Robert Schuman Centre

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Negative and Positive Integration in the Political Economy of European Welfare States

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I. Introduction

The process of European integration is characterized by a fundamental asymmetry, described accurately by Joseph Weiler (1981) as a dualism between supranational European law and intergovernmental European policy making. As Weiler (1994) points out, political scientists have for too long focused only on aspects of intergovernmental negotiations while largely ignoring the establishment, by judge-made law, of a European legal order with precedence over national law. This omission has kept us from recognizing the politically significant parallel between Weiler's dualism and the more familiar contrast between 'negative' and 'positive integration' (Tinbergen 1965; Rehbinder and Stewart 1984) - i.e. between measures increasing market integration (by eliminating restraints on trade and distortions of competition) and common European policies to shape the conditions under which markets operate.

The main beneficiary of supranational European law has been negative integration. Its basic rules were already contained in the 'primary law' of the Treaties of Rome. From this foundation, liberalization could be extended, without much political attention, through the interventions of the European Commission against infringements of Treaty obligations, and through the decisions and preliminary rulings of the European Court of Justice (ECJ). By contrast, positive integration depends on the agreement of governments in the Council of Ministers and is subject to all the problems of intergovernmental policy making. This explains the frequently deplored asymmetry between negative and positive integration (Kapteyn 1991; Merkel 1993). The most likely result is a competency gap, in which national problem-solving capacity is severely constrained while European policy is restricted by the lack of intergovernmental agreement. As a consequence, the political economy of European democracies is being fundamentally changed.

II. Negative Integration: The Loss of Boundary Control

After World War II, the boundaries of the state became coextensive with the boundaries of markets for capital, services, goods and labour. Initially a response to the Great Depression -which ended an earlier era of open capital markets and free world trade - these boundaries were certainly not impermeable. But transactions across them were effectively controlled by national governments: investment opportunities were generally restricted to national economies and firms were mainly challenged by domestic competitors. International trade grew slowly, and since governments controlled imports and exchange rates, international competitiveness was not much of a problem. While these conditions lasted, government interest rate policy controlled the rate of return on financial investments. If interest rates were lowered, job-creating real investments would become relatively more attractive, and vice versa. Thus, Keynesian macro-economic management could smooth the business cycle and prevent demand deficient unemployment; while union wage policy, where it could be used for macro-economic purposes, was able to control inflation. At the same time, government regulation and collective-bargaining controlled the conditions of production. Since all competitors could be required to produce under the same regimes, the costs of regulation could be passed on to consumers. Hence, the return on investment was not necessarily affected by high levels of regulation and union power; capitalist accumulation was as feasible in the union-dominated Swedish welfare state as it was in the American system of free enterprise.

During these 'golden years' the industrial West European nations could develop their own capitalist welfare states - and their choices were remarkably different (Esping-Andersen 1990). But despite these differences, all were quite successful in maintaining and promoting a vigorous capitalist economy, while also preventing the destruction of particular social, cultural, and/or ecological values (Scharpf 1991a; Merkel 1993). But market-correcting policies depended on the state's control of its economic boundaries. Once this capacity was lost, through the globalization of finance and the transnational integration of markets, the 'golden years' came to an end.

Now, the minimal rate of return that investors can expect is determined by global financial markets, not national monetary policy. And real interest rates are generally about twice as high as they were in the 1960s. If a government now tries to reduce interest rates below the international level, the result is no longer an increase in job-creating real investment, but an outflow of capital, devaluation, and a rising rate of inflation.[1] Similarly, once the capacity to control the boundaries of markets for goods and services is surrendered or lost, the state can no longer ensure that all competitors will be subject to the same regime. So if the costs of regulation or collective-bargaining are increased nationally, they can no longer be passed on to consumers. Instead, imports will increase, exports decrease, profits will fall, investment decline, and firms will go bankrupt or move production abroad.

Under these conditions, countries are forced to compete for locational advantage in the form of a Prisoner's Dilemma game (Sinn 1993; 1994). If nothing else changes, the 'competition of regulatory systems' that is generally welcomed by neo-liberal economists and politicians, may well become a downward spiral of competitive deregulation. But there is a hope, at least among unions and the political parties close to them, that what is lost in national regulatory capacity might be regained at the European level. Against these hopes, however, stands the institutional asymmetry of negative and positive integration.

