique et les moyens militaires**

Il s'agit de réconcilier Cologne et le Kosovo. (80% des opérations aériennes étaient le fait des USA). Certes, on peut s'interroger sur la « stratégie » de l'OTAN au Kosovo. Toutefois, il est indéniable que les capacités des Européens posent une série de problèmes : - budget insuffisant (les Européens dépensent 60% du budget militaire américain, or ils sont loin d'avoir 60% des capacités américaines) et en baisse constante. Trop d'effectifs (2 millions) et pas assez de capacités mobiles. Différences dans la structuration des forces armées et dans les doctrines. Burden sharing entre Européens : en R&D militaire, deux pays assurent 80% des dépenses européennes etc.

D'où l'exercice sur la convergence des capacités, l'objectif étant que l'UE dispose à terme d'une capacité de projection rapide de 50 000 hommes.

#### **2) Les différences politiques intra-européennes.**

Les avancées institutionnelles prévues (COPS, transfert UEO/UE, etc...) supposent que soient résolues trois séries de questions :

- les Européens de l'OTAN non membres de l'UE. La discrimination est inacceptable, mais la différenciation est légitime. L'UE ne peut fonctionner qu'à 15, même si les 6 autres pays peuvent et doivent être consultés et associés de facto aux opérations militaires décidées par l'UE.
- les pays de l'UE non membres d'une alliance militaire. Ils ne doivent ni être « piégés » indirectement vers une alliance d'auto-défense, ni empêcher les membres des alliances de maintenir ou développer leur solidarité.

- le poids militaire différent des Etats membres. Il faudra concilier la décision politique à 15 et la mise en œuvre d'une opération militaire à moins de 15. La coopération renforcée dans le deuxième pilier devrait être une perspective à reconsidérer.

### 3) Les relations euro-américaines

Les Américains ont durci le ton à l'égard de la défense européenne et des perspectives ouvertes à l'Union. Quatre raisons possibles : la campagne électorale. La « victoire » de l'OTAN au Kosovo ; l'enterrement du débat sur la globalisation de l'OTAN ; les contradictions traditionnelles des Etats-Unis à l'égard de la défense européenne.

Certes, l'Administration a corrigé quelque peu sa position : les 3 D ont été remplacés par les 3 I (Include, improve, indivisibility). Mais les inquiétudes américaines demeurent, notamment sur la notion d'« autonomie » européenne et de préséance politique de l'OTAN.

Commentaires possibles :

- le rôle politique de l'OTAN dans la gestion des crises n'est pas avéré (cf groupe de contact)
- l'intérêt fondamental des USA est de disposer d'une marge de manoeuvre, alors qu'ils sont aujourd'hui obligés d'intervenir toujours et partout faute de relais européen organisé et crédible
- l'effort européen en matière de capacités n'entraînera pas une augmentation des dépenses au détriment de l'OTAN mais une réaffectation des ressources au bénéfice de tous et surtout de l'interopérabilité euro-américaine.
- l'ambition européenne est modeste : gérer les Balkans. Il n'y a pas là risque de concurrence avec la puissance américaine.
- Il est difficile d'institutionnaliser les relations OTAN/Union, avant que l'Union ne soit allé au bout du processus décidé à Cologne.

### Conclusion

L'investissement de l'UE dans les Balkans est énorme, tant en terme humain (KFOR : 50 000 hs, dont 80 % d'Européens pour au moins 10 ans) qu'en termes financiers (KFOR, 11 bn \$, 10 bn \$ par an, Pacte de stabilité : 50 bn \$ sur cinq ans). Les Européens sont donc obligés d'être sérieux en matière de PESC et de défense. D'autant que les opinions sont favorables (cf Eurobaromètre 99: 71% des Européens sondés sont en faveur d'une politique de défense commune). Autrement dit la question du « retour sur investissement » se pose désormais à l'Union en terme politique.



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**THE EURO INFLUENCE ON FINANCIAL  
CONSOLIDATION AND REGULATION IN THE  
PREPARATION FOR THE ACCESSION TO EU  
(The Case of the Czech Republic)**

Karel Zeman

Association for the Study of International Relations

**Preparation for accession to EU (and to Economic and Monetary Union)** is a key challenge facing the economic and financial system in the Czech Republic.

To become a member of the EU the Czech Republic has to meet two major criteria

- to create a fully functioning market economy
- and to be able to cope with both the competitive pressures and market forces that exist within the Union.

