Legal Issues of Economic Integration

Wolters Kluwer
Law & Business

KLUWER LAW INTERNATIONAL

Published by:
Kluwer Law International
P.O. Box 316
2400 AH Alphen aan den Rijn
The Netherlands

Kluwer Law International
Lower Ground Floor
Prospero House
241 Borough High Street
London SE1 1 GA
United Kingdom

Sold and distributed by:
Turpin Distribution Services Ltd
Stratton Business Park
Pegasus Drive
Biggleswade
Bedfordshire SG18 8TQ
United Kingdom

Subscription enquiries and requests for sample copies should be directed to Turpin Distribution Services Ltd.

Subscription prices, including postage, for 2007 (Volume 34):
EUR 284.00 / USD 355.00 / GBP 209.00.
This journal is also available online. Online and individual subscription price are available upon request. Please contact our sales department for more information at +31(0)172 64 1562 or at sales@kluwerlaw.com.

Legal Issues of Economic Integration is published quarterly.

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ISSN: 1566 6573

Legal Issues of Economic Integration 34(1): 5–25, 2007.

Some Reflections on Economic Policy

***By** René Smits**

Abstract

This essay is based on a paper presented at the Conference on Legal Foundations of International Monetary Stability, held in London (GB), 27–28 April 2006, which was held to celebrate Dr Rosa Lastra's book with the same title (Oxford University Press, 2006). Professor Smits analyses the asymmetry between economic and monetary union from a legal perspective. The author concludes that there is more scope for policy coordination among the EU States in spite of the basic distinction between the two elements of Economic and Monetary Union in the EU, under which Member States remain largely competent to pursue their own economic policies even when a single monetary policy is conducted at Community level. He explores the possible contents of more aligned economic policies, notably on free movement of persons, education, energy and public health. He ends with a few considerations on economic policy choices and the furtherance of happiness.

I. Economic Union: The Contours

1. The Main Difference between Economic and Monetary Union

The main difference between the economic union and the monetary union elements of the European Economic and Monetary Union (EMU) lies in the attribution of exclusive competences in the field of monetary policy to the Community level of government while competences for economic policy have remained largely with the Member States, albeit that the latter are to be pursued within a Community legal and policy framework. In this essay, I propose to establish that this division, while fundamental, is less pronounced than commonly considered, so that the present legal provisions provide more scope for coordination of economic policy than currently undertaken. In the second part, I present some views on the kind of economic policies which, in my view,

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should be pursued to take full advantage of the single currency and the single market and to serve best the interests of the citizens of Europe.[1]

2. *Economic Union: Principle, Provisions, Prohibitions, Procedures*

The economic union can best be described on the basis of *Four 'P's'*:

i) the basic principles, laid down in Articles 4 and 98 EC,
ii) the three fundamental prohibitions (Articles 101–103),
iii) the major provisions working these out (Articles 99 and 104, as well as Article 100 EC, which has a special status), and
iv) the procedures established on the basis of the two former provisions: the multilateral surveillance procedure and the excessive deficit procedure (EDP).

3. *The First 'P': Basic Principles*

Article 98 EC requires Member States ('shall') to conduct their economic policies with a view to contributing to the achievement of the objectives of the Community and in the context of the Broad Economic Policy Guidelines (BEPGs). Both the Member States and the Community are to 'act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources'. Article 4 EC contains the 'mission statements' for, or the definitions of, economic and monetary union. The first para. defines 'economic union' as follows: '(…) the adoption of an economic policy which is based on the close coordination of Member States' economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competition.' Article 4 (3) EC requires the Community and the Member States to act in compliance with guiding principles for EMU, i.e.

– stable prices
– sound public finances and monetary conditions

and

– a sustainable balance of payments.

1. This essay reflects my own thinking. Its proposals may not be attributed to the *NMa* or to the Netherlands' Ministry of Economic Affairs. The author gratefully acknowledges the comments of the discussion during the conference at which a paper was presented on which this essay is largely based. The reflections of Ms. Phebe Miller, honorary senior research fellow and Ph.D candidate at University College London, have been gratefully taken into account.

4. The Second 'P': Prohibitions

Before we look at the elaboration of the principles in provisions and procedures, a remarkable element of the economic union should be mentioned. In line with the free market thinking which the Treaty confesses to,[2] it requires governments to stand on their own when funding budgets. Any government is forbidden to rely on direct central bank credit in the form of overdraft facilities or the direct purchase by central banks of their debt instruments.[3] Moreover, privileged access to finance by financial institutions has been outlawed.[4] Moreover, the Treaty makes clear that obligations undertaken by States are not underwritten by fellow States, or by the Community: the so-called 'no bail-out' clause[5] implies that public authorities of EU States cannot rely on backing by the Community or by other States. They have to repay their own debts. These provisions should ensure that States and their subdivisions fund themselves in the markets, apart from receiving tax receipts and, thus, are subject to the discipline of the financial markets.

