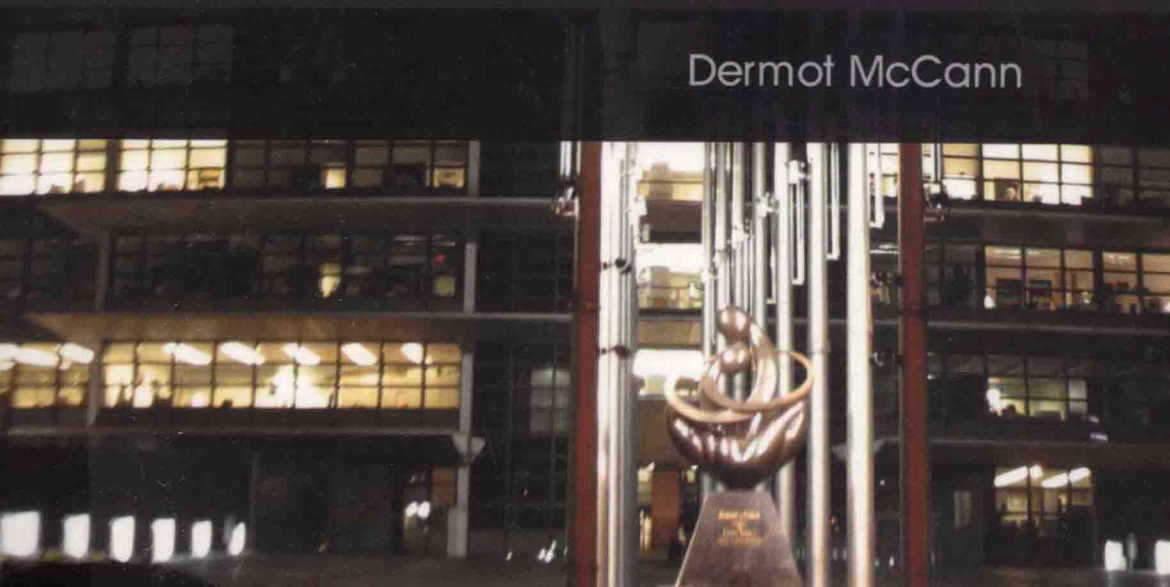




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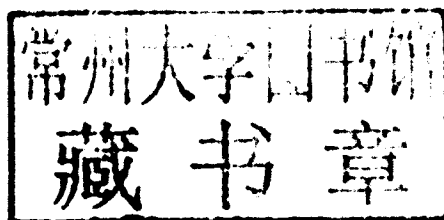
Dermot McCann



# The Political Economy of the European Union

An Institutional Perspective

DERMOT MCCANN



polity

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**To Mary and Muireann**

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## Abbreviations

ALMP	active labour market policies
BDI	Federation of German Industries
BEPGs	Broad Economic Policy Guidelines
CAP	Common Agricultural Policy
CBI	Confederation of British Industry
CDOs	Collateralized Debt Obligations
CEEP	Centre Européen des Entreprises Publique
CEN	European Committee for Standards
CENELEC	European Electrical Standards Coordinating Committee
CFI	Court of First Instance
CME	coordinated market economies
DG EcFin	Economics and Finance Directorate General
ECB	European Central Bank
ECGN	European Corporate Governance Network
ECJ	European Court of Justice
ECMR	European Community Merger Regulation
Ecofin	Council of Finance and Economic Ministers
EDP	Excessive Deficit Procedure
EEC	European Economic Community
EES	European Employment Strategy
EGLs	European Employment Guidelines
EMCO	Employment Committee
EMF	European Metalworkers' Federation
EMS	European Monetary System
EMU	European and Monetary Union
ERM	Exchange Rate Mechanism
ESD	European Social Dialogue
ESM	European Social Model
ETUC	European Trade Union Confederation
EWC	European Works Council
FSAP	Financial Services Action Plan
FSU	Finnish Seamen's Union
IPO	initial public offerings
ISD	Investment Services Directive
ITF	International Transport Workers' Federation

LME	liberal market economies
MBR	Mandatory Bid Rule
MiFID	Markets in Financial Instruments Directive
MMC	Monopolies and Mergers Commission
MNCs	multinational corporations
NAIRU	non-accelerating inflation rate of unemployment
NAP	National Action Plan
NCAS	National Competition Authorities
NTBs	non-tariff barriers to trade
OFT	Office of Fair Trading
OMC	Open Method of Coordination
PECs	pacts for employment and competitiveness
QMV	Qualified Majority Voting
SEA	Single European Act
SGP	Stability and Growth Pact
SMEs	small and medium-sized enterprises
TEU	Treaty on European Union (Maastricht Treaty)
UEAPME	Association of Craft and Small and Medium-sized Enterprises