At first sight, the Czech Republic has already progressed a long way to meeting these criteria: private enterprise is the dominant form of ownership; direct fiscal intervention is not excessive; price stability had been maintained and a high degree of trade integration with the EU has been established.

The Czech Republic has indicated that it accepts and will comply fully with the EMU acquis as defined by title VII of the EC Treaty and the other relevant texts. It has also stated that the administrative structures to implement and enforce the acquis will be in place.

But according to Regular Report 1999 (/2/, p. 37), **the Czech Republic has made little additional progress in its preparation for participation in Economic and Monetary union.** As regards the acquis that has to be implemented before accession, the legislation on privileged access of public authorities to financial institutions is in conformity with the acquis, as is that on the independence of the Czech National Bank. However, the legislation on the central bank still provides for the possibility to provide short-term credits to the government by purchasing State treasury bills within three months of their purchase.

Compliance with the EMU acquis is conditional on completion of the process of liberalisation of capital movements.

According to assessment in terms of the Copenhagen criteria (/2/):

- **The Czech Republic can be considered to be a functioning market economy.**

However, ~~there are still some~~ structural problems, related to remaining shortcomings in the legal framework and problems of enforcement. Priorities for reform should include

- \* the completion of the bank privatisation process;
- \* a cleaning up of banks' portfolios;

- \* further measures to improve corporate governance.

There should be increased transparency in the public accounts to prevent a further accumulation of liabilities by public institutions. It is also important that the authorities adopt policies to restore economic growth and ensure sustainability of the external accounts over the medium-term.

- **The Czech Republic should be able to cope with competitive pressures and market forces within the Union in the medium term**, provided that it implements the remaining necessary structural reforms swiftly. The authorities need to concentrate on developing an environment supportive of business activity, and thus conducive to economic growth. In this respect, the improvement of the legal framework, the strengthening of corporate governance, the acceleration of enterprise restructuring, and the continued reform of the financial markets, are essential. This will result in more efficient enterprise and banking sectors and lead to sustained increases in productivity and competitiveness.

Two important documents with great consolidation and regulation capacity for financial sector and total economy (and for preparation the accession to EU) have been adapted:

- **Czech National Bank Monetary Strategy** (approved by the Board of the Czech National Bank on 8 April 1999)
- **Joint Assessment of the Economic Policy Priorities of the Czech Republic** has been agreed with the European Commission (on the basis of the adapted "Economic Strategy of the Assession to the European Union" by the Czech government in May 1999).

The CNB Monetary Strategy is a basis for **monetary policy co-ordination with the economic policy** of the government and the Joint Assessment of economic policy priorities includes **both macroeconomic and structural policy measures**.

## **1. Basic Features of the Monetary Policy**

The Czech Republic accession to EU in itself is not tied to any quantitatively specified criteria for price and monetary stability. Nevertheless, as early as in this phase it is desirable to create conditions for keeping inflation and the interest

rate differential as low as possible. This already ensues from the necessity of creating preconditions for closer links of Czech currency with the euro, regardless of whether the rules for the current exchange rate system (ERM II) will apply to new EU member states, and thus to EMU candidates, or whether the scheme will be adjusted. It is also possible that there will not be a significant gap between the Czech Republic's entry into the EU and into EMU.

Accession to the eurozone is tied to the fulfilment of a set of macroeconomic criteria, including price and monetary ones. The current member states qualified for membership by meeting the Maastricht convergence criteria.<sup>1)</sup>

The substantial gap in price levels will be the principal problem of the Czech Republic's accession. This view has been fostered by the fact that, at present, the price level in the CR is only 43 % of the EU average and international comparisons (eg with Poland and Hungary) indicate that the difference is bigger than would correspond to our economic level. From this it is concluded that if the gap is maintained, or even if it is narrowed somewhat, it will be a destabilising factor in our accession to the EU, or may even prevent it altogether. Under this line of reasoning, attempts to stabilise at low inflation are in fact undesirable or even counterproductive.

The convergence processes in the price area will necessarily continue also after the Czech Republic's accession to the EU. These are long-term processes, with inertia and many barriers. After all, this is exactly what the experience of the EU countries documents. Even after decades of a single market and integration processes, the price levels of the member states continue to differ by up to  $\pm 30\%$  from the EU average.

To achieve a balance between economic growth and price and monetary stability, it is desirable that the main parameters of the long-term inflation target be

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<sup>1)</sup> In the price area, the criteria require that inflation measured by the year-on-year consumer price index (CPI) not exceed the average of the three countries with the lowest inflation by more than 1.5 percentage points. At the same time, nominal long-term interest rates in candidate countries must not exceed the average value of the three countries with the lowest inflation by more than 2 percentage points. In addition, it is required that the exchange rate be included in the ERM exchange rate systems for at least two years prior to EMU entry and fulfil its stability criteria.

