

# European Integration: The Third Phase And Beyond

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## Abstract

**The application of a dynamic framework for analysing European integration combining the insights of historical institutionalism with the observation of self-organisation reveals that the European Union (EU) entered a third phase of sustained and rapid growth in the mid-1980s that was qualitatively different from two previous phases. The analysis of the Union budget as an indicator of institutional growth points to the existence of distinctive growth periods in the EU's history that can be explained in terms of specific limits on institutional capacity. On this basis it is possible to consider the present capacity of the EU to find appropriate solutions to the challenges it faces. The indications are that monetary union is driving a process of further institutional transformation from which a more powerful inner core will emerge.**

## Introduction

The uneven pace of European integration is a feature of its development that has been problematic in the search for a general explanatory theory and with this, the understanding of its stability as an organisational arrangement. The 1985 agreement to complete the Single European Market was a qualitative leap forward in a process that appeared to have exhausted its potential in the previous decade. Renewed interest in the integration phenomenon inspired a new search for explanatory theories.

The large body of research that has emerged in the past decade has enriched our appreciation of the complex interplay between individuals, institutions and external forces in delivering certain outcomes. But we are still in search of a theory or modification to existing theory that can explain the qualitatively different phases of the integration process. So far, we have a number of partial theories that can be classified more or less along the lines of agent-based, exogenous event or functional explanations. While all of these contribute to the understanding of parts of the puzzle, we are still left guessing as to how to adjudicate between these to understand the present, and more importantly, surmise the future.

Indeed, the goal of a single theory may not be attainable or even appropriate in explanations dealing with such complexity. But the case-specific validity of existing explanations invites the possibility that an ordered synthesis may fill in some of the gaps. In this paper I propose that the investigation of underlying systemic factors provides a vital link in advancing the understanding of sudden changes in institutional performance.<sup>1</sup> The analysis of systemic factors reveals the conditions under which certain types of activities or outcomes are likely to take place. Through this we can take an enlightened view as to which of the alternative causal explanations is likely to prevail under different conditions and how these might be played out over the next few years.

An example of this approach is demonstrated through the analysis of the European Union (EU)<sup>2</sup> budget as an indicator of institutional transformation. Quantitative and qualitative changes in the development of the budget are used to identify the existence of phase changes in the integration process. These are linked to an investigation into the systemic features of the EC/EU that might have initiated these phase changes. The overall

institutional structures impact upon outcomes. The results of this study corroborate the belief that a transformative phase in European integration occurred in the mid-1980s after more than a decade of relative stagnation and points to the existence of specific underlying systemic causes that date back to events in the late 1960s.

The interpretative methodology applied is consistent with a critical realist perspective.<sup>3</sup> European integration is understood to be the result of a dynamic interplay between agents and an emergent institutional arrangement.<sup>4</sup> To develop explanations of the forces underlying this process, it is necessary to understand the nature of institutional structure and how it impacts upon agency. While the constraining effects of institutional structure occupy one side of the analytical spectrum, the role of agents in sustaining and developing institutional structure occupies the other. The concept of institutional capacity<sup>5</sup> is used to explore the dynamics of this interaction between structure and agency. It is observed that individual agents can impede the process when institutional capacity is low. Conversely, agents can accelerate the process when capacity is high.

The stop-go character of integration in Europe is linked to the existence of specific institutional characteristics that limited capacity during the 1970s. A partial resolution of these limits in the mid-1980s increased capacity and pushed the integration process onto a new growth phase. While not contesting the influence of external events and international actors (Sandholtz and Zysman 1989), or of the promotion of national interests in influencing outcomes (Milward 1991; Moravscik 1991, 1993), my claim is that the impact of such factors can be understood within the context of institutional capacity. Through an understanding of institutional capacity it is possible to explain the constraints and opportunities that determine the impact that different factors bring to bear on a process.

The application of this approach to the situation of the late 1990s suggests that the integration process has sustained the rapid growth phase initiated in the mid-1980s but that certain limits are being approached that will need to be resolved. The imminent emergence of a single currency is a continuation of a transformative period that began in the mid-1980s but brings with it a structural change that will see the formal establishment of an inner core of member states surrounded by an outer core of variable integrators.

This is an important structural transformation that will enable the next wave of enlargements to proceed on looser political terms while sidestepping the sensitive issue of diluting the existing power structure. Following a practice that already exists, a proliferation of overlapping decision-making committees will reflect differential integration levels, with an inner tier committee of single currency members becoming the most powerful. As has been so often the case in the past, we are witnessing another phase of deepening before widening – an observation that confirms the principle of ‘self-organisation’ (see below) in the evolution of organisational arrangements.

### **Institutional Self-Organisation: Developing Explanations of Institutional Change**

The theoretical framework underlying this research adopts an historical institutionalist perspective in which it is proposed that institutions matter, are capable of autonomous behaviour and exhibit path-dependent development.<sup>6</sup> From this starting point, the approach is extended to consider the nature of institutional change.