In theory, the desirability of negative integration or liberalization is not seriously challenged in the EU member states. The basic commitment to create a 'Common Market' was certainly shared by the governments that signed the Treaties and the national parliaments that ratified them. It found its legal expression in the 'primary law' of Treaty provisions requiring the elimination of tariff and non-tariff barriers to trade and the promotion of undistorted competition. But what may not have been clearly envisaged then was the effect of the doctrines of direct effect and supremacy of European law established early on through the decisions of the ECJ. Once these were accepted, the Commission and the Court could promote negative integration without involving the Council of Ministers.[2] At the same time, under the 1966 Luxembourg Compromise, measures of positive integration could be blocked in the Council by a single member state veto. This is not the case under national constitutions where market creating and market-correcting measures are, in principle, equally legitimate, and both depend on the mobilisation of political support.

The text of the Treaties of Rome did not actually require the Community to abolish the constitutional parity between the protection of economic freedom and market-correcting intervention (Joerges 1991; 1994a). But via the supremacy of European law, the four economic freedoms and injunctions against distortions of competition have gained constitutional force (Mestmäcker 1994: 270). Meanwhile, options for European social and economic intervention have been impeded by the high level of intergovernmental consensus required for positive integration.

III. Positive Integration: The Limits of Intergovernmentalism

While negative integration was advanced, as it were, 'behind the back' of political processes, measures of positive integration require explicit political legitimation. As long as the Luxembourg Compromise was applied, indirect democratic legitimacy was derived from the necessary agreement of all members of the Council. The price of unanimity was, of course, a sclerotic decision process. The Single European Act (SEA) of 1986 was supposed to change this by returning to qualified-majority voting (QMV) for harmonization decisions - 'which have as their object the establishment and functioning of the internal market' (Art. 100A). In consequence, it is now no longer necessary to bargain for every last vote (Dehousse and Weiler 1990). However, voting strengths and rules in the Council are set so that groups of countries united by common interests can rarely be outvoted. In any case, the veto remains a last resort for even individual countries; and unanimity still applies to a wide range of Council decisions. In sum, the need for consensus remains very high for positive integration measures.

Nevertheless, the Community *is* actively harmonizing national regulations in key areas such as health and industrial safety, environmental risks, and consumer protection (Joerges 1994b; Majone 1993). Indeed, it began to do so long before the SEA; and these regulations are defining high levels of protection (Eichener 1993; Voelzkow 1993; Héritier et al. 1994). How can this be explained given the high consensus requirements in the Council of Ministers?

Unanimity or QMV rules institutionalize veto positions; and the existence of multiple veto positions reduces the capacity for political action (Tsebelis 1995). But whether this actually results in blockages depends on the constellations of interests at play. If these are harmonious ('pure coordination games') or at least partly overlapping ('mixed-motive games'), unanimous agreement and effective solutions should be possible. Blockages are most likely in constellations of *conflicting* interests - and even then, agreement may be achieved if the losers can be compensated by side payments or package deals (Scharpf 1992b). If positive integration in Europe runs into insurmountable barriers, the likely explanation will be conflicts of interests that are too intense to be settled within the EU's institutional framework.

Such conflicts do in fact exist. But they are not everywhere, and there is no reason to think that they are always virulent in areas of positive integration. In order to show this, I will concentrate on regulatory policy and on conflicts between economic and political interests. It is assumed for this purpose that rationally self-interested governments will consider three criteria in evaluating proposed European regulations: the extent to which the mode of regulation agrees with their own administrative routines; the likely impact on the competitiveness of industries and employment at home; and - where these are politically activated - the demands and apprehensions of their electorates.

The boundary separating consensual and conflict-prone constellations can be roughly equated with the conventional distinction between product-related and process-related regulation (Rehbinder and Stewart 1984, 10). In the case of product-related regulations, the persistence of different national quality and safety requirements would perpetuate the fragmentation of EU markets. Since all countries agreed to the creation of the single market, it can be assumed that the common economic interest in unified European standards outweighs divergent interests. Thus, while countries might differ in their substantive and procedural preferences, agreement on common standards is likely to be reached. But this is not true for process-related environmental and safety regulations[3]; and it is even less so for social regulations (Leibfried and Pierson 1992; Lange 1992) which increase the cost of production.

