Fiscal Constitutionalism in EMU

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Forthcoming in: International Journal of Organization Theory and Behavior
This version: June 5th, 2003

ABSTRACT

The Maastricht process set up economic and fiscal criteria that member states of the European Union are expected to meet in the preparation for and when having joined the third stage of EMU. According to EMU rules, the Commission monitors the fiscal behavior of the participants but member states themselves--as members of the Council of Ministers--finally vote on the Commission recommendations. It is therefore questionable whether these criteria actually constrain member state governments from running excessive deficits. This paper adopts a constitutionalist perspective to address this question by asking how member states will interpret or even change the fiscal rules of the EMU in the future. Council decision-making in the area of EMU politics is analyzed using data on the economic and fiscal positions of current member states and acceding countries from Eastern and Southern Europe. The findings suggest that enlargement will shift policy outcomes, but, if compared to the situation at the time of the signing of the Maastricht treaty, the effect is rather marginal.

INTRODUCTION

With the entrance into the Economic and Monetary Union (EMU), twelve of the current fifteen member states of the European Union (EU) have moved away from the comfortable position of having both money-creating and taxing powers. Since 1999 an independent European Central Bank is responsible for monetary politics so that national governments' room for maneuver is limited to fiscal policy instruments when trying to steer their national economies. It is also argued that member states' powers are increasingly confined as global and European economic integration promotes the mobility of tax bases. The argument is that the "globalization" of labor and capital leads to a race-to-the-bottom of tax systems and a convergence of fiscal policies more generally [1],[2]. Because it was feared that governments--once having lost the option to re-finance their debt using monetary politics--will accumulate their deficits and run into government insolvency, member states imposed fiscal constraints on themselves to pre-empt any such situation after the introduction of the Euro. These constraints are found in the Maastricht Treaty on European Union (TEU) and the Stability and Growth Pact. They define in some detail what economically correct behavior is as well as the criteria states are expected to meet both before and after entering the third stage of EMU. The most prominent of which are the 3% government deficit and the 60% public debt thresholds. The question whether these criteria actually constrain member state governments remains open, however. Moreover, with ten Eastern and Southern European countries set to join the Union on May 1, 2004, it is feared that an early participation of acceding countries at the EMU will imply a more heterogeneous and weaker monetary union.

In this paper, I address these questions by analyzing the prospects of economic and fiscal politics in the enlarged EU. I argue that the convergence criteria laid down in the TEU and the Stability and Growth Pact are vague and subject to interpretation or even change. Given the inherently imperfect nature of contracts, the question whether a particular country is in compliance or non-compliance with these criteria has to be decided on a case-by-case basis. According to the EMU rules, the Commission has the responsibility for monitoring the fiscal behavior of member states but member states themselves--as members of the Council of Economic and Finance Ministers--finally decide on the recommendations of the Commission. This setting is likely to undermine the enforcement of EMU rules. Whilst countries that easily meet the convergence criteria will not hesitate to blame a fiscally irresponsible EMU member, countries that themselves are actually not meeting or at risk of not meeting the criteria are less likely to do so. In general, as EU member states have different budgetary and economic positions, they are likely to have different views on the applicability of the convergence criteria and therefore different positions when voting on the opinion of the Commission. The enforcement of the EMU framework is thus subject to both a Commission proposal and a political decision of the Council of Ministers who decides by qualified majority vote. This raises the question as to what are the likely outcomes of this decision-making process, given the institutional framework of the EU and the conflict of interest between member states with respect to EMU politics.

Whilst recent developments in EMU have already raised the fear of a weakening of the convergence criteria, most academic attention focuses on the economic effectiveness of the Stability and Growth Pacts' punishment mechanism [3],[4]. Another strand in the literature has even questioned the economic usefulness of the pact [5]. Little attention, however, has been paid to the problem of the feasibility of its enforcement (see however, [6]): Whether EMU rules will be enforced or not is questionable given the fact that member states themselves vote on the interpretation of the criteria laid down by the TEU and the Stability and Growth Pact [7]. Moreover, the accession of Eastern and Southern European countries to the EU is likely to intensify the economic and fiscal divergence between member states and make the effective control of countries' fiscal behavior even more difficult [8].

This paper adopts a constitutionalist perspective on the EMU and asks how the fiscal rules of the EMU will be interpreted or even changed in the future by analyzing Council decision-making in the enlarged EU. The results suggest that EMU politics in 1992 reflected the positions of Germany and France rather than that of other member states or the Commission. In particular, the convergence criteria of the Maastricht treaty come close to what was preferred by the two EU core states. The accession of Eastern and Southern European countries will shift outcomes in the enlarged EU but this effect is rather marginal. Moreover, the enlarged Union's capacity to act in EMU politics will decrease, but again, the loss of efficiency might be considered modest.