Most observed change is incremental and is understood in terms of the normal demand-response function of ongoing institutional activity. Occasionally, however, a ‘transformative’ change occurs which alters fundamentally the way that a specific institutional arrangement functions. Figuratively speaking, this constitutes a change to the ‘rules of the game’ and sometimes, a change to the ‘game’ itself. Although path-dependency may still be observed, this type of change is not a predictable outcome of prior institutional arrangements.

Historical institutionalism is unable to explain why transformative change occurs. However, change of this type has been widely observed to exhibit certain tendencies that have

historical institutionalist observation of path-dependent change, the proposition that transformative change is determined by systemic capacity. Organisational arrangements, whether physical living systems or social systems can be described in terms of the limits that define their capacity to adapt to new pressures. The process of incremental change drives adaptive systems towards their limits and as this occurs, their capacity to respond to new demands becomes increasingly constrained.

In contrast to the traditional view of stable equilibrium, a system that appears stable may in fact be approaching a crisis. Conversely, evidence of rapid change is a sign of stability in the survival of a particular arrangement. Organisational systems that reveal inadequate response capabilities to ongoing pressures are vulnerable to destabilisation. They may be replaced very suddenly or wind down through a longer process of attrition. To survive and grow they must undergo a transformative change that will alter the limits on their existing institutional capacity.

Institutional arrangements such as the European Union can be analysed historically for evidence of adaptive capacity and changes in performance in the explanation of their evolution. This approach can be used to assess the nature of the limits that act on such arrangements and the latter's prospects for further growth and adaptation. To identify such limits, it is necessary to develop a measure of the historical process and within this to seek evidence of systemic change that might account for an underlying change in behaviour.

### **Identifying Systemic Change in Institutional Development**

The methodological framework adopted to identify systemic change in the EU's development applies the insights of an historical institutionalist approach to the measurement of integration as a developmental process. To develop an objective measure of integration, it is necessary to focus on an aspect that can be tracked and quantified historically. Possible measures could include the growth of intra-EU transactions, the growth of the regulatory regime or the growth of the administrative structure.<sup>8</sup>

The particular measure selected for analysis in this study is the EU budget. It is argued that the budget can be used as a proxy for measuring integration. Without the commitment of financial resources, real changes in organisational arrangements do not take place even though they may be the subject of much rhetoric. The real growth of the EU budget compared to that of national public sector budgets offers a measure of the relative growth of governance at Union level. The growth of the budget also indicates the pace of integration itself. A rapidly growing budget signifies expanding policy implementation costs. To check that this is related to the rate of integration and not simply to the growth of bureaucratic structures, the administrative budget is analysed separately and its growth compared with that of the overall budget.<sup>9</sup>

The analysis of the budget enables the identification of differential rates of change in the integration process. Short-term fluctuations are attributed to contingent events such as exchange rate movements, the take-up of new policies, bumper years in agricultural production, etc. Longer term trends in budgetary growth, whether a slow down or acceleration, are assumed to reflect a fundamental change in the underlying systemic structure. Some of this growth is attributable to the longer-term impact of a sequence of enlargements.

The interpretation of the budget data is complemented by a detailed analysis of institutional developments. The latter include any change that alters the core structure of the EU, i.e. the growth and emergence of formal institutions, procedural changes, decision-making rule changes, enlargements, etc. The analytical process is necessarily iterative, employing both inductive and deductive lines of reasoning. The knowledge of institutional developments is used to interpret the budget data. The latter then confirms whether certain

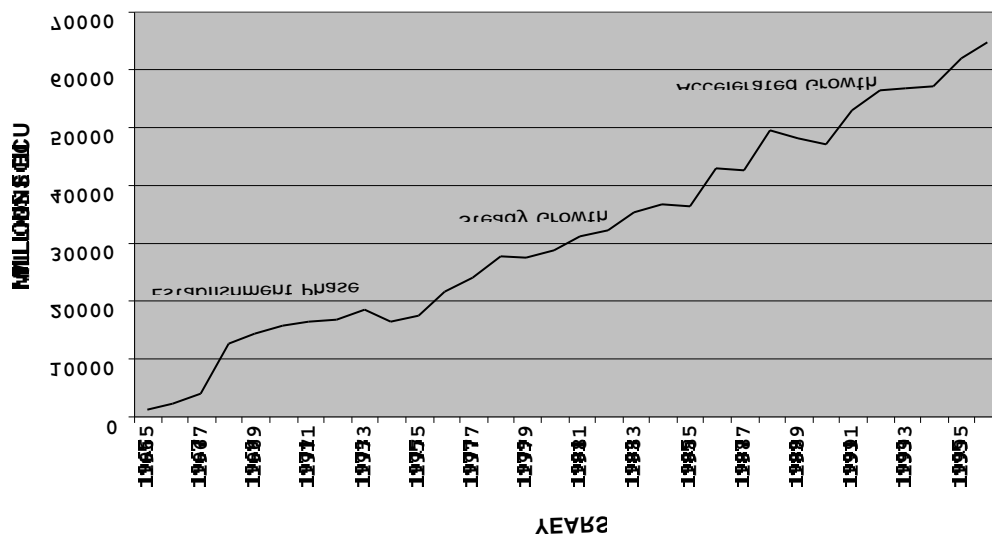
underlying structure. Conversely, the indication of a permanent change in budget development is used to identify institutional changes that appear to be systemic.