In the case of product-related regulations, the interest constellation is shaped by the institutional framework: under Art. 30 of the Treaty, 'quantitative restrictions on imports and all measures having equivalent effect' are prohibited between member states. Under Art. 36, however, such measures are allowed if they are 'justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants..'. In other words, if national regulations serve one of the purposes specified in Art. 36, the default outcome in the absence of a common European regime would be continued fragmentation in European markets. Even if no country favours this outcome, the member states will still differ with regard to the level of EU regulation they desire. Rich countries will generally prefer higher levels of consumer and environmental protection than poor countries. Thus, the resulting constellation of interests is likely to resemble the 'Battle of the Sexes' game (Figure 1) in which negotiated agreement is generally difficult, but not impossible to achieve.

Moreover, even when European regulations have been harmonized, Art. 100A (4) allows countries wanting high levels of protection to introduce more stringent regulations. This changes the default outcome in favour of high-regulation countries and boosts their bargaining power. Thus, it is not wholly surprising that the harmonization of product-related regulations has achieved the 'high level of protection' envisaged for 'health, safety, environmental protection and consumer protection' in Art. 100A (3) (Eichener 1993).

		Rich Countries	
		High	Low
Poor Countries	High	3 2	1 1 NA
	Low	1 1 NA	2 3

Figure 1: Preference for high or low EU standards in product-related regulations. NA = non-agreement.

But the institutional framework and interest constellations are very different for *process*-oriented regulations. These do not affect the useability, the safety or quality of products produced. Steel from furnaces with high sulphur dioxide emissions is indistinguishable from steel produced with expensive emission controls. The same is true for cars produced by workers with or without paid sick leave in firms with or without codetermination. So there is no way in which

Art. 36, or any other Treaty escape clause, could justify excluding, taxing, or discriminating against, products produced under conditions differing from those in the importing state.

Thus, in the absence of common European regulation, all member states may find themselves in a Prisoner's-Dilemma constellation and tempted to reduce process-related rules, and cut back on welfare, to improve competitiveness. This would clearly facilitate the adoption of common European standards. And the Prisoner's Dilemma loses its pernicious character if binding agreements are possible. Since this is assured in the EU, European re-regulation at the level desired by member states should be possible. Yet it is here that the difficulties begin.
There are, firstly, differences in national regulatory style. These are likely to produce 'Battle-of-the-Sexes' games (in which member states would prefer EU agreement on levels of regulation but differ on style) superimposed on the Prisoner's Dilemma which, by itself, would not prevent agreement. Greater difficulties arise from ideological differences. Some governments may not share 'social democratic' or 'green' preferences for high levels of regulation, and may even welcome external competitive pressures to help them achieve domestic deregulation. Such difficulties may vary from one election to the next. But conflicts of interest arising from different levels of economic development are more deeply-rooted.

The EU includes some of the most efficient economies in the world alongside others barely above the threshold level, manifest in large differences in (average)[4] factor productivity. If the less developed countries are to remain competitive in the EU's internal market, their factor costs - in particular wage, non-wage labour and environmental costs - have to be lower as well. Industrial labour costs in Portugal and Greece are, respectively, one sixth and one fourth of those in Germany;[5] and differences in social-security levels and environmental costs are of the same magnitude (Ganslandt 1993). If harmonization raised these costs to the level of the most productive, the competitiveness of the less productive economies would be destroyed. If exchange rates were allowed to fall accordingly, the result would be higher domestic prices and hence, impoverished consumers. If exchange rates were maintained (e.g. in a monetary union), deindustrialization and massive job losses would follow - as in Eastern Germany when subjected to West German regulations under a single currency. The more enterprises are subject to international price competition,[6] the less politicians in the poorer countries could agree to cost-increasing harmonization.[7] And in contrast to relations between East and West Germany, rich EU countries would not be willing (or able) to compensate them with massive transfer payments.

Agreement would be no easier if the costs of social or environmental regulation were financed through higher income or consumption taxes rather than by firms. As long as average incomes in the poorest EC countries are less than a fifth of average incomes in the rich, the former must defend themselves against EU environmental and welfare harmonization. And unlike East Germany in the process of German unification, these countries are fully aware of their own best interests and the EU's constitution gives them an effective veto. The resulting interest constellation is represented as a game matrix in Figure 2.