Given the ongoing adjustment of relative prices and the certain distortion in expressing changes in the quality of goods and services, as well as in technological progress, the European Central Bank has defined price stability as inflation of less than 2%.

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the result of a joint assessment and consensus between the government and the central bank (CNB).

The CNB proposes that **the long-term inflation target** for year-on-year net inflation be specified in the form:  $2 \% \pm 1$  percentage point; this target should be achieved in 2005.

This proposal is based on the assumption that **the Czech Republic's accession to the EU can be expected sometime between 2003 and 2005.**

The proposed mid-value for the long-term inflation target, and consequently the definition of the price stability category for the Czech economy, is slightly higher than the target declared for eurozone countries by the European Central Bank. This primarily reflects the fact that the probable extent of the distortion of price indices due to changes in the quality and range of goods and services, as well as to the more intense adjustment of relative prices in the still transforming Czech economy, will continue to be larger than in eurozone countries.

A comparison of the proposed long-term target for 2005 ( $2 \% \pm 1$  percentage point) and the current medium-term target for the year 2000 ( $4.5 \% \pm 1$  percentage point) shows that the long-term target establishes only a very slow trajectory toward price and monetary stability. A linear trajectory (from which the reality will deviate to a greater or lesser extent in individual phases) would mean net inflation falling by about 0.5 percentage points a year. In essence, this involves creating the prerequisites for stabilising the disinflation that has already been achieved and for completing the shift to a low-inflation economy.

In locating the realistic alternatives for the Czech Republic's accession to the EU in the period between 2003 and 2005, **the CNB regards it as justified to consider the 2005 horizon as the period for attaining price and monetary stability.** A comparison of the potential costs and effects for the possible alternatives, ie for 2003 in particular, confirms the legitimacy of this choice.

In forthcoming years, the CNB will announce its **inflation targets** based on an assessment of new information and forecasts to ensure that the long-term inflation target is met within the projected horizon and at minimal cost. When setting the upper and lower limits of the corridor for its targets, the CNB will be guided by the principle that the setting and implementing of these targets must not:

⇒ generate an acceleration in inflation (allowing for exogenous and temporary influences),

⇒ be directed below the price stability level, defined as  $\% \pm 1$  percentage point.

Achieving and maintaining price and monetary stability is one of the preconditions for long-term development for the small and very open Czech economy. It is also an inevitable prerequisite for future integration into the EU and EMU. It is in the common interest of the government, central bank and all other entities, including trade unions, to achieve this goal at minimal cost.

Analyses clearly show that with a co-operative approach and credible inflation targets shared by economic entities, it is possible to achieve the objective of price and monetary stability within the proposed horizon of 2005. Moreover, the positive development of inflationary expectations, reduction of transaction costs and better flexibility and adaptability of the economy can minimise the costs accompanying the above process. In contrast, with non-cooperative decision-making and behaviour it is necessary to rely more on restrictive economic policies. Under such conditions, the costs, in the form of negative effects on aggregate economic output and employment, could be much higher, or the time horizon for meeting the long-term target might have to be prolonged.

The economic policy of the government, especially in the fiscal and wage-income areas, and the monetary policy of the central bank are communicating vessels and create the overall macroeconomic environment in the economy. Even though specific conditions change over time and in individual phases, as does the appropriateness of the settings of the above policies, the general trend should not be one of a tight monetary policy subsequently offsetting or counterbalancing excessively relaxed wage-income or fiscal dimensions. On the contrary, the conditions of the still transforming and, at the same time, very open Czech economy should normally require a prudent wage-income policy combined, as far as possible, with a more relaxed monetary policy.

In the present environment of increasing globalisation of capital flows, the vulnerability of small, open economies (which are not sufficiently shielded by co-operation with the dominant institutions and monetary authorities in their regions) is increasing. The Czech economy has a substantial degree of openness, and its

**economic and price development is sensitive to trends and changes in its external environment.** It is therefore desirable to co-operate with international institutions, reduce in-built uncertainties and eliminate the unfavourable consequences of any deviations and the possibility of these being reflected in the decisions of foreign investors and domestic market participants.