Taken together, the analysis of the budget and that of institutional evolution, offer insights into the underlying characteristics of the EU systemic structure – when and why it changed. This then provides insights into the strengths and weaknesses of the present structure and the promise it holds for the future.

### The Growth of the EU Budget

In Figure 1, the historical growth of the Union budget suggests three phases during which an established pattern in budget growth changed. During the initial 1965 to 1975 period, Community expenditure rises quickly, increasing on average by 1,500 million ECU per annum (equivalent to an average rate of 18 per cent).

The shape of the growth curve during this establishment phase is typical of the ‘S-shaped’ curve observed in emergent systems. This reflects the fact that the rate of diffusion or take-up of a new process accelerates exponentially as it passes through a population until a point is reached at which the scope for further extension along the same lines becomes increasingly limited. At this stage an innovative change is required that will increase its capacity of adaptive response to new demands and push it onto a new growth trajectory. If this does not occur, the process will approach stasis. From this point it may remain static, decline slowly or be replaced quite suddenly by a competing process.



SOURCE OF DATA: European Commission General Reports (annual) and Budgetary Documents

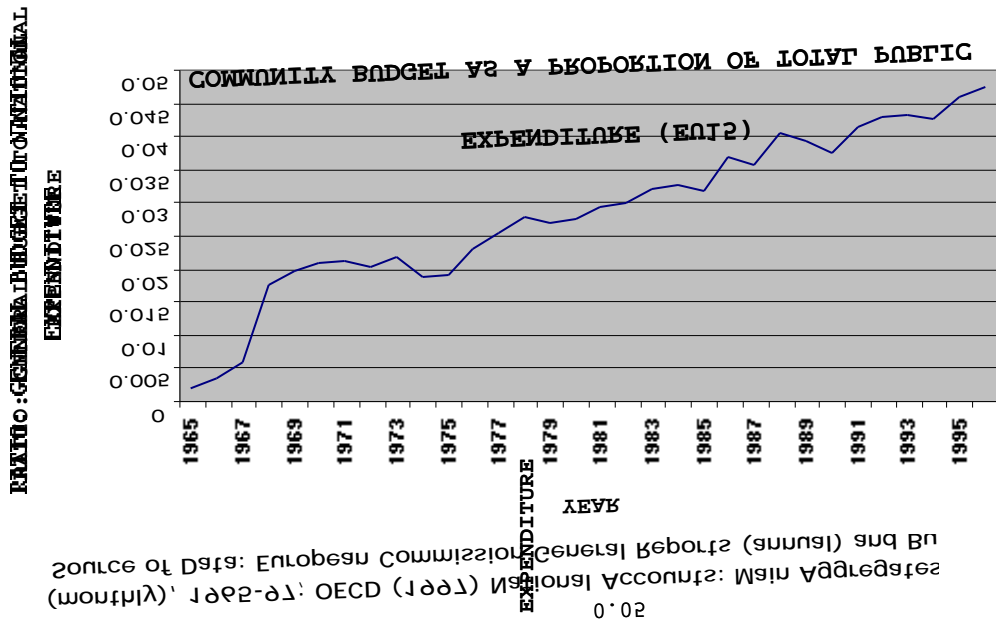
**Figure 1. The Union Budget 1965-96**

The period of slower growth from 1975 to the mid-1980s suggests that the EC had reached a limit on its development potential within the existing institutional framework. During this second period, the annual growth rate drops to five per cent and the real budget records an average increase of 1,460 million ECU per annum.

After 1985, the integration process entered a new phase accounted for by a sudden surge in the growth of the budget. The increased fluctuations recorded between 1986 and 1990 are accounted for by international exchange rate movements that impact directly on the large

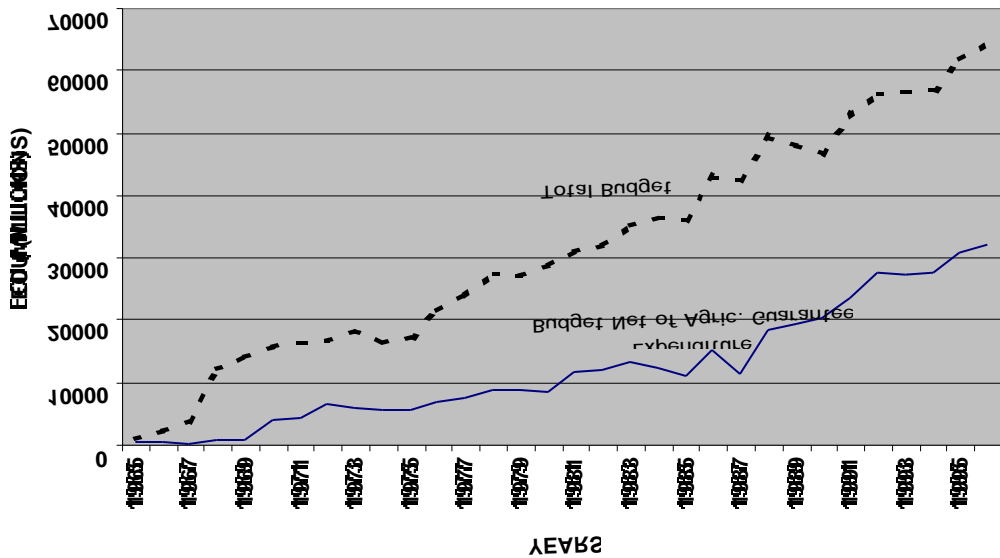
correlation between the growth of the budget and gross domestic product. The annual percentage growth rate recorded for this third period drops to 3.8 per cent but this translates into an absolute increase in the budget of roughly 2,040 million ECU, a 25 per cent increase over the previous decade.