		Rich Countries High	Rich Countries Low
Poor Countries	High	(1) 3 1	(2) 2 3 NA
Poor Countries	Low	(4) 2 3 NA	(3) 1 2

Figure 2: Preference for high and low EU standards in process-related regulations. NA = non-agreement.

Take the case of controls on industrial emissions. Highly industrialized and polluted rich countries are likely to prefer high EU standards (cell 1), which would also protect their own industries against 'ecological dumping'. They would least like to have common (and binding) low standards (cell 3). But for the poor countries, high standards (cell 1) would endanger less-productive firms. Even common rules imposing uniformly low standards (cell 3) would be unattractive, since their less-productive firms would then be exposed to competition from deregulated competitors in high productivity countries. So, for them, the best outcome would be non-agreement (cells 2 and 4) which would also be the second-best outcome for the rich countries. As a consequence, the status quo is likely to continue.

To summarize, positive integration has achieved remarkable progress in the harmonization of product-related regulations. But the harmonization of process-related environmental and welfare regulations is proving much more difficult. Meanwhile, negative integration is restricting national capacities for dealing with the problems created by market integration. Solutions to this dilemma can be sought in two directions - by increasing European problem-solving capacities or by enabling member states to protect their own interests in a transnationally integrated market.

IV. Solutions I: Increasing European Problem Solving Capacity?

Given pervasive conflicts of interest, problem solving at the EU level might be facilitated either by institutional reform to improve conflict resolution or by finding ways of making that conflict more manageable.

1. Majoritarian Solutions ?

Obviously, conflict resolution would be most directly assisted if the EU continued the move towards majority voting. If decisions could be reached by simple majority, high-productivity countries could impose high standards on the rest of the Union - provided they can agree among themselves. But constitutional changes in the EU depend on unanimity: the near foundering of the EU's Northern enlargement on the voting issue shows that potential losers are unlikely to agree to a regime in which they might be consistently outvoted. In this regard, the 'joint decision trap' (Scharpf 1988) is still in good repair.

Moreover, further moves towards full majority voting would generate a fierce debate about the 'democratic deficit'. As long as the legitimacy of EU governance rests primarily on the agreement of democratically accountable *national* governments, those citizens whose governments are outvoted have no reason to consider such decisions legitimate. In fact, even the cautious expansions of QMV in the SEA and at Maastricht have triggered debates so critical of majority decision making that future progress will need to be based on more solid foundations of legitimacy. Creating these above the nation state is problematic, for more is needed than simply an increase in the formal competencies of the European Parliament. Representation and majority rule will assure legitimacy only if the body politic allows the imposition of sacrifices on some members of the community in the interest of the whole; if there is the possibility of a public discourse over which sacrifices are to be imposed for which purposes and on whom; and if the leaders are accountable to the public and able to exercise effective power. But the lack of a common language is a major obstacle to the emergence of a European-wide public discourse: thus, we have no EU-wide media, no EU-wide political parties, and no political leaders with EU-wide visibility and accountability.

For the time being it is unlikely that institutional reforms could greatly increase the capacity for EU-level conflict resolution. Weiler's (1981) diagnosis holds: in contrast to the legal processes defining and enforcing the supranational law of *negative* integration, the political processes required for *positive* integration will remain intergovernmental and easily blocked when national interests diverge. But what of European strategies to *minimize* conflict?

2. Regulation at Two Levels?

A range of such strategies are in principle available (Scharpf 1994). For example, in the harmonization of product-related standards, agreement has been facilitated by restricting Council involvement to the formulation of 'principles', while the details are left to corporatist standardization bodies. Moreover, in process-related *environmental* regulations, Art. 130T now allows any member state to maintain or introduce more stringent protective measures, provided they are 'compatible with this Treaty' (i.e. with negative integration).

This opens up the possibility that the obstacles to agreement on process-related regulations might be reduced by a variant of 'variable geometry'. The Prisoner's Dilemma game that European countries are forced to play is not played with equal intensity among them all. Regulatory competition is most acute between countries that produce the same type of goods at similar levels of productivity and production costs. But countries producing at very different levels of productivity and costs do not usually compete with each other in the same markets. Thus, the failure to adopt single European standard would imply that two Prisoner's Dilemma games are being played: one among the most efficient countries that compete on productivity, the other among the less efficient that compete on costs.