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## Introduction

The European Union (EU) embodies a remarkable experiment in inter-state cooperation. In the 50 odd years since its inception, it has evolved from a small community of six West European countries to encompass the great majority of European states, stretching from the Atlantic isles to the Russian border and from the Arctic Ocean to the Mediterranean Sea. At the same time, its policy remit has greatly expanded. Although it was founded as a customs union, by the early twenty-first century questions of immigration, asylum, anti-terrorism cooperation, foreign and defence policy had forced themselves to the centre stage of EU politics to an extent that would have been inconceivable in earlier decades. Though progress has been unsteady and the direction of development strongly contested, integration has persisted even as the international political and economic landscape that shaped its early development has been transformed by the end of the Cold War and the rise of new economic powers.

Unsurprisingly, the political dynamics of this remarkable process of integration have attracted considerable attention. The factors that have persuaded national states to accede to it, the nature and power of the Union's governing institutions and, of course, the ways in which policy is made have all been the subject of extensive analysis. Perhaps equally unsurprisingly, these literatures have generated profound disputes concerning the very nature of the process. Thus, for example, where some analysts perceive in integration the partial transcendence of the nation-state in the international arena, others argue that its progress further demonstrates the innovative capacity of such states to devise new institutional structures to satisfy national interests. Similarly, where some view EU institutions as powerful actors capable of shaping the direction of integration, others regard them as servants of the member states labouring faithfully to implement the deals that they have agreed among themselves. At issue are fundamental questions concerning the power and status of nation-states in the context of the most ambitious experiment in cooperative regional integration yet witnessed.

However, an understanding of the implications of European integration for member states requires more than simply an assessment of the degree to which they dominate its decision-making procedures. It is also necessary to consider the extent to which 50 years of European law and policy have served to change their internal institutional character. How transformative for states

is membership of the EU? This question is no more pertinent than in relation to the economy. The core business of European integration has been economic integration. The commitment inscribed in the Treaty of Rome to realize the 'four freedoms' of movement in goods, services, capital and people has provided the political impetus and legal basis for a vast array of subsequent policy initiatives. Barriers to trade in goods and services have been stripped away. The free circulation of capital and people has been substantially realized. A new currency has been established, removing one of the most powerful instruments of economic management available to states. How has all of this activity affected the role and character of domestic political economic institutions in member states?

Recognition of the importance of this question has been sharpened by recent studies in comparative political economy, which have attested both to the often subtle institutional diversity of capitalism across states and to the economic and political significance of these differences. From financial to labour markets, from the role of the state to the collective representative organization of business and labour, national 'models' or 'varieties' of capitalism have evolved highly distinctive governing institutions. These institutions profoundly influence the productive strategies of firms and the distribution of power and resources among socioeconomic actors. Systems of corporate law and finance shape how corporations are owned and governed. Competition policies, labour market rules, social policy rights, etc. affect the terms upon which the factors of production can be acquired and 'mixed' in any given economy. Together, these institutions largely determine the capacity of actors, ranging from workers to capital investors, to protect and advance their interests. To the extent that the EU's pursuit of 'ever closer union' impinges substantially on these properties, the fundamental political economic character of member states may be significantly altered.

The case for characterizing the EU as an agent of national political economic transformation is predicated on a number of closely related arguments. Firstly, European integration is understood to embody a commitment not only to market liberalization but also to the institutionalization of a European system of liberal market governance. Without the creation of such a regulatory system, the benefits to be derived from opening up cross-border trade would, in practice, be undermined by the persistence of national legal and administrative bias. Genuine market liberalization requires the establishment of a liberal European governance system. Secondly, the establishment of such a governance system at the European level is seen to present a profound challenge to the sustainability of national institutional arrangements in a substantial number of member states. This reflects the fact that, in many such states, non-liberal institutional forms play a central role in economic governance. Liberal Europe looks to markets to coordinate economic activity and seeks to protect and enhance competition as the best means of achieving economic efficiency and development. The role of the public authorities is

to uphold this system. For states such as Britain, this project tends to work with the grain of established national practice. In contrast, however, markets in 'non-liberal' or 'illiberal' economies are supplemented by a high level of non-market coordination between stakeholders, and a large amount of public intervention in private decision-making over finance, investment and consumption is common (Streeck, 2001: 4). Moreover, employment and welfare protection weigh more heavily as policy objectives than they do in liberal economies. Thus, in Germany, Austria and the Netherlands, it is frequently the case that creditor banks sit on the governing boards of debtor firms; that business associations play a central role in managing inter-corporate relations; and that employees enjoy substantial representation rights within the firm. In France, Italy and Spain, the state continues to exercise a powerful influence over corporate investment and restructuring decisions in key economic sectors, particularly when national corporate actors are threatened by foreign-owned ones. For these systems of 'organized' capitalism, European liberal market governance presents a potentially transformative threat (Höpner and Schäfer, 2007: 5–6).