In Figure 2 the Union budget is shown as a proportion of average national public expenditure growth for the fifteen EU member states.<sup>10</sup> Overall, this shows that over most of the period the Union budget rises at a faster rate than national expenditure, indicating the growth of governance at Union level. The data also amplifies the results presented in Figure 1 by correcting for the general trend of increasing public expenditure. The ratio of the Union budget to public expenditure records values of .00158, .00126 and .00152 for the 1965-75, 1976-85 and 1986-96 periods, again confirming the qualitative change that occurs in these different periods, particularly the positive surge after 1986.



**Figure 2. Union Budget Relative to National Public Expenditure (EU15)**

One aspect of the budget that obscures the growth of its policy extension component is the large automatic portion that relates to the Common Agricultural Policy (CAP). Figure 3 shows the growth in the total budget against the growth in the non-agricultural budget. It reveals the long slow trend in the growth of the non-agricultural budget until 1985, after which it increases more rapidly than the automatic agricultural component. The non-agricultural budget grew at 15 per cent in 1965-75, 4 per cent in 1976-85 and 6.5 per cent in 1986-96, again confirming the expectation that non-automatic expenditure proceeded at a faster rate after the mid-1980s. A comparison of non-agricultural expenditure in relation to trends in public expenditure within Europe confirms this finding revealing that non-agricultural expenditure grows more rapidly after 1985.

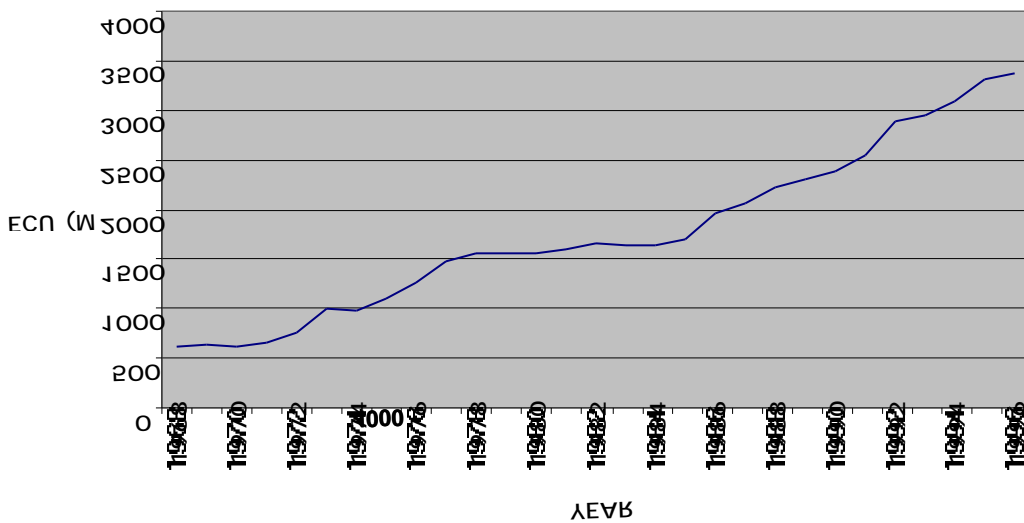


Source of Data: European Commission General Reports (annual) and Bulletin (semi-annual)

**Figure 3. Growth in Total Budget Relative to Growth in Non-Agricultural Spending 1968-96**

The analysis of the growth in administrative expenditure offers a measure of the growth of the EU as a governance regime. Although there is a natural tendency for administrative budgets to expand, the rate and pattern of this expansion may confirm some of the insights already gained from the growth of the general budget. Figure 4 records the real growth of administrative expenditure between 1968 and 1996. A rapid increase is observed from 1970 to 1977, followed by a flat period of very little growth until 1986. After this, it assumes a strong positive trend through to 1996 (the latest year for which comparative data are available).

A comparison of administrative expenditure with the general budget indicates that administrative expenditure remained constant during the slow growth of the general budget over the 1970s. This suggests that budget increases during this period can be attributed to the increased resource demands of existing policies rather than to further integration through policy extension. For the latter to occur, some growth in the administrative budget would have been required.