## 2. Macroeconomic Scenarios

The Joint Assessment has been based primarily on the government's "Economic Strategy of EU accession - Competitiveness, Growth, Employment, Solidarity" of May 1999. This document includes a wide range of policies. In particular, the long-term monetary strategy of the central bank (CNB), and medium-term fiscal projections produced by the government, have been important contributing documents to this Joint Assessment.

The main objective of the economic policy of the Czech government is to

- meet the Copenhagen criteria,
- and to close the gap in GDP per capita between the Czech Republic and the European Union. To this end, the medium-term target for economic growth has been set at 2 to 3 percentage points above GDP growth in the EU. In a break with the past, economic policy is to be pursued with greater attention to sustained increases in the competitiveness of the Czech economy, rather than focussing too much on macroeconomic policy.

The Joint Assessment outlines **two quantitative macroeconomic scenarios**. The scenarios extend to the year 2005 and serve as an illustration of the likely macroeconomic outlook under different policy choices.

The more optimistic main scenario, the "pro-growth" scenario, assumes that the government adopts proactive macro and micro economic policies designed to eliminate the remaining structural weaknesses in the economy and promote competitiveness. This pro-growth scenario projects

- low but positive **annual GDP growth** of an average 2.1 % between 2000 and 2002, accompanied by a rise in unemployment due to accelerated economic

restructuring. This would be followed by much higher growth of 5 % per year from 2003 onwards,

- **consumer price inflation** edges up in the first three years, partly as a result of the final steps of price deregulation, which will be completed by 2002. Nevertheless, the underlying trend in net inflation is downwards, and the scenario is fully compatible with the Czech National Bank's proposed long-term target of 2 % ( $\pm 1$  %) for the end of 2005,
- **the general government deficit** is reduced from over 3 % of GDP in 2000, or more than 5 % before net lending, to sustainable levels after the year 2002,
- **the current account of the balance of payments** is projected to return close to balance by 2002.

The aim of the Joint Assessment is to help in the prioritisation of policies and in their sequencing. Economic priorities and the timetable for the completion of social and structural reform have to be set realistically and carefully. If the government tries to do too much over too short a period, it will quickly run into significant budgetary constraints. The accumulation of high general government deficits will prove unsustainable in the long run and make it difficult for the monetary authorities to be more accommodating. On the other hand, if the government fails to tackle the high levels of mandatory expenditures on the public budgets, and fails to make the public finances more transparent, it is likely to encounter the same problem even without having set the necessary reforms in motion.

The only way out of this dilemma is the route chosen by the current government, which is the same as that followed by EU governments in the run up to EMU:

- public finances need to be made completely transparent and hidden debts must be revealed,
- the remaining administered prices should be liberalised in accordance with a clear timetable.

This will allow monetary policy to be based on the convergence at a reasonable pace of inflation rates to euro-zone levels, and will help to build a lasting social consensus behind the need to keep real wage increases below the trend of

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labour productivity improvements. For this, it is essential that wage bargaining is based on forward-looking inflationary expectations and that the monetary authorities provide an explanation to the public when they are not able to keep inflation within the specified target range. In turn, the need to maintain a sufficient degree of exchange rate stability will act as an indispensable disciplinary force on the fiscal authorities.

**Co-ordination and consensus are key words in the formulation and implementation of economic policy in the Czech Republic.** An important prerequisite for an appropriate mix of economic policies is a regular exchange of views between the government, social partners, and the Czech National Bank (CNB), notwithstanding its independence.

The central bank (CNB) has a statutory responsibility to ensure the stability of the currency. Monetary policy aims to achieve currency stability by maintaining price stability at minimal cost and without excessive fluctuations in economic output and employment. Although in transition economies some overall inflation can be helpful in accommodating relative price adjustments, **the Czech monetary authorities consider high inflation to be very unstable and volatile, and certainly inappropriate for a small open economy.** Therefore, the CNB is trying to consolidate on the progress made so far in reducing inflation, and to converge gradually to the low inflation rates prevailing in the EU.

The main instrument of monetary policy is **interest rates.** The delays with which interest rate changes are transmitted, and their eventual impact on inflation and the volume of credits are, however, difficult to estimate. In addition, the indirect effects of changes in these rates on exchange rate stability in an environment of liberalised capital movements cannot be ignored. Moreover, these effects are more uncertain for rapidly developing economies than for more mature economies. Monetary policy in catching-up economies is successful when it combines the containment of nominal exchange rate fluctuations with real exchange rate appreciation reflecting the prospect and realisation of productivity growth and quality improvements. Exchange rate stability achieved within a regime of managed floating and liberalised capital movements is a strong indication of sound economic policies and political stability.