These findings also throw light on the question of what the prospects of economic policy-making at the EU level are. Even with the establishment of EMU, the responsibility for fiscal policy-making remains at the national level. Trade and financial market integration, however, is supposed to result in spillovers that call the effectiveness of strictly decentralized fiscal policies into question [9]. The Maastricht treaty thus emphasizes economic and fiscal policy co-ordination between member states in order to enable member state governments to respond to economic shocks in a coordinated and efficient way. It is, however, not obvious that EMU policy-making at the EU level will be as simple as it is at the member state level: At the national level, macroeconomic stabilization policies require governments to find a policy-mix of monetary and fiscal policy, or, if there is an independent central bank, a suitable fiscal policy. At the EU level, stabilization policies necessitate a collective decision of EU member states on their joint policy response. Article 99 of the Treaty Establishing the European Community states that "Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council". But how will those policies in the Council of Ministers come about? Given the existing heterogeneity in member states' economic and budgetary positions, is it a mere coordination or will this new policy area generate a severe conflict of interest? And how will the accession of twelve Eastern and Southern European countries change the prospects for finding a fitting policy-mix?

In what follows, I first review the constitutional provisions of the EMU. As any constitutional rule they are subject to interpretation. For sound domestic reasons member states have different views on the convergence criteria and in the past, some of them have tried to get their own interpretation accepted by others. Evidence from the EMU history suggests that some of these efforts have been successful which means that the EMU has already undergone constitutional change. Second, I use data on the economic and fiscal situation of member states to determine and evaluate the conflict space that represents their presumably different views on EMU rules. Finally, employing a spatial model of legislative choice, decision-making outcomes in the policy area of EMU are determined and their change over time is assessed.

CONSTITUTIONALISM IN THE EMU

The entry into the final stage of EMU is considered as arguably the most important event in the history of European integration [10]. One reason is that money is a main attribute of national sovereignty; another reason is that national policy-makers lose a key policy instrument. Losing monetary politics as a macroeconomic stabilization tool, however, may help governments to avoid getting into a careless fiscal position in the first place [11]. But even if the monetary union has a positive long-term effect on member states' fiscal consolidation, EMU politics represents a collective action problem in the short-term. Whilst the EMU provisions on tight fiscal discipline and non-bail-out are in the common interest of all countries, individual member states and their myopic governments in particular have a clear incentive to defect--once they are member of the monetary union. In this context, defection means that a member state adopts an unconsolidated fiscal policy or conducts an economic policy that is not in line with the “Broad Economic Policy Guidelines” [12]. In the first case, the Council of Ministers may fine a country running an “excessive deficit”. In the second case, the Council can publicly condemn a country for endangering the proper functioning of EMU. In both cases, punishment is dependent on a Council majority vote. In what follows, I will first explain the criteria for economic and fiscal convergence that EU member states are expected to comply with, how compliance is monitored, and how the EU decides on defections. Second, I provide evidence from the history of the EMU suggesting that the punishment of non-compliant countries is by no means automatic, but subject to an inherently political decision.

What constitutes a reliable fiscal policy is specified in the Maastricht treaty and the Stability and Growth Pact.[1] According to Article 104(2a) of the Maastricht treaty, the general government deficit is expected to not exceed 3% of gross domestic product (GDP) and government debt should be at or below 60% of GDP. Although these provisions set up “technically easily measurable and politically highly visible” [13] thresholds, the same treaty article continues with two qualifications. States have no excessive deficit if the deficit ratio “has declined substantially and continuously and reached a level that comes close to the reference value“ or if “the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value”.

The Stability and Growth Pact strengthens the Maastricht procedures. It intends to ensure fiscal discipline not only in the run up to monetary union, but also after member states have qualified once the threat of exclusion has vanished. To allow for counter-cyclical fiscal policies the pact requires member states to aim for "medium-term objectives of budgetary positions close to balance or in surplus". The target here is a zero deficit and the 3% threshold represents the lower end of the safety margin around the medium-term goal [14]. Interestingly, the Council regulation on the deficit procedure does not mention the criteria on the debt-to-GDP ratio when defining the implementation of the "excessive deficit procedure". The procedure itself is straightforward and in line with the Union's institutional history that has always bound majoritarian decision-making in the intergovernmental Council to the agenda-setting power of the supranational Commission. The Commission monitors the budgetary situation of the member states and drafts reports on countries that are considered to have a critical deficit. Based on the recommendations of the Commission, the Council of Ministers then decides whether an excessive deficit exists. Hereby, it acts by qualified majority where votes are weighted according to Article 205 TEU. An exemption is, however, provided for member countries that experience economic shocks: a deficit is considered "exceptional" if real GDP is declining by 2% while a decline between 0.75-2% may be judged as exceptional by the Council.