Source: European Commission General Reports (annual) and Bulletin (semi-annual)

#### Figure 4. EU Administrative Expenditure 1968-96

Overall, the evidence on the Union budget, non-agricultural spending and administrative expenditure supports the proposition that the integration process passed through three qualitatively distinct phases. The growth of administrative expenditure (Figure 4) depicts the three periods most clearly and suggests that the growth of EC governance was at a virtual standstill during the 1975 to 1986 period. The next task is to identify the underlying causes of these phase changes through a consideration of the impact of institutional limits on the behaviour of institutions and agents in driving this process within a changing environment.

#### Identifying Systemic Limits on Institutional Change

The empirical data on the Community budget and its administrative expenditure component indicates that from the early 1970s until 1987, the general budget was driven by increased expenditure on Community policies even while administrative expenditure was being squeezed. Further analysis on the structure of Community spending reveals that a large part of the increase over this period is accounted for by agricultural spending, although expenditure on non-agricultural policy areas was also increasing (at a slower rate).

After 1988, the general budget and the administrative budget both reveal strong positive rates of growth. At the same time, the non-agricultural budget increases as a proportion of the total budget, confirming the rise in non-compulsory spending that was initiated with the setting of new objectives under the Single European Act and the subsequent financial perspectives agreed for 1988-92 (Delors I) and for 1993-99 (Delors II).

The slowing down of real budgetary growth at the end of the 1960s coincides with the end of the transition period establishing the customs union and the CAP. Up until this point, Community expenditure was supplied annually by member country contributions in accordance with an agreed GNP key developed to balance benefits and contributions from the policy mix. In 1975, the entry into force of the Treaty of Brussels ended the partial reliance on GNP-based contributions, replacing this portion of revenues with a VAT call-up rate limited to 1 per cent of a notional VAT base applied to each member state.<sup>11</sup> This was the first year that Community expenditure was tied directly to the economic fortunes of the member states.

Although the new system of 'own resources' ostensibly gave the Community an independent source of funds, the revenue arrangement imposed a ceiling on the growth of Community expenditure that soon proved to be insufficient. The first and second resources, generated by customs duties and agricultural levies declined over time as successive GATT rounds achieved tariff reductions and the growth in Community agricultural production led to a decline in agricultural imports. At the same time, CAP spending, deemed 'compulsory' by Treaty, exploded to absorb all of the first and second resources and most of the third VAT resource. Limited powers acquired by the European Parliament enabled it to propose modifications and amendments to the draft budget and to adopt or reject the budget, but the power to alter levels and sources of Community revenue remained firmly within the intergovernmental sphere under conditions of unanimous decision-making.<sup>12</sup>

The financial framework completed in 1975 was designed to protect CAP spending with a source of revenue that applied uniformly to all member states irrespective of benefits received.<sup>13</sup> Prior to her entry into the Community it was known that Britain would receive fewer benefits under the existing provisions of the so-called common market (Preston 1997:29). Fearing a subsequent backlash against the CAP, the French exchanged their consent to British membership for a set of institutional reforms that would safeguard existing policies. However, the institutional set-up necessary to protect the agricultural policy and its financing *conferred negative power on each member state in respect of policy extension as well as policy alteration*. In other words, unanimity was required to alter existing provisions such as the CAP, as well as to agree any increase in Community finances that would be associated

with the introduction of new policies. As CAP obligations increased, spending on the tiny non-compulsory component<sup>14</sup> and administration were squeezed.

The renegotiation of the terms of accession for Britain in 1974 resulted in an agreement to establish a 'budgetary correcting mechanism'. By 1978 when the progressive phasing in of Britain's budget contributions was complete, it became apparent that the budgetary correcting mechanism severely limited the level of rebate for reasons unrelated to her position as a large net contributor. When Margaret Thatcher was elected Prime Minister the following year, the core of her European policy hinged upon a permanent redress of Britain's budgetary position. This continued the stalemate in Community decision-making until it was resolved at the Fontainebleau Summit in 1984.

The slower growth of the budget after 1975 can be attributed to a combination of factors that include: the capacity of national leaders to resist any proposals involving increases in expenditure and their resolve to do so under adverse economic conditions; the larger than expected drain on Community resources absorbed by the CAP; and the establishment of absolute financial limits that limited policy extension. Instead of releasing the Community institutions to develop common policies, the implementation of Community 'own resources' within such a framework was a Trojan horse. Little scope existed for the introduction of new policies that would further the stated objectives of integration.

Between 1978 and 1987 annual budgetary conflict between the European Parliament (EP) and the Council of Ministers (and within the Council itself) confirms the negative impact of an inadequate budget. During this period, the Community was forced onto 'provisional twelfths' financing (Community expenditure is restricted each month to one-twelfth of the previous year's budget) three times. In most years one or two supplementary budgets were required to meet expenditure requirements that exceeded those agreed in the annual budget.

By 1983 Community resources were exhausted within the agreed 1 per cent VAT limit. Since the raising of the 'own resources' ceiling required Treaty amendment, this sparked a crisis in Community financing through which Britain was able to exploit its individual veto to extract a satisfactory resolution to the dispute over its net contributions. It was this crisis that initiated the transformative changes necessary to safeguard the future of the integration process.