From this analysis, the solution seems obvious: while preventing competitive deregulation requires the harmonization of process-related regulations, there is no need for a single, uniform standard. Instead, an explicit agreement on two standards offering different levels of protection at different levels of cost would suffice. The rich countries could then commit themselves to high standards, while the poor could agree to lower standards that would protect them from ruinous competition. As their economies grow, the lower standard could be raised and brought into line with the higher.

Compared to the difficulties of reaching agreement on EU-wide uniform standards, negotiations on double standards should be much easier (Figure 3). Moreover, in contrast to other proposals for a two-speed Europe, the club of high-regulation countries would have no interest in excluding applicants who feel able to conform to their levels. The most difficult choice would be faced by 'middle' countries, like Britain or Italy, who would need to decide whether they dare compete on productivity or must compete on cost.

		Rich Countries		
		High	Low	Double
Poor Countries	High	4 1	2 3 NA	2 3 NA
	Low	2 3 NA	1 2	2 3 NA
	Double	2 3 NA	2 3 NA	3 4

Figure 3: Process-related regulations with the option of a double standard. NA = non-agreement.

3. *But What if Institutions Matter?*

So far we have looked only at negotiations between rich and poor countries, and have assumed that within each group agreement should be relatively unproblematic. But this applies only to process-related *environmental* regulations. In the case of industrial-relations and social-welfare regulations, even two level-harmonization would encounter enormous difficulties because qualitative and institutional differences are more salient.

Sweden and Switzerland, for example, are among the most highly developed countries in the world; and yet they differ greatly in the share of GDP they devote to public welfare transfers and services. And while Germany and Britain have similar levels of union density, they have quite different structures of union organization and collective bargaining. Moreover, German industrial relations are embedded in highly developed systems of labour, collective-bargaining and co-determination law; while British labour relations have developed under the maxim of 'free collective bargaining'. So quite apart from any cost considerations or possible side payments, an EU legal regulation of industrial relations is likely to be unacceptable to both British employers and unions. Whereas unions in Germany - and elsewhere in the EU - rely strongly on the legal effectiveness and enforceability of state regulations (Crouch 1993).

Thus, in social welfare and industrial relations, even among the advanced countries, constellations of interest will not produce benign 'Battle-of-the-Sexes' games. Instead, with two qualitatively different types of institutional arrangement, we would have a constellation in which both sides might prefer non-agreement to a harmonized system (Figure 4).

Type 1 Countries

		1	2
Type 2 Countries	1	3 1	2 2 NA
	2	2 2 NA	1 3

Figure 4: Harmonization of welfare and industrial-relations regulations among countries of a similar level of development, but with different institutions. NA = non-agreement.

Institutional differences between member states are politically salient either because powerful interest groups defend the status quo or because they are part and parcel of social and political identity. This is clearly the case where sectors have been sheltered from market forces by the state. These ‘sectors close to the state’ (Mayntz and Scharpf 1995) include education and basic research, health care, radio and television, telecommunications, transportation, energy and water supply, waste disposal, financial services and agriculture where state protection from the market has produced quite different institutional arrangements. But practically all of them - from the Commissions’ point of view - could be considered non-wage barriers or distortions of competition. And the logic of negative integration implies their removal - as is currently happening in telecommunications, air transportation and financial services.
However, some of these restrictive institutional arrangements may be justifiable, so that - under Arts. 36 and 100A, or Art. 76 - their harmonization might be more appropriate. But how could the Council reach agreement on a common system of financing and delivering health care to replace the British, Italian and Swedish tax-based, public health systems as well as those of France, Germany and Austria which combine compulsory health insurance and private health care? Old-age pensions are similarly problematic. Here, the move from the German pay-as-you-go insurance system to a common system based, say, on the British two-tier model - combining tax-financed basic pensions and supplementary private insurance - is practically impossible. For the now active generation would have to pay twice - once for the present generation of pensioners under the old system, and again for their own life insurance under the new.

In short, there are important sectors where EU-wide harmonization may be infeasible. But should negative integration should be allowed to run its course where institutional structures are seen as restricting trade or competition? If so, existing balances of values and interests will be upset. In some sectors, these costs have been considered politically acceptable - but there is no reason why this should always be so. Where it is not, negative integration will either be forcefully resisted or it may lead to social disintegration and political delegitimation, as in East Germany after the destruction of indigenous institutions.