If the deficit remains above 3% for two years, the Council may impose sanctions on the member state. In particular, it may require the member state to make a non-interest-bearing deposit with the Community which can be converted into a fine if the deficit remains excessive for two consecutive years after the first imposition of the deposit [6]. Article 104(7)(9) and (11) TEU, specifies that the Council "acts on a recommendation from the Commission by a majority of two-thirds of the votes of its members ... excluding the votes of the representative of the Member State concerned." (Article 104 TEU).

The provisions regarding economic coordination are somewhat different, but intend to supplement the deficit procedure described above. According to Article 99(1) TEU, member states “shall regard their economic policies as a matter of common concern and shall coordinate them within the Council.” In contrast to the deficit procedure, the prerequisites that member states are expected to meet, are not defined in the treaty. Rather the Council of Ministers passes, acting by qualified majority on a Commission recommendation and a European Council conclusion, “broad guidelines of the economic policies of the Member Sates and of the Community” (Art. 99(2) TEU). Again, the Commission monitors the coordination of economic policies. Based on the reports of the Commission, the Council of Ministers then decides whether a country’s policy mix “risk[s] to jeopardize the proper functioning of the economic and monetary union” (Art. 99(4)). The Council may even make its recommendations public. On both matters the Council is acting by qualified majority.

The actual effect of these provisions, however, is uncertain. Based on the political economy literature on government fiscal performance, a number of studies has analyzed the impact of the Maastricht process on fiscal policy-making in the member states of the European Union. Whilst some authors found “empirical evidence ... that there is a distinguished effect of the Maastricht commitment on fiscal policies in Europe” [15], the more recent literature is more pessimistic as regards the constraining effects of EMU rules on member states budget deficits. The tentative conclusion is that rather there is a general trend for fiscal consolidation in OECD countries in the 1990s ([13]; [16]; [17]). It has also been argued that direct fiscal policy coordination at the EU level remains limited so far ([18]). Moreover, the economic necessity of such constraints has been questioned. Basically, there are two reasons why fiscal stringency requirements may even be inefficient in the case of the EMU [19]. First, most member states had to decrease expenditure or increase taxes in order to fulfill the deficit criteria exposing themselves to the risk of deflation and recession. Second, there is limited room to counter negative output crisis by stabilization policies (in countries and at times where governments adhere to Keynesian economic policies). Rather pro-cyclical fiscal policies will result that could foster a recession.

Why is this important? It is exactly this type of argument that member state governments have frequently used when proposing a reconsideration of the Maastricht convergence criteria:

- In spring 2002, the German government promised to have a balanced budget in 2004 in order to prevent a negative report on its budgetary policy. Against the will of EU Economic Affairs Commissioner Pedro Solbes, in its meeting of February 12th, 2002, the Council of Ministers abstained from blaming Germany and Portugal for their budgetary situation. In September 2002, Solbes announced that--given the economic downturn in the EU--the Commission is even willing to give up the target of a balanced budget in 2004. In return for it, the pact's rules for fiscal consolidation should be tightened (Süddeutsche Zeitung, September 25, 2002, p. 23).
- In October 2002, French President Jacques Chirac and German Chancellor Gerhard Schröder proposed a flexible interpretation of the Stability and Growth Pact that takes into account budgetary restrictions in economic downturns. The background was that the French budget plan for 2003 envisaged a deficit of 2.6% whilst Germany was expected to have a budget deficit above the 3% threshold in 2002 (Financial Times Deutschland, October 16, 2002, p. 15).

The history of the EMU also provides examples of a more implicit rule change:

- In the first deficit procedure in 1994, the Council--based on the recommendation of the Commission--decided that all member states, besides Luxembourg and Ireland, had excessive deficits. Hallerberg reports that in the Commission's opinion Ireland met the criteria because the debt ratio was decreasing even though it was clearly above 60%. This represented a rule change: "From thenceforth the deficit level was the crucial marker, not debt" [18].

- When deciding on the entrance into the third stage of EMU, member states granted themselves generous exemptions from the Maastricht criteria. In particular, the exchange rate criterion was interpreted loosely for Finland and Italy, which had been in the Exchange Rate Mechanism for only 15 and 16 month, respectively [20].[2] In 1998, the year member states were judged ready for EMU, only two of the twelve Euro countries met all of the numerical Maastricht criteria to the letter [21].

In sum, there is evidence that the constitutional provisions of the EMU are rather vague and have already been subject to various "re-interpretations", i.e. a more or less explicit rule change. As member states have different economic and fiscal positions, they have different interests in a rule change and therefore make various efforts to alter the criteria. In the remainder of this article, I analyze the implications of this situation for EMU politics in the present and the enlarged EU. The fact that enforcement mechanisms are not automatic, but are political decisions raises the question as to what the likely outcomes of such voting processes are.