The agreement on the British budget rebate mechanism reached at Fontainebleau was combined with the agreement to increase the VAT call-up rate to 1.4 per cent (effective from 1986 to coincide with the accession of Spain and Portugal) as well as a commitment to contain CAP spending. In the aftermath of this breakthrough in the deadlock, Community leaders focused immediately on the institutional arrangements that had impeded progress for over a decade by appointing the Dooge Committee on institutional reform. Although other proposals for institutional reform had come and gone with little effect, it was the Dooge Report that ultimately was translated into the internal market agreement and the reforms embedded in the Single European Act. This suggests that the success of the Dooge Report was related to its timing as well as its content.<sup>15</sup>

By 1987, the 1.4 per cent VAT limit was exhausted and Community finances were plunged into another crisis. This time, however, the renewed commitment to integration, ushered in by the agreement to complete the Single European Market (SEM) and to the reforms embodied in the 1986 Single European Act (SEA) enhanced the capacity of the Community to resolve the financial constraints that had plagued it for almost two decades. The most important institutional change that emerged during this transformation was the agreement to extend the use of Qualified Majority Voting to policy areas activated by the SEM. This was a direct response to the paralysis in decision-making that had overwhelmed Community institutions over the previous decade.

Following the SEA's entry into force in mid-1987, the Commission President – Jacques Delors – was able to link the funding of Community policies to the stated goals of the

setting of an expenditure limit linked to Community GNP and the setting of a five year financial perspective in which allocations to individual policy areas were agreed in advance. This landmark agreement removed the budget as a limit on the integration process. Not surprisingly, the continued operation of the British budget rebate was confirmed within the Delors package.

After 1987, the rate of growth of the Community budget and the administrative budget increased substantially and continued to accelerate through to the most recent year for which comparative data are available. Since the implementation of Delors I in 1988, the annual budget has been adopted on time without a protracted inter-institutional struggle indicating that the ceiling on Community resources has not acted as a limit on institutional capacity since this time. Indeed, in 1992 when the second financial perspective was adopted, the actual budget was still within the ceiling that had been set in 1988.

Although Community leaders substantially reduced the new expenditure levels proposed by the Commission for 1992-97 and extended the period to 1999, the 1997 budget was still within the limit established for that year. The Commission's most recent proposal for a financial perspective for the 2000-2006 period remains within the 1.27 per cent limit of EU GNP even after the estimated costs of accession of five countries and Cyprus (European Commission 1998). However, the success of this latest proposal hinges on substantial further reductions to the CAP and has been the subject of heated debate among Union leaders. If CAP spending is not curtailed then the EU may find itself once again restricted in its institutional capacity to sustain the integration process.

Overall, the analysis of the budget indicates that events in the 1980s released the integration process from a limit. The Delors I agreement to link expenditure to GNP removed budgetary conflict as the central issue in the regular summit meetings of the European Council permitting Community leaders to look to the future for the first time in many years. However, Delors I was predicated on the earlier SEA agreement in which vital institutional reforms were introduced to underpin the agreement to complete the Single European Market.

On budgetary evidence, the SEA appears to be the single most important transformative institutional change since the Community was established. The conflict over the budget and Britain's ability to exploit its powers within this context provided the arena from which this most important institutional reform emerged. Although the agreement on majority voting had been specified for single market legislation, its use expanded into areas where it was sanctioned under the Rome Treaty but had been avoided since 1965 when the French temporarily withdrew from the Community in protest.

In summary, it would appear that the slower, middle period of the integration process was limited by a perverse combination of events in the early 1970s that left the Community with insufficient 'own resources' alongside institutional inflexibility in the capacity to alter financial provisions and established policies. This served to restrict the capacity of the Community to respond to new demands posed by the first enlargement or those arising from international pressures. However unsatisfactory, the impaired arrangement limped along until the Community reached an absolute financial limit that threatened its ability to meet existing obligations, thus threatening its very legitimacy. At this point Community leaders were forced to concede to Britain's demands. Essentially the struggle was not about the retention of national sovereignty but about the distribution of benefits among member states. It appears unlikely that Britain would have been nearly so 'awkward' on ideological grounds if they had been on the winning side of the redistribution stakes.

### **Explaining Institutional Transformation: The Stops and Starts of Integration**

The analysis of Union budget growth identifies three periods of systemic change in the history of European integration. This observation prompted the examination of institutional evidence

with a change to internal institutional structure. The subsequent analysis suggests that between 1970 and 1985 the underlying capacity of the European Community to accommodate new demands was limited by specific structural inflexibilities introduced prior to the first enlargement.

The Fontainebleau agreement of 1984 marked a vital breakthrough in budgetary reconciliation. After this, Community leaders were able to conclude seven years of accession negotiations with Spain and Portugal and to take the momentous decision at Milan in 1985 to press forwards with the SEM. The introduction of majority voting in the SEA turned out to be a fundamental institutional change that released Community leaders from the decision-making impasse of the 1970s. The subsequent 1988 agreement on financial reform under Delors I came in the wake of a new spirit of cooperation precipitated by the SEM/SEA agreement and removed the budget as a limit on the integration process.