5. The Third 'P': Provisions

The main provisions of the economic union, setting out the framework within which States are to pursue their economic policies, are Articles 99 and 104 EC. The former reiterates the Community dimension of national economic policies[6] and lays down a mechanism for coordination. As will be further explained below, this takes place in the Council on the basis of commonly agreed upon guidance for economic policy, the aforementioned BEPGs. The latter provision sets out the prohibition of excessive government deficits and lays down the

2. In Article 98 EC, as quoted above, and in Article 105 EC, which requires the European System of Central Banks (ESCB) to 'act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 4.'
3. Indirect credit by way of secondary market purchases by central banks of government bonds has not been outlawed, as these financial instruments have a major role in central banks' operations to supply liquidity to the financial markets and, thereby, to influence interest rates. *See* the seventh and eighth recital of the preamble to, and Article 2 (2) of, Council Regulation No. 3603/93 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b (1) of the Treaty, OJ 1993, No. L 332/1. Please note that Articles 104 and 104b have been renumbered Articles 101 and 103, respectively, by the Treaty of Amsterdam (1997).
4. *See* Articles 101 and 102 EC and the Regulation cited in the previous footnote as well as Council Regulation No. 3604/93 specifying definitions for the application of the prohibition of privileged access referred to in Article 104a of the Treaty, OJ 1993, No. L 332/4. Please note that Article 104a has been renumbered Article 102 by the Treaty of Amsterdam.
5. Article 103 EC.
6. Article 99 (1) EC reads as follows: 'Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council, in accordance with the provisions of Article 98.'

procedure that should ensure compliance with this basic requirement of EMU. It should be noted that all Member States are subject to both provisions with one exception and one derogation. The exception is the United Kingdom to which Article 104 (1) EC ('Member States shall avoid excessive government deficits') does not apply, just as the provisions on sanctioning excessive deficits does not apply to this State with an opt-out.[7] The States with a derogation, i.e. the Member States that have not yet adopted the single currency, are subject to the basic provision but not to the sanctions that can be applied in the context of the EDP to their fellow Member States that did adopt the euro.[8] Denmark, the only other State with an opt-out,[9] is in the same position as the Member States with a derogation.[10]

The economic union comprises one other major provision which is often overlooked: Article 100 EC. It gives the Community an economic policy competence of its own. Article 100 (1) EC makes the Council competent to 'decide upon the measures appropriate to the economic situation'. Since the Treaty of Nice (2001), the Council, always acting on a proposal from the Commission, can act by qualified majority voting (QMV). The exact nature of the 'measures', which may be adopted, has not been specified. Although the competence is specifically ('in particular') given for cases of scarcity ('if severe difficulties arise in the supply of certain products'),[11] it is not limited to this kind of occurrence.[12] It is thus legally possible to adopt common economic policy measures for the whole Union.

7. Paragraphs 5 and 6 of the UK Opt-out Protocol ensure that the United Kingdom is merely required to endeavour to avoid excessive deficits (Article 116 (4) EC) and that the paras on sanctions do not apply to it, just as they are not applied to States with a derogation (i.e. States that, because of lack of sufficient convergence, temporarily are exempt from the obligation to adopt the single currency) and Denmark. The other paras of Article 104 EC do apply. In 2006, the Council adopted a decision establishing that the United Kingdom runs an excessive deficit (Council Decision of 24 January 2006 on the existence of an excessive deficit in the United Kingdom (2006/125/EC), OJ 2006, No. L 51/14).
8. *See* Article 122 (3) EC, para. 5 of which excludes the States with a derogation from voting in these cases.
9. Contrary to popular opinion, Sweden does not have the benefit of an opt-out but organises its exclusion from the Eurozone through non-compliance with the convergence criteria (notably by not making *Sveriges Riksbank* independent and suitable for integration into the ESCB and by not joining the ERM-II exchange rate mechanism linking the 'out' currencies with the euro). The ten newly acceded Member States all enjoy a derogation pursuant to Article 4 of the 2003 Act of Accession (OJ 2003, No. L 236). Slovenia will adopt the euro on 1 January 2007.
10. *See* the Danish Opt-out Protocol.
11. And, to my knowledge, Article 100 EC has only been used in this context: Council Directive 98/93/EC of 14 December 1998 amending Directive 68/414/EEC imposing an obligation on Member States of the EEC to maintain minimum stocks of crude oil and/or petroleum products, OJ 1998, No. L 358/100. *See*: <http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:31998L0093:EN:HTML>
12. In this essay, the provision on financial assistance (Article 100 (2) EC) is not discussed.

6. The Fourth 'P': Procedures (Including the Stability and Growth Pact)

The economic union is characterized by two distinct procedures which should ensure a close enough coordination of economic policies to underpin a single currency. They have been further elaborated by the Stability and Growth Pact (SGP), an agreement to strengthen surveillance and to speed up and 'clarify' (i.e. pin down to prearranged application) the EDP.