THE CORE OF EMU POLITICS

In the past, a broad literature has analyzed decision-making in the Council of Ministers comparing different voting rules, various options for institutional reform or several scenarios of previous or forthcoming enlargements of the community. Most studies use voting power indices and compare member states' voting power under present conditions against their power in the enlarged and/or reformed EU ([22]; [23]; [24]; [25]; [26]; [27]; [28]). Not surprisingly, almost all recent studies find that first, the incumbents (relative) voting power to initiate policy change decreases with the entrance of new member states. Second, given the qualified majority quota of about 71%, the Union's capacity to act decreases with the accession of new member states. Voting power analyses also conclude that the institutional reform by the Treaty of Nice will change the collective capacity to act and countries' relative position in the decision-making framework only marginally. Whilst these studies are informative when considering situations of constitutional choice, their ignoring of actors' policy preferences allows for generalized rather than policy area-specific analyses of enlargement and institutional reform [29],[30]. This paper, therefore, adopts a different research strategy [31]. First, I use data on the economic and fiscal situation of current and future member states to estimate the conflict space in EMU politics. Second, I use a spatial model of strategic interaction to study empirically the interaction between the legislative provisions of the EU and member states' policy preferences.

In spatial models of legislative choice, collective decision-making processes are described by focusing on two characteristics: the preferences of the actors involved in decision-making and the institutions these actors partake. In this setting, policy outcomes result from the interaction of the committee members and can be of two principal types, change or no change to the status quo policy. The basic model assumption is that actors care about policy outcomes but because they have different backgrounds, identities or formal roles, their preferences on policy outcomes may differ and lead to a collective choice problem. Given the conflict of interest, policy outcomes will vary depending on where the status quo is and how the institutional framework assigns political power to the actors involved [32]. Based on a spatial model setup [33],[34] a large number of studies has analyzed the interplay between actors' policy positions and the institutional framework of the European Union [35],[36],[30].

I follow this approach using standard assumptions about the key actors involved in EU decision-making, their preferences, and the strategic implications of the EU decision-making procedures. First, delegates of member state governments are the key decision-making actors in the Council of Ministers. Delegates act as perfect agents of their governments and therefore represent "national interests". Similarly, the Commission is conceived as a unitary actor. Second, if one or several issues are on the agenda, individual actors have a "position" that is a most preferred policy in the one- or multidimensional issue space. Council members and the Commission have circular indifference curves around this ideal point so that for any two policies the preferred one is closer to her ideal point. Third, given that actors' policy positions are identifiable, outcomes depend on the voting scheme and the location of the status quo.

When it comes to the prediction of policy outcomes, a reasonable assumption is that the final outcome of the decision-making process is an undominated policy. A committee will hardly agree on a proposal if there is an alternative proposal that is preferred by a majority of committee members. If no such alternative exists the initial proposal is undominated and thus a possible outcome. In this context, the institutional framework defines what exactly constitutes a majority. Here comes the "but": it is a well-known result in social choice theory that in two- or multi-dimensional issue spaces undominated policies do generically not exist under simple majority rule [37],[38],[39]. In the absence of institutions that restrict the sequence of proposals, all policies are dominated by at least one alternative that is preferred by a simple majority of committee members. In these situations, majority rule processes may be chaotic; they might have outcomes but these are by no means stable.

There are several reasons, however, why we should not presume that EU legislative processes produce unstable outcomes or even end up in chaos. First, the Council of Ministers does not act under simply majority rule, but typically--depending on the treaty article concerned--by qualified majority or unanimity [40]. Stable outcomes, however, are more likely for larger majorities [41]. Second, basically all Council decisions must be based on a Commission proposal so that the sequence of proposals is in fact restricted [35]. Third, the Council of Ministers meets in different formations to deal with different policy areas [42]. This is likely to reduce the number of conflict dimensions involved and thus make the existence of stable outcomes more likely.

In the following analysis the game-theoretical concept of the core is used to predict decision-making outcomes. The core is the set of all alternatives in the policy space that are undominated. Accordingly, the unanimity core or Pareto set covers the set of outcomes that cannot be beaten under unanimity. The qualified majority core may shrink the set of unbeatable outcomes. The focus on the core enables me to relax the problem of having to identify the exact location of the status quo because the core is internally and externally stable: if the status quo is located outside the core, the outcome will be located inside the core--as at least one outcome within the core will be superior to the status quo for (at least) one winning coalition; if the status quo is located inside the core, policy change is impossible since at least one actor in any winning coalition would be worse-off.

In order to compare policy outcomes before and after enlargement, I thus assume that every member state is interested in being located in or close to the core. To characterize changes in EMU politics, two elements are considered: First, if the core expands, I conclude that policy change is less likely and therefore EU enlargement may lead to legislative gridlock at the EU level. Second, I argue that EU enlargement will raise particular concerns if the center of the core moves away from the area that is marked off by those economic and fiscal conditions that meet the Maastricht criteria.