The significance of the SEA and the Delors I financial perspective are reflected in the acceleration of the integration process thereafter. Short-term fluctuations in the budget after 1988 mirror reduced CAP spending and the recession of the late 1980s. Since 1988 the Community entered a phase of sustained and rapid internal development. This is confirmed by the significant developments that followed, including the successful implementation of a majority of the single market measures, increased funding for non-compulsory policies, a new approach to CAP reform, German reunification and the Maastricht Treaty on European Union (TEU).<sup>16</sup>

## **Conclusions**

The budget has been used as one example of how systemic change can be identified in a process of institutional development. This has revealed two significant structural changes in the EU's history – the first was the imposition of resource limits in the early 1970s and the second was the change in decision-making rules introduced in the mid-1980s.

Further confirmation of this finding has been found in the examination of other aspects of the integration process. Separate investigations into the history of economic and monetary union (EMU), CAP reform and a sequence of enlargements confirm the importance of systemic structure on adaptive capacity. It has been found that the development of internal policies such as the EMU and CAP were constrained by the EC systemic structure in the same way as the budget. In both cases, the pledge to develop these policy areas is almost as old as the Union itself. And yet, it was not until they could be linked with the transformative change of the mid-1980s that it was possible to break out of the pre-existing structure that restricted integration on all fronts.

The enlargement record confirms a process in which the protection and resolution of internal institutional arrangements receives priority. Negotiations impose the full 'acquis communautaire' on acceding countries irrespective of their needs and capabilities. Acceding members have not been able to challenge any aspect of the EC/EU's policies prior to accession but have had to wait until they can exploit their decision-making power to exact concessions. The institutional structure can only be altered from the inside and the alterations that do occur invariably add new layers to the existing structure.<sup>17</sup> Prior institutional arrangements are extremely difficult to reverse.

The role of agency is acknowledged to be fundamental in this process. The influence of individuals such as De Gaulle, Thatcher and Delors on subsequent outcomes is striking. But the history of integration also reveals the capacity of structures to empower or constrain agency in directing such processes. Margaret Thatcher was able to impede further integration during the period that Britain's agreement was pivotal to its survival (as De Gaulle had done two decades earlier). But once the budget rebate was agreed and the Community financial

External events are also central to the formulation of demands and expectations from institutional arrangements. In the case of the EU, the influence of declining international competitiveness and domestic performance have been widely acknowledged in the pressures for completing the Single European Market. However, these pressures were already strong in the 1970s following the collapse of the fixed exchange rate system and the impact of two energy shocks.<sup>19</sup> Even so, it was not until the institutional structure was released from certain limits on its capacity that it was able to develop appropriate responses to international pressures.<sup>20</sup>

The analysis presented here does not diminish the importance of agency nor suggest that the changes were in any way automatic. Rather, the analysis of agency in bringing about structural change is fundamental to the understanding of this complex process. The overriding conclusion of this research is that systemic change was necessary for agency to exploit opportunities as they were presented. Resulting structural changes then acquired their own dynamic that propelled the process onwards. At the same time, it is accepted that the agents themselves are empowered by the structure and can therefore change in different time periods. Thus, intergovernmental bargaining might offer the best explanation of some aspects of this process but the role of Union institutions and specific individuals within them have been important at other times.

The understanding of the systemic limits that constrain or promote the development of the EU as a governance regime offers certain insights into its future prospects and capacity for meeting the challenges that it faces as we approach the next millenium. Although it has managed to keep within the budget ceiling of 1.27 per cent of GNP, in 1998 it is rapidly approaching this limit. Union leaders are already engaged in heated discussions in respect of the financial perspective proposed under Agenda 2000. Commission forecasts indicate that substantial cuts in agricultural price subsidies will be required for the budget ceiling to remain adequate.

At the same time, the commencement of the final stage towards economic and monetary union by eleven member states in 1999 constitutes a fundamental structural change known as a 'bifurcation' in self-organising systems. In this case, the limits on institutional capacity to accommodate the next wave of applicants will be resolved by the deepening of an 'inner core' of integrators and their separation from the broader, more flexible arrangement that will link the others. Ultimate control over the integration process will rest within this inner core.

Under the new arrangement, it is probable that the financing and execution of integrating policies will be linked to the sphere of participation by individual members. Those within the inner core will be able to advance their separate and common interests most. This will make it possible to admit new applicants without the financial and economic burden posed by their admission to the full 'acquis' while at the same time permitting further deepening for the inner core of more affluent members. For the group of acceding countries, the arrangement might bear a stronger resemblance to a regional trade agreement with a large neighbour rather than to the emergence of common governance presently associated with the core members. For those that have not met the single currency requirements or have not elected to join, strong pressures to join the inner core will emerge because of the implicit power the inner core will gain from closer integration.