Finally, it is contended that this conflict between the creation of a truly liberal European economy and the maintenance of illiberal national institutional structures is intensifying. In particular, it is suggested that economic integration is now entering a 'new, post-Ricardian phase in which it systematically clashes with national varieties of capitalism' (ibid.: 6). The Union and, above all, powerful elements within the European Commission are accused of seeking to enforce the dominance of liberal principles of economic governance through a convergence of national institutional structures. Recent European Court of Justice (ECJ) decisions on issues ranging from firm incorporation rules to collective bargaining rights have served to deepen this challenge. Integration 'asymmetrically targets the institutions of organised capitalism and, therefore, results in a "clash of capitalisms"' (ibid.). EU policy initiatives designed to institutionalize a liberal market in Europe pose an ever greater threat to the integrity of the political economic order in a substantial number of member states.

None of these contentions is unproblematic. The existence of the Common Agricultural Policy alone would suggest that the description of European integration as liberal economic in nature needs some qualification. More broadly, Europe has been characterized for much of its existence by quite a shallow form of economic integration that has impinged only to a limited extent on national regulatory arrangements. In addition, the supposed more recent triumph of liberal economic principles in the EU needs careful assessment. The presence of a substantial element of support for 'organized' or 'regulated capitalism' within the EU has been widely noted (Hooghe and Marks, 1999). Treaty negotiations are frequently marked by a conflict of 'liberal' and 'regulated' visions of capitalism (Pollack, 1998). Recent initiatives pursued by the Commission on the welfare rights of part-time workers hardly conform with

liberal economic prescriptions favouring labour market flexibility as a means to improve growth and employment performance in Europe (Wallace, 2004: 115–16). Moreover, the extent to which the building of a truly liberal Europe requires the reconfiguration of many deeply rooted national institutions, and the economic and political relations that they embody, is also open to dispute. More sanguine views suggest that national systems can effectively adapt to the changing European context while retaining the essential features of their national institutional arrangements (Schmidt, 2002b). Substantial change in economic conditions is not a new phenomenon, and national varieties of capitalism have frequently demonstrated a capacity to absorb these pressures while retaining their distinctiveness (Hall, 2007: 41). The irreconcilability of liberal Europe and non-liberal national institutional arrangements cannot be assumed.

Furthermore, even if such irreconcilability did obtain, there is reason to question the capacity of the EU to force through radical changes in national systems. By their nature, these systems are deeply embedded both politically and socially. National administrative and/or private actors may well be able to resist in full or in part the imposition of what they perceive to be undesirable changes. More broadly, national governments often balk when the full implications of the commitments they have made become apparent. Since his election in 2007, the French President Nicolas Sarkozy has repeatedly and forcefully reasserted the right of the nation-state to intervene in the process of industrial change, notwithstanding EU rules. Though the rhetoric in other states may be less confrontational in tone, practice reflects a similar perspective. Thus, for example, an attempt by American interests to buy Italia Telecom in 2007 was repelled by a domestic coalition of industrial and financial actors orchestrated by the Italian state. A bid by a German firm to purchase the Spanish energy group Endesa in the same year was so delayed by Spanish government interference that it ultimately failed. The prevalence of defensive nationalism in Europe does not invalidate the ‘clash of capitalisms’ thesis. Indeed, it suggests that many member states perceive a genuine and substantial threat from EU policy to their established arrangements and practices. However, the nature of their response also indicates that they may yet retain both the will and the capacity to shape their own destinies and to resist wholesale incorporation into a new, more liberal, Europe.