THE EMU CONFLICT SPACE IN AN ENLARGED EU

In conducting an analysis of decision-making in an enlarged EU, a major problem concerns the identification of actors' policy preferences. Most studies on the decision-making framework of the European Union use strong assumptions on the distribution of the countries' policy positions. Power analyses widely assume that actors' policy positions are uniformly distributed [29],[43],[28]. Others suppose that member states are divided into larger groups, such as Northern and Southern member states or large and small countries [25],[20],[44], and that the accession of many small Eastern countries raises concerns of the large countries [45].

To illustrate the heterogeneity of the prospective members of EMU, economists have used macroeconomic indicators to forecast the dispersion in the economic structure of member states [8]. Yet these indicators have to be selected and translated into countries' policy positions in the relevant conflict space. With respect to policy-making in the EMU, conflict between member states may arise with respect to both the policies in and the rules of the EMU framework. On the one hand, member state governments are faced with different levels of economic development, financial systems and fiscal positions. For that very reason they might prefer different policies and/or rules to respond to economic crisis and budgetary shocks. On the other hand, the EMU rules themselves are flexible and open to interpretation as examples in the recent history of the EMU show. Thus, given that member states are faced with different economic and fiscal conditions, conflict may arise as to whether member states fulfill the requirements under the EMU criteria or not.

To analyze the conflict space in EMU politics, I use five indicators that refer to both the fiscal and the macroeconomic situation of present member states and acceding countries of the EU:

Budget deficit and government debt (as per cent of GDP) are the two key indicators for evaluating fiscal consolidation according to the EMU rules (Article 121 TEU). The inflation rate is another Maastricht criteria, but it also refers to the macroeconomic performance of a member state. Besides the latter, economic growth and the rate of unemployment are two key variables in the political economy of economic policy-making. Table 1 shows present and future member states' performance with respect to these five indicators in 1992 and 2000. Figures for 1992, the year the Treaty on European Union was signed, represent the conflict of interest at the stage of the EMU founding. Data for 2000 are the last available and are used as "best estimates" for the future conflict space in the enlarged Union. To avoid results that are based more on yearly fluctuations than on stable, country-specific patterns, all figures are adjusted to their three years-average.

** Table 1 **

To delineate the policy space in which member states are located and make decisions on economic and fiscal policies at the EU level, the initial space of five fiscal and macroeconomic indicators has to be analyzed to see whether conflict lines or cleavages between member states overlap or are cross-cutting. If, in an extreme case, member states are divided into two polarized groups with respect to any of the five indicators, the resulting conflict is likely to be essentially uni-dimensional. If, on the other hand, all five indicators are uncorrelated, the conflict space might not be reducible. To find the relevant dimensions of conflict and member states positions on those dimensions, factor analysis is used. Table 2 shows the results for the twelve member states of the EU in 1992 plus the three accession countries of 1995, Austria, Finland and Sweden. The eigenvalues suggest that a solution with two factors, i.e. a two-dimensional representation of the conflict space is adequate. The government finance indicators all load substantially on the first factor. The countries' situation as regards deficit and inflation is neatly captured by the first dimension with factor loadings having the expected opposite signs. The second factor covers the countries' macroeconomic situation with unemployment and growth loading substantially only on this second dimension. But inflation which is used as both a government finance and economic indicator does not load on the second factor whereas government debt is more related to the second than to the first dimension. Thus, as one might have expected, the financial and the macroeconomic situations of EU member states in 1992 can not easily be separated. In the following, I will refer to the first and second factor as the government finance and the macroeconomic dimensions for reasons of parsimony.

** Table 2 **

In a next step, factor scores are calculated to obtain the policy positions of the member states in the two-dimensional space. As a key objective of this paper is to compare EMU politics over time, policy positions have to be estimated so that they are comparable. I therefore use the results of the factor analysis of 1992 to predict the policy positions of both the 15 member states and the 10 acceding countries in 2000. Consequently, removed policy positions of the present member states indicate that the government finance and/or economic situations at the domestic level have changed. Stable policy positions signify unchanged domestic conditions. It has to be stressed that these positions do not represent a member states' *preferred* financial and economic situation. The fact that Luxembourg and Greece are located at different ends of the policy space does not mean that the former government prefers budget surpluses and full employment whereas the Greece government favors budget deficits and high unemployment rates. Rather, it indicates that the two governments are likely to differ with respect to their preferred policies in EMU politics and their interpretation of the EMU rules *because* they have different domestic constraints.