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In principle, the Czech Republic can join the EU with any exchange rate regime between the current managed float and a full peg to the euro. Although it is premature to consider the change of the present regime to a more fixed exchange rate arrangement, the CNB and the government recognise that current policy must position the economy for ultimate adoption of the euro as currency. The appropriate timing for adoption of the single currency will require a high degree of fundamental convergence with the EU. A key consideration for the decision on full membership of the euro-zone will be the long-term sustainability of public finances - it is also one of the main challenges facing the Czech government at present.

The general government budget of the Czech Republic moved from moderate surpluses to small deficits up until 1998, to an estimated deficit for 1999 of 3.3 % of GDP. The expected deficit figures include the use of resources to cover state guarantees and indirect liabilities. Overall, the gross "hidden" debt (including risk-adjusted estimates for possible liabilities from state guarantees) amounted to approximately 13 % of GDP at the end of 1998, which is about the same as the level of recorded government debt.

### 3. Financial Consolidation and Regulation

A key weakness of the Czech economy remains the financial sector. The banking sector continues to be seriously over-burdened by bad loans, with some banks more badly affected than others (classified credits form around one third of the loan portfolio). The build up of a large number of classified loans in the past was partly due to the passive attitude that state-owned banks adopted towards bad debtors. However, this situation has improved over the past year with stricter bank supervision and the cleaning up of the most affected banks in the run-up to their privatisation. But, classified credits continue to be accumulated due to the poor health of the economy. The privatisation of the remaining state-controlled banks, improvements in bankruptcy legislation, and increased separation between the commercial and investment arms of banks should improve the situation further, whilst also improving the framework for corporate governance.

In the past the insufficient regulatory framework and the wide variety of trading channels and practices led to frequent non-transparent deals and price manipulation in the Czech capital market. **The regulatory framework has been strengthened through the establishment of a Securities Commission.** However, the capital market is still largely illiquid, does not encourage strong corporate governance, and is a negligible source of finance for commercial and industrial enterprises. The continued presence of divergent prices for the same stock due to the fragmented organisation of the securities market remains an important problem.

**EMU presents the financial system with important challenges. In a highly competitive environment expected to arise from EMU pressure on financial stability.** In that regard, a more structural co-ordination between the financial sector supervisory authorities would be appropriate.

Building a sound market-oriented financial system is fundamental to the transition for the accession to EU and EMU. The development of sound and stable financial sector in the Czech Republic needs

- the development of regulatory and supervisory arrangements that support the operation of market discipline
- the creation of an institutional setting and financial infrastructure necessary for sound finance
- the promotion of market discipline and corporate governance over financial institutions.

**The legal and institutional infrastructure of prudential supervision and regulation of financial institutions and transparency and fairness of security market** in the Czech Republic is based on international experiences and agreements.

In the Czech banking sector the medium-term "Conception for the further development of banking supervision" (approved by the Czech National Bank [CNB] Bank Board in January 1998) is based on the "Core Principles for Effective Banking Supervision and Regulation" of the Basle Committee on Banking Supervision and Regulation (which were announced at the International Conference of Banking Supervisors held in Sydney in 1989: the Czech Republic was one of the countries that participated in the drafting of these principles)

State supervision and regulation of **the Czech capital market** is based on the application of the "Objectives and Principles of Security Regulation" by the International Organisation of Security Commissions (IOSCO).

Responsible institution for the state supervision and regulation of **the Czech insurance market** is the Ministry of finance.

The EBRD's Office of the General Counsel conducted a **survey ranking the Central European Candidate Countries (CECC) for accession to EU according to extend and effectiveness of financial laws and regulations**. The survey questions were based in large part on core principles developed by the Basle Committee and IOSCO. The survey attempted to measure how the financial laws and regulations in the region approximate core international principles.

Countries that have received a 3 rating have reasonably comprehensive financial laws and regulations in the banking sector.

Most transition economies have received a 3 rating for the functioning securities market.

According to used classification system **the extensiveness of legal rules on banking and securities activities, the legislation for banking and securities activities in the Czech Republic is reasonably comprehensive** but would benefit from further refinement in some areas. Banking regulations generally conform to the Basle Committee's Core Principles. For achieving conformity with minimum international standards (IOSCO) further refinement to regulation of securities intermediaries and/or investment funds and creation of shareholders depositories and registers is needed.

The **effectiveness** of legal rules on banking and securities activities in the Czech Republic is influenced by the inconsistentness which create a certain degree of uncertainty.

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