V. Solutions II: Restoring National Boundary Control?

We need therefore to think about how the advance of negative integration can be constrained. This is not a problem where liberalization has to be achieved through decisions in the Council of Ministers. Governments concerned to maintain existing institutional structures are still able to block Commission initiatives. But they have no formal power to prevent the Commission from proceeding against nationally privileged 'undertakings' by way of directives under Art. 90 (3) of the Treaty.[8] And they have even less control over the Commission's power to issue 'decisions' against individual governments under the same article, or to initiate infringement procedures before the Court under Art. 169. Moreover, given the doctrine of direct effect, any individual or corporation could challenge national arrangements before a *national* court, which could then obtain a preliminary ruling from the ECJ under Art. 177.

Thus, political controls will not work - or more precisely, they will only work asymmetrically. As long as the Council must proceed via QMV or even unanimous decisions, a small minority will be able to block positive action. But large majorities, or even unanimous votes would have to be mobilized to correct any extension of *negative* integration through the decisions of the Commission or the Court. The question then is whether it may be possible to limit legally the capacity of the Commission and the Court to extend negative integration beyond what the Council would also find politically acceptable.

At Maastricht, it is true, governments took care to exclude the Court from 'common foreign policy and security policy' and 'cooperation in the fields of justice and home affairs' (Article L). This is, surely, an indication that the Court's power to convert Treaty obligations into supranational law, and to interpret their meaning beyond the original intent, is now a matter of political concern. This may also have contributed to the inclusion of a 'subsidiarity clause' in Art. 3B (2) of the EC-Treaty. If that was the case, however, restraining the Court is unlikely to be achieved through the clause itself (as opposed to the change in the political climate which it symbolizes).

By restricting subsidiarity to 'areas which do not fall within [the Community's] exclusive competence', negative integration is left untouched. Moreover, the subsidiarity clause is unlikely to have much legal effect on positive integration (Dehousse 1993). Given the heterogeneity of member state conditions and capacities, it is inconceivable that a court could strike down any European measure that was supported by a qualified majority by denying that 'the objectives of the proposed action cannot be sufficiently achieved by the Member States'. It is probably more realistic to see the clause primarily as a political appeal for self-restraint directed at the Council of Ministers.

What might make a legal difference, for negative as well as for positive integration, is indicated by the most important decision favouring negative integration. In *Cassis de Dijon* (120/78 ECR, 1979, 649), the Court did not hold, as is sometimes assumed, that the 'mutual recognition' of products was an unconditional obligation of member states. Before Germany was ordered to admit the French liqueur, the Court examined the claim that the German requirement of a higher alcohol content was justified as a health regulation, and found it totally spurious (Alter and Meunier-Aitsahalia 1994: 538-39). If that had not been so, the import restriction would have been upheld under Art. 36 of the Treaty which permits quantitative restrictions 'justified on grounds of public morality, public policy, public security, the protection of health and life of humans, animals or plants...'.

Thus, the Treaty *itself* recognizes certain national policy goals that override the dictates of market integration. Admittedly, the Commission, and the ECJ even more so, have done their best to assure the priority of negative integration by applying extremely tough tests before finding that a national regulation is neither discriminatory nor a disguised restriction on trade. In fact, the Commission has followed a consistent line, according to which product-related national regulations either will be struck down, under *Cassis*, because they serve no valid purpose, or must be replaced by harmonized European regulations under Art. 100A (Alter and Meunier-Aitsahalia 1994). What matters here, however, is the reverse implication: national regulations restricting imports, that serve one of the valid purposes listed in Art. 36, must be allowed to stand unless, and until, European harmonization is achieved.

For product-related regulations, therefore, negative integration does not take precedence over positive integration, and the competency gap mentioned in the introduction is in fact avoided. However, that is not true of *process*-related regulations which, since they do not affect the quality or safety of the products themselves, would never justify exclusion under Art. 36. Moreover, such regulations must also not violate the rules of European competition law (Arts.

85ff), must not insulate public service agencies against competition (Art. 90), and must not amount to competition-distorting state aid (Art. 92).