In the following section, I derive and evaluate the core under qualified majority rule (QM-core) for the twelve member states in 1992 and compare its size and location with the QM-core of the enlarged EU of 25 member states. In addition, as the EMU rules also allow for two-thirds majorities on some decisions, two-thirds majority cores (2/3-cores) for the EU-12 and EU-25 are calculated.[3] The QM-core of EU-12 may serve as a baseline as it represents the situation at the time of the negotiation and signing of the Maastricht Treaty. EU-25 is the most simple enlargement scenario, namely that all present acceding countries will actually join the Union in 2004. Bulgaria and Romania will not accede before 2007. I also assume that EMU enlargement will follow right immediately that is two to three years after EU entry as laid down in the treaties' specific procedures for joining the EMU. The basic argument is that the accession decision is a political decision even though it is based on the Maastricht rules. Exceptions, however, were also granted for the current EMU members [20].[4] The comparison of EU-12 and EU-25 then indicates how outcomes are likely to shift. Applied to the EU-12 of 1992, the QM-core covers the set of policies that cannot be defeated by a 71% majority of member state weighted votes, i.e. 54 of the 76 bloc-votes. After the Nice institutional reform that fixed afresh the weights, a qualified majority vote in the EU-25 must satisfy a quota of 236 of the 321 bloc-votes provided that it is supported by a simple majority of member states and represents a minimum of 62 per cent of the total population of the Union.

COUNCIL DECISION-MAKING IN EMU POLITICS

The configuration of positions in EMU politics, at the time of the signing of the TEU in 1992, is shown in Figure 1. In addition to the policy positions of the twelve member states at that time and those of Austria, Finland and Sweden who entered the EU in 1995, The location of the Maastricht treaty and the position of the European Commission is also estimated. With respect to government finance, the location of the Maastricht treaty is based on the EMU thresholds, that is a budget deficit of 3% of GDP, a government debt of 60% of GDP, and an inflation rate that equals the average of the three best performing countries. In 1992, the average was 2.27. The convergence criteria of the Maastricht treaty, however, represent minimal requirements that EU member states are expected to meet. I assume that, by contrast, the Commission is more ambitious and prefers zero deficit and debt. Estimating the position of the Maastricht treaty and the Commission with respect to unemployment and growth is more difficult. Obviously, unemployment rates of zero are economically not desirable and large growth rates likewise have adverse effects. But the TEU does not mention what appropriate figures should be and also the position of the Commission at that time is unclear. At the Luxembourg Summit on employment in 1997 putting into effect the Employment Title of the Treaty, member states agreed on the target of a 70% participation rate by 2010 but the corresponding unemployment rate will depend on country-specific conditions. I therefore fix the treaty's rate of unemployment and GDP growth at the country median in 1992 (7.1 and 2.1, respectively). These figures are also used as a conservative estimate of the Commission's position even though the Commission is likely to have a more ambitious viewpoint.

** Figure 1 **

Figure 1 shows that in 1992 member states differed widely in their domestic conditions. Germany, France, Denmark and the Netherlands are located at the center of the EMU policy space being faced with similar government finance and economic challenges. Extreme located countries are Greece on the right side having a high budget deficit and inflation, Ireland suffering from an unemployment rate of over 10%, and Finland which experienced a deep recession in the early 1990s. By contrast, Luxembourg is the only country that in 1992 would have meet the two key convergence criteria on deficit and debt as indicated by the area in the lower left corner. Does the Maastricht Treaty reflect the Commission position? Obviously not. The two-dimensional representation of the EMU policy space suggests that the Commission's position is similar to that of Luxembourg whereas the Maastricht Treaty comes close to the ideal points of the EMU "core states", Germany and France, as well as Denmark and Austria.

What would the policy outcomes in 1992 have been, if the EMU had started right after the signing of the Treaty on European Union with participation of all twelve countries that were EU member states at that time? Figure 1 displays the QM- and 2/3-cores as the set of likely outcomes under qualified majority and two-thirds majority voting in the Council of Ministers. Both are centrally located with the 2/3-core being a subset of the QM-core and covering about half of its area. According to the spatial model setup, we would expect that decisions of the Council--acting with qualified or two-thirds majority--should be located in the core areas and therefore should be close to the ideal policies of the center group of Denmark, France, Germany, and the Netherlands. Interestingly, the provisions of the Maastricht treaty on EMU come close to this core location. All other member states, however, must fear being outvoted under both voting rules; this is true for both economically poorly performing states (Greece, Ireland) and Luxembourg, the model pupil of EMU.

Figure 2 shows the situation for an enlarged EU-25 using government finance and economic data of 2000. Looking at the country locations in the policy space, four things are apparent: First, positions of all former member states have considerably changed. Second, recalling that any move towards the lower left corner signifies an improvement in government financial indicators, most states have made considerable progress with France being the sole exception. Third, the new member states from Eastern and Southern Europe are located at positions that were occupied by EU-12 member states in 1992. In fact, the accession countries would not increase the heterogeneity of positions in 1992: the Czech Republic has a position that is similar to that of Finland in 1992; Hungary, Malta, and Slovakia come close to Italy's former position. Fourth and finally, the conflict space suggests that current and new member states will still have clearly divergent policy preferences after enlargement.