This book will evaluate these sharply contrasting perceptions of the EU’s economic project. Using the conceptual tools of comparative institutional political economy, it will examine the impact of EU policy on the political economic governance of member states. Is the effort to realize fully European market and monetary integration enforcing a fundamental transformation of their institutional governance? Are the EU’s initiatives particularly challenging to non-liberal, organized political economies? Has the EU’s liberal ambition taken a more aggressive form in recent years? In addressing these questions, the analytical focus will be on those domains of economic governance that

comparative institutional political economy has identified as constitutive of national capitalisms: product, financial and labour markets. How does EU policy challenge national patterns of governance in these crucial areas? How effective has it been in implementing its policies and how successful have these policies been in achieving their objectives? Though there will be some consideration of those states that have recently joined, the overwhelming focus of attention will necessarily be on the pre-2004 member states, the so-called EU15. These are the countries that have been most fully and extensively exposed to the EU. These are the states whose well-entrenched institutions of capitalist governance often present the greatest obstacles to the realization of the EU's liberal ambitions. It is through the examination of the nature and extent of change in these countries, and most especially the extent of change evident in those most marked by non-liberal institutional practices, that the transformative power of the EU can be gauged most accurately.

### **Organization of the Book**

The examination of these issues is conducted in two broad stages. The first stage is concerned with conceptual clarification and historical contextualization. Chapter 1 will examine the conceptual underpinning of an institutionalist approach to the examination of the impact of the EU on national political economies. What are economic governance institutions and why do they matter? What do concepts of national 'varieties' or 'models' of capitalism mean? How do they differ across the member states of the EU and with what consequences? In what ways and through what mechanisms does the process of European economic integration challenge or threaten these institutions? Chapter 2 will then provide a broad historical survey of the breadth, depth and progression of integration. In terms of market building, what have been the principal objectives and instruments of EU policy? Is it correct to construe the central thrust of European market-building as a liberal economic enterprise? How has this project evolved over time? In particular, how precisely does the advent of the single market and single currency challenge the integrity of national institutions of economic governance in product, financial and labour markets?

The following five chapters will then examine the specific development of EU policy in relation to product, financial and labour market regulation and its implications for established national institutions. Can its policies be properly characterized as embodying a liberal, transformative project in respect of national political economies and their governance institutions? To what extent is the EU capable of achieving its objectives? Is there evidence of substantial change in the institutional character of domestic systems? Can the extent of change that is evident be justifiably described as transformational? Chapter 3 will examine the nature and impact of the EU's competition policy on the governance of product markets. Chapter 4 will examine EU initiatives

relating to corporate law and financial market regulation and, specifically, the challenge that they present to established national systems of corporate ownership and governance. Chapter 5 will deepen the analysis through the examination of the impact of these initiatives on patterns of corporate ownership and control in Germany and Italy. Both countries possess institutional arrangements that differ substantially from the Anglo-American norms informing much of the EU's reform programme in the area of finance and corporate governance. An understanding of the extent and dynamic of change in these national systems will offer considerable insight into the transformative capacity of EU policies. Finally, chapters 6 and 7 will examine the evolution and impact of EU policy in relation to labour markets. Chapter 6 will focus on EU social policy and, especially, employment policy. Chapter 7 will then examine the EU's developing industrial relations role and its impact on national systems. General conclusions will then be drawn in the final chapter.



# Economic Governance, National Models of Capitalism and the Challenge of European Integration

## Introduction

The examination of the European Union's role in reshaping economic governance in member states is essentially an exercise in institutional analysis. National political economies are composed of institutions that structure and regulate economic activity, delimiting how actors can behave and interact. The challenge presented by the EU stems from the impact of its policies on these institutional systems. In what ways and to what extent does it necessitate their reform? Before these questions can be properly examined, however, two key issues must be addressed. Firstly, the nature and significance of national institutional systems must be clarified. What constitutes an institution of economic governance? In what way do institutional systems structure the functioning of economies? How are we to distinguish liberal from non-liberal institutions? What does it mean to speak of national 'models' or 'varieties' of capitalism? Secondly, it is necessary to clarify how EU policy affects these institutional systems. What are the linking mechanisms between EU initiatives and national institutional reforms? An appreciation of the challenge presented by EU policy to national systems requires the analysis of the dynamic of 'Europeanization', the process whereby state practices are brought into conformity with EU legal and policy prescriptions, as much as it does the exploration of the policies themselves. How effective is the EU in enforcing change in member states?

## Social Embeddedness and Institutional Governance

The constitution and governance of market economies is a subject that has attracted considerable attention from comparative political economists in recent years. While conceptualizations of the issues and problems involved vary greatly, two core contentions are commonly shared. Firstly, it is argued that far from being universal in nature, capitalist economies are deeply enmeshed in the wider institutional structures of the society in which they operate. Economic activity is embedded within a specific social context and is mediated and shaped by the particular institutions that exist there (Coates, 2005, Jackson and Deeg, 2006: 11). Consequently, the functioning of economies inevitably differs significantly across social contexts. It is neither possible