If this state of affairs is considered unsatisfactory, one may need to go further in the direction indicated those provisions contained in Arts. 36, 48 (3), 56 (1), 66 and 100A (4) which allow restraints on the free movement of goods, persons and services if they serve one of the 'police-power' purposes of public morality, public policy, public security, public health, etc. In practice, however, none of these exceptions is still of great importance, since the Commission and the Court have interpreted them in extremely restrictive fashion. The de-facto priority of negative integration over national policy preferences has generally been re-established through judicial interpretation.

It remains to be seen whether the same fate awaits the even more explicit reservation clauses introduced by the Maastricht Treaty - for instance Art. 126 (1) which permits the Community only a very limited entry into the education field, 'while fully respecting the responsibility of the Member States for the content of teaching and the organization of education systems and their cultural and linguistic diversity.' By its language at least, the clause will only set limits to the narrowly circumscribed educational competencies of the Community: it will not offer immunity against charges that national education systems might represent restraints on trade and distortions of competition in the market for educational services.

If national policy preferences and institutional traditions are to survive, it seems that more powerful legal constraints are needed to stop the imperialism of negative integration. A radical solution would be to abolish the constitutional status of European competition law by taking it out of the Treaty altogether, leaving the determination of its scope to the political processes of 'secondary' legislation by Council and Parliament. This would create a constitutional balance at the EU level among competing policy purposes, as is true in national systems. In addition, it might be explicitly stated that national legislation remain in force unless, and until, it is shown to be in clear conflict with a specific provision of European legislation. This is the de-facto state of European law with regard to product-related regulations in the market for goods. It could and should be extended to the markets for services, and in particular to transportation and financial services. These would be changes which, unlike the subsidiarity clause, would really make a difference. In addition, it might be worthwhile to specify in the Treaty itself those policy areas for which member states will retain primary responsibility. The most plausible candidates would be the areas discussed above - education, culture, the media, social welfare, health care, and industrial relations and, of course, political and administrative organization.

As I have argued elsewhere, this would give the constitution of the Community a bi-polar character, similar to the 'Dual Federalism' which the American Supreme Court read into the U.S. Constitution before 1937, or to the case law of the German constitutional court protecting the *'Kulturhoheit'* of the Länder (Scharpf 1991b; 1994;). There is, of course, no hope that a clear demarcation line between European and national areas of policy responsibility could be defined. But an explicit dualism would force the Court and the Commission to balance the claims for the economic perfection of market integration against equally legitimate claims for the maintenance of national institutional integrity.

But would any of this make any real difference? The EU must, after all, remain committed to the creation of a common market; and so it also must retain legal instruments to defend free access to markets against protectionism. Thus, prohibitions against trade restrictions would need to be retained. What could change is the degree of perfectionism with which restrictions are defined. Even more important: constitutional changes could protect, or reestablish, the powers of national governments to take certain sectors out of the market altogether, or to organize them in ways that modify the market. If that implies a loss of economic efficiency, it should not be the business of the Community to prevent member states from paying that price.

VI. Social Regulation in One Country ?

But even if the legal straightjacket of negative integration could be loosened, that would not reverse the changes occurring in the political economy of capitalist welfare states. National economies are largely exposed to transnational competition, capital has become globally mobile, and enterprises are freely able to relocate production throughout the EU. And as factor mobility has increased, national capacity to reduce the rate of return on capital investments below the international level, either by lowering interest rates or by imposing additional costs on firms, has been lost (Sinn 1993). In that sense, there is certainly no path that would lead back to the postwar 'golden age'.

From the point of view of political democracy, it would be dangerous to deny the existence of such constraints; but their significance should not be exaggerated. It is true Keynesian macro-economic management is no longer possible at the national level, and is not yet available supranationally. It is also true that the rate of return from productive investment, which capital owners can claim, has increased considerably. Any attempt, by governments or unions, to reverse these losses by redistributive programmes in a national context would fail.

Beyond that, however, the basic relationship between capitalist economies and democratic states is still the same. As pointed out above, even in the postwar period, the symbiosis of capitalism and democracy was only successful because the costs of the welfare state were borne by workers and consumers, rather than by capitalists. If this 'impossibility theorem of redistribution' is accepted, the loss of national regulatory capacity reduces itself to the relatively technical question of where the costs of (new)[9] regulation should be placed. If they are placed on firms that are exposed to international competition, and if all other conditions remain the same, there will be a loss of international competitiveness and a fall in profits, investment and employment. But, of course, other conditions need not remain the same. The rise in the costs of regulation could be compensated through wage concessions, through a rise in productivity or, as long as the European Monetary Union does not yet exist, through devaluation. In effect, these compensatory measures would, again, shift the costs onto workers and domestic consumers.