** Figure 2 **

What will be policy outcomes in an enlarged European Union? Looking at the location and size of the core, there are changes, but they are not severe. One the one hand, the size of the QM-core doubles indicating that under qualified majority voting all status quo policies located between the ideal points of France, Latvia, Germany, Estonia, Cyprus and Lithuania can not be changed. Thus it is unlikely that new EMU policies will disregard the position of these countries, and generally there will be less potential for policy change. On the other hand, the QM-core itself has shifted to the upper left side but has not moved towards the zero-deficit, zero-debt position of the Commission along the Maastricht-Commission axis. This suggests that even in the enlarged EU-25, decision-making outcomes will reflect policy positions of member states that have government financial conditions similar to those of EU members in 1992. In sum, the accession of Eastern and Southern European countries seemingly shifts both cores in EU-25, but this effect is rather marginal given the core locations at the beginning of the Maastricht process. Moreover, the enlarged Union's capacity to act in EMU politics will decrease, but the loss of efficiency might be considered modest.

NOTES

[1] The Stability and Growth Pact consists of three documents: a European Council resolution and two Council of Ministers regulations on the excessive deficit procedure and on surveillance.

[2] According to the 6th Protocol of the TEU, “the third intent of Article 109j(1) of this Treaty shall mean that a Member State (MS) has respected the normal fluctuation margins provided for by the ERM of the EMS without severe tension for at least the last two years before the examination“.

[3] QM- and 2/3-cores are calculated using the programs LIMED and QHULL (cp. [46]). LIMED (available at http://www.tbraeuninger.de/download/download.html) requires the commercial program GAUSS and computes limiting q-dividers (hyperplanes) in two- and three-dimensional policy spaces for uni- and multicameral legislatures with actors having weighted and/or unweighted votes. QHULL (available at http://www.geom.umn.edu/software/qhull) computes the core by intersecting halfspaces (defined by the limiting q-dividers calculated by LIMED) about a given core point.

[4] See Eichengreen and Ghironi [8] for a discussion of reasons why accession countries will seek and gain entry at an early date.

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ACKNOWLEDGEMENTS

This research is supported by the Deutsche Forschungsgemeinschaft (grant No. BR1851/3-1).

Table 1: Fiscal and macroeconomic situation of EU member states and accession countries in 1992 and 2000[1]

	Budget balance (% GDP)		Government debt (% GDP)		Inflation		Growth		Unemploy-ment rate	
	1992	2000	1992	2000	1992	2000	1992	2000	1992	2000
Belgium	-6.80	-0.43	128.45	115.30	3.03	1.04	2.10	3.10	6.83	8.53
Denmark	-2.15	2.33	67.05	51.23	2.38	2.17	0.90	2.70	8.43	5.03
Germany	-2.85	-0.87	42.80	60.83	3.15	0.76	4.32	2.30	6.10	8.70
Greece	-11.70	-1.77	86.15	103.87	18.58	3.70	1.27	3.57	7.10	11.23
Spain	-4.30	-1.33	46.85	62.93	6.19	2.07	2.23	4.17	17.00	16.27
France	-3.00	-1.87	37.80	58.53	2.99	0.60	1.70	3.13	9.63	10.87
Ireland	-2.35	3.03	94.15	47.57	3.20	2.03	4.57	10.33	14.50	5.83
Italy	-9.95	-1.63	105.05	113.83	5.96	1.81	1.40	2.10	8.80	11.20
Luxembourg	1.35	4.43	4.65	5.90	3.32	0.98	4.26	7.03	1.83	2.47
Netherlands	-3.40	0.60	79.50	62.00	2.92	2.10	2.80	3.83	5.87	3.43
Austria	-2.25	-1.90	58.05	63.90	3.54	0.73	3.11	3.10	5.07	4.00
Portugal	-4.95	-2.00	66.15	54.30	11.22	2.56	3.03	3.77	4.43	4.60
Finland	-3.70	3.37	32.25	46.70	4.27	1.28	-3.20	5.00	7.17	10.47
Sweden	-4.40	2.60	59.80	63.83	7.37	0.16	-0.39	3.77	3.47	7.13
United Kingdom	-4.45	2.00	38.70	45.53	6.35	2.49	-0.23	2.67	8.60	5.97
Cyprus		-3.63		62.53		1.93		4.77		3.47
Czech Republic		-4.00		15.43		6.39		0.43		8.00
Estonia		-1.73		6.07		5.75		3.73		11.97
Hungary		-5.43		59.43		12.34		4.77		7.07
Latvia		-2.90		12.77		3.51		3.87		14.30
Lithuania		-4.03		20.97		2.93		1.70		14.47
Malta		-8.40		59.20		2.26		4.30		4.97
Poland		-2.67		42.73		9.52		4.30		13.53
Slovak Republic		-5.77		30.63		8.63		2.73		15.77
Slovenia		-1.80		25.45		7.60		4.53		7.50

[1] Average over three years (1990-92 and 1998-2000).