Ultimately, the EU must be seen as an ongoing response to the growth of interdependence and globalisation. The perception that it will remain as an agreement to pool sovereignty by nation states, or that it will become a federal or confederal 'superstate' advances organisational concepts from the past that overlook the developmental nature of social organisation within an evolving society. The evidence presented here indicates that the

'outs' but between the 'core members' and the 'variable integrators'. Through developing better understandings of the forces underlying this complex process, we can identify its strengths and weaknesses and direct its development towards the promotion of peace, prosperity and security.

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## Endnotes

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<sup>1</sup> Institutional performance expresses the ability of organisational arrangements such as the European Union to respond satisfactorily to the demands made of them.

<sup>2</sup> The term European Union is used generally throughout the discussion except where references concern its functioning in earlier periods - for these the general term European Community (EC) has been applied.

<sup>3</sup> The critical realist approach warns against theories that overlook the mutually constitutive nature of agents and structures in the development of society. This is developed by Giddens (1984) in his *theory of structuration* and forms the basis of the agent-structure debate in international relations (see Wendt 1987).

<sup>4</sup> The definition of institutions used here conforms to that proposed by North (1990) and March and Olsen (1984, 1989) and is taken to include all facets of social organisation including rules, regulations, physical buildings, formal institutions, procedures and norms and beliefs.

<sup>5</sup> Institutional capacity relates to the ability of institutional arrangements to perform the tasks expected of them. The demands placed upon institutions emanate from the continually changing environment (both internal and external) of which they are a part. Thus there is a continual need for institutions to develop adaptive responses and grow, but their ability to do this is limited by their capacity.

<sup>6</sup> Historical institutionalist approaches to European integration have been undertaken by Bulmer 1994, Peterson 1995 and Pierson 1996.

<sup>7</sup> The concept of self-organisation is used to explain the increasing complexity observed in the evolution of living systems (including social). It is associated with the seminal contribution of Nobel laureate Ilya Prigogine within the natural sciences and has been extended to a range of social science applications (see Allen 1996; Burley and Foster 1994; Daneke 1988,1990; Dyke 1988; Kiel 1992; Prigogine and Stengers 1984; Prigogine and Allen 1982).

<sup>8</sup> The study of changing norms and beliefs is also a measure of integration but these are more problematic to measure objectively. The use of functional indicators such as expenditure are assumed to reflect a wider process that includes the development of a sense of 'community' as originally proposed by Deutsch (1957).

<sup>9</sup> In the case of the EU, growth in the administrative budget could also correlate with further integration provided

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<sup>10</sup> The public expenditure growth of the fifteen EU member states is considered adequate to establish general trends in public spending over the period. Although individual countries may deviate from the average from time to time this would have a very small impact on the expenditure trends of the overall group of member states and does not merit the development of a weighted index to coincide with enlargements. Moreover, in terms of relative contributions to the data being used, the larger economies – accounting for over 80 per cent of EU GDP – have been members of the Community since the mid-1970s (the original six account for 65 per cent).

<sup>11</sup> The implementation of a standardised VAT system took several years to be implemented throughout the Community. The 1980 budget was the first to be financed under the new system.

<sup>12</sup> Under Article 201 of the Treaty of Rome, any increase in the 1 per cent VAT call-up would require an amendment to the Treaty and ratification by national parliaments (EC Bulletin 3-70, Part One, Ch. II).

<sup>13</sup> In fact, the VAT component discriminated against the poorer member states because it does not apply to investment – an activity that grows as a country becomes wealthier.

<sup>14</sup> Officially, all Community expenditure arising directly from the Treaties was termed ‘compulsory’ and was under the sole jurisdiction of the Council. Mainly, this comprised the guaranteed price subsidies established under the Common Agricultural Policy and in the early period accounted for three-quarters of total expenditure. Most other budget lines were termed ‘non-compulsory’ and involved the European Parliament in decision-making procedures.

<sup>15</sup> A parallel Ad Hoc Committee on a People’s Europe chaired by Pietro Adonnino agreed at the same time had little impact (Dinan 1994: 141).

<sup>16</sup> Based on the foregoing analysis, the budgetary implications of economic and monetary union would be expected to be significant but this will not occur until EMU is implemented. Thus, the TEU may prove to be a political transformation that is not yet visible in the physical data.

<sup>17</sup> Thus, the UK settled for a budget rebate to correct a distributional imbalance that was caused by the agricultural policy. Apart from the UK problem, there were a host of other problems associated with the CAP but even the recent CAP reforms have relied on new policy instruments rather than a change to old policies.

<sup>18</sup> The convening of intergovernmental conferences after 1985 were agreed despite UK objections as was the most important agreement at Maastricht to proceed with monetary union.

<sup>19</sup> The current realisation of a single currency is also a process that began in the late 1960s with the demise of the Bretton-Woods system of fixed exchange rates. Under the 1970 Werner Plan it was even agreed to complete monetary union by 1980. Nevertheless, the firm commitment to monetary union did not eventuate until the late 1980s, after it became linked with the completion of the Single Market.

<sup>20</sup> Even the 1979 European Court of Justice path-breaking *Cassis de Dijon* decision was made six years before it was implemented in the Single Market agreement.