However, the same result could be achieved more directly and with much greater certainty if the costs were not imposed on firms at all. If new social regulations, such as the German disability-care insurance, were financed through taxes on incomes and consumption, rather than through payroll taxes, enterprises would stay competitive and investments profitable. One example is provided by Denmark, where 85% of social costs are financed from general tax revenues. Since the international competitiveness of Danish enterprises is not affected, the (very costly) welfare state does not play any role in discussions about the competitiveness of the Danish economy.[10] Of course, consumable incomes will be reduced, but this is as it would, and should be in any case.

I do not wish to claim, however, that all objectives of social regulation in the postwar decades could also be obtained in the future without endangering international competitiveness. Even less would I suggest that the growing tax resistance of voters would be easy to overcome.[11] Compared to the postwar decades, the range of choices available to national democratic political processes has certainly been narrowed. But it is not as narrow as many contributions to the current debate suggest. Moreover, it can be widened to the extent that countries and regions succeed in developing their comparative advantages so as to exploit niches in increasingly specialized world markets. But this depends on a high degree of policy flexibility, and a capacity to respond to specific locational conditions and changing market opportunities at all levels of policy making - as well as in management and industrial relations.

Thus, the European economy may indeed need the larger market, and hence common rules, to keep up with American and Japanese competitors in areas where economies of scale make a difference. But Europe will certainly fall behind if negative integration paralyses national and subnational problem solving; and if only unsatisfactory compromises can be reached after long and difficult negotiations at the EU level. To succeed in the global economy, Europe depends on more effective European policy making with better democratic legitimation. But it depends equally on the autonomous problem-solving capacities of national and subnational polities. While the debate about subsidiarity may help limit the perfectionism and the rigidities of positive integration, we also need a debate on limiting the perfectionism of negative integration. Only if we succeed in both can we combine the efficiency of the larger market with enhanced EU problem solving capacity and the preservation of national - and subnational - democracy.

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Notes

1. Conversely, national monetary policy does have the power to attract capital, by setting national interest rates above the international level. But in doing so, it will raise the exchange rate, which decreases the international competitiveness of the national economy.

2. Negative integration was and is pursued by the Commission primarily through "decisions" and "directives" under Arts. 89 and 90 and through action against national infringements of Treaty obligations under Art. 169. Of the same practical importance is the direct application of European law in ordinary legal disputes before national courts and the possibility, under Art. 177, of preliminary rulings of the ECJ at the request of any (even inferior) national court. Again, the Council is not involved, and governments will typically appear before the Court only in the role of defendants.

3. Streeck (1993: 10) correctly points out that process-related environmental and safety regulations may create obstacles to trade in the market for machine tools and production plants. Thus he includes these in his definition of "market making", as distinguished from "market correcting", regulations.

4. Naturally, Portugal and Greece (just like eastern Germany) also have islands of above-average productivity, especially in new plants of multinational corporations.

5. According to surveys conducted by the Swedish employers' association (SAF), overall costs of a man-hour in industry ranged in 1993 between 33 Swedish krona in Portugal, 56 krona in Greece, and 204 krona in Germany (Kosonen 1994).

6. Of course, the intensity of price competition varies between sectors. For example, in agriculture, "Southern products" hardly compete with "Northern products".

7. Thus, it is not only the opposition of enterprises that stands in the way of a European social policy (Streeck 1993). Governments in economically weaker states must, on their own account, anticipate and try to avoid the exit option of capital.

8. On the other hand, governments which, for domestic reasons, might not wish to agree to a Council directive may actually prefer deregulation by way of Commission directives and decisions.

9. Presumably, if an economy has been viable so far, its regulatory costs are reflected in current prices and exchange rates.

10. The major threat to the viability of the Danish model, incidentally, comes from European plans to harmonize VAT rates.

11. Here, in my view, is the real reason for the current crisis of European welfare states. Given lower rates of economic growth, rising costs of environmental protection, continued mass unemployment, and a growing retirement population, the willingness of blue and white collar voters to bear an ever rising tax burden has become the critical constraint on all policies dependent on democratic legitimation.

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