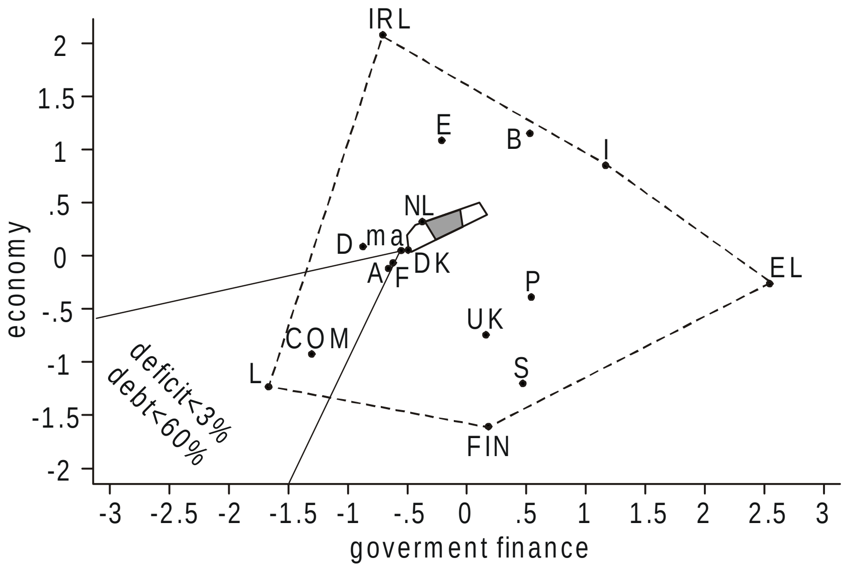
Source: Eurostat, Statistical Yearbook 2002; Eurostat: Luxembourg, 2002. Budget deficit and government debt figures are not available for 1990. Data on Inflation: World Bank, Word Development Indicators; World Bank: New York, 2002. Inflation data are not available for 2000.

Table 2: Factor loadings[1]

	Factor 1	Factor 2
Budget balance	-0.95	(-0.20)
Government Debt	0.54	0.68
Inflation	0.81	(-0.19)
Growth	(-0.43)	0.53
Unemployment rate	(0.02)	0.68
Eigenvalue	2.09	1.24
N=15		

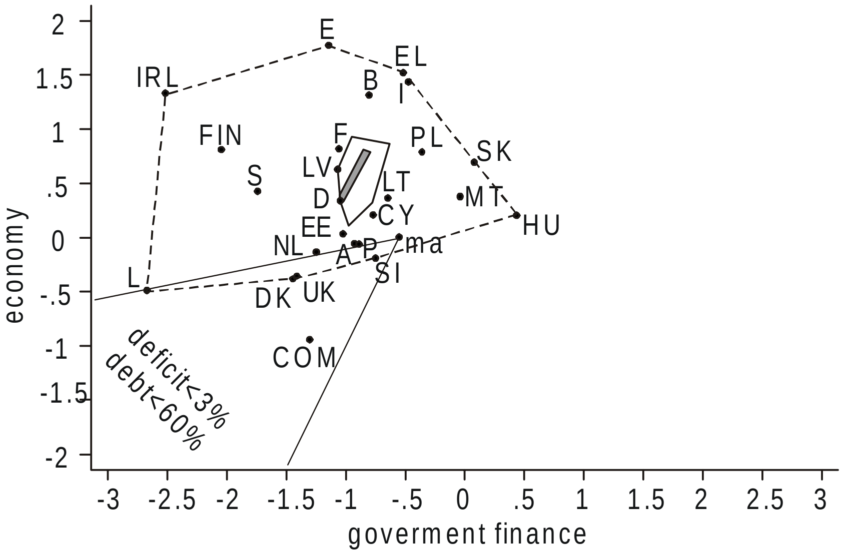
[1] Principal-components factor method. Eigenvalue of third factor is 0.93.

Figure 1: EU-12 two-thirds and qualified majority core in EMU politics



Key: 2/3-core, QM-core, unanimity core, ma--Maastricht Treaty; COM--Commission; A--Austria, B--Belgium, DK--Denmark, E--Spain, F--France, FIN--Finland, UK--United Kingdom, D--Germany, EL--Greece, IRL--Ireland, I--Italy, L--Luxembourg, NL--Netherlands, P--Portugal, S--Sweden.

Figure 2: EU-25 two-thirds and qualified majority core in EMU politics



Key: 2/3-core, QM-core, unanimity core, CY--Cyprus, CZ--Czech Republic, EE--Estonia, HU--Hungary, LT--Lithuania, LV--Latvia, MT--Malta, PL--Poland, SK--Slovakia, SI--Slovenia, for other abbreviations, see Figure 1.