The so-called 'multilateral surveillance procedure' encompasses the monitoring of economic policies and their consistency with BEPGs, which the Council adopts annually. The latter are a recommendation addressed to the Member States.[13] Should the Council, acting on the basis of Commission reports, establish that a State's policies 'are not consistent with the [BEPGs] or that they risk jeopardising the proper functioning of economic and monetary union', it can address a recommendation to that State and, by separate decision, publish it.[14] The only instance, thus far, of such a recommendation was the highly contested one to Ireland (2001).[15] The BEPGs and the multilateral surveillance procedure encompass the entire spectre of economic policies and are not confined to budgetary policy.

The EDP is restricted to compliance with the budgetary norms. This multistep procedure seeks to ensure that the avoidance of excessive deficits is monitored in a political and not a judicial context. While, normally, compliance with Community obligations is ensured by the Commission and sanctioned by the European Court of Justice (ECJ),[16] in this sensitive policy area, the role of the ECJ has been excluded when it comes to establishing whether an excessive deficit exists and deciding which consequences this should have.[17] Its role is limited to reviewing the legality of the acts, or omissions, of the Commission and the Council, the main players in this procedure.

The EDP is based an a continuous monitoring by the Commission of the

13. *See* Council Recommendation of 12 July 2005 on the broad guidelines for the economic policies of the Member States and the Community (2005 to 2008) (2005/601/EC), OJ 2005, No. L 205/28.
14. Article 99 (4) EC. The Council acts on a recommendation of the Commission when adopting its recommendations and on a proposal from the Commission when deciding to publish it. The difference between the two forms of initiative lies in the unanimity required in the Council to amend a Commission proposal (Article 250 (1) EC).
15. Council Recommendation of 12 February 2001 with a view to ending the inconsistency with the broad guidelines of the economic policies in Ireland (2001/191/EC), OJ 2001, No. L 69/22. *See*, also, Council Decision of 12 February 2001 making public the recommendation with a view tending the inconsistency with the broad guidelines of the economic policies in Ireland (2001/192/EC), OJ 2001, No. L 69/24.
16. Articles 226 and 227 EC.
17. Article 104 (10) EC.

existence of excessive deficits on the basis of a *qualitative* assessment[18] founded on *quantitative* criteria, i.e. a ratio of 3% of a government current deficit to its State's GDP and a ratio of 60% of total government debt to GDP.[19] Essentially, the following phases can be discerned:

1) the Commission prepares a *report* in case of a Member State not fulfilling the requirements under one or both of the criteria (Article 104 (3))
2) the Ecofin Committee[20] gives an opinion (Article 104 4))
3) the Commission addresses an *opinion* to the Council (Article 104 (5))
4) the Council *decides* that an excessive deficit exits (Article 104 (6)) and makes a *recommendation* to the Member State concerned (Article 104 (7))
5) if no effective action has been taken in response to this recommendation within the time period laid down therein, the Council can *make* its recommendations *public* (Article 104 (8))
6) if a Member State persists in failing to put the Council's recommendations into practice, the Council may give *notice* to this Member State with a specified time-limit to remedy the situation, possibly requiring it to submit reports within a specific timetable to examine that State's adjustment efforts (Article 104 (9))
7) ultimately, the Council may impose *sanctions* or 'intensify' those already applied (Article 104 (11)).

The main sanction that can be applied is a fine[21] but, for Member States with a derogation or an opt-out, the procedure ends with (the publication of) a recommendation. The Member State concerned does not vote on steps in respect of itself beyond the establishment of a deficit.[22] As noted, the 'out' Member States do not vote on the further steps that only apply to the 'ins'. Again, the Commission's initiatives are taken in the form of recommendations.

Finding that the provisions agreed in Maastricht were too timid to avoid excessive deficits in a graying Europe without the stimulus of prospective membership of the monetary union, the SGP was agreed to in 1997. The Eu-

18. Article 104 EC makes clear that finding 'gross errors' and assessing compliance with budgetary discipline entail an overall assessment which should take into account qualifying exceptions to the deficit and debt ratios (quoted in footnote 25 below), the adherence to the <golden rule> that only government *investment* expenditure may be financed by deficits and 'all other relevant factors'.
19. Set out in the Excessive Deficit Protocol attached to the EC Treaty.
20. A high-level committee composed of representatives of the Member States, the Commission and the European Central Bank (ECB) with special preparatory tasks in the area of EMU and with the overall obligation to keep the economic and financial situation of the States and the Community under review and to report to the Council and the Commission. *See* Article 114 (2)–(4) EC.
21. For all four possible sanctions, *see* Article 104 (11) EC.
22. Article 104 (13) EC.

ropean Council adopted a Resolution in which it laid down the commitment of Member States to achieve a budgetary balance or surplus over time and, to a large extent, filled in the discretionary powers of the Commission and the Council. The latter adopted two Regulations[23] which give effect to the Resolution. These three texts together constituted the SGP. On the basis of the first regulation, Member States are to submit convergence (for the 'out' Member States) or stability (for the 'ins') programmes setting out the time-path towards balanced budgets over time. The Regulation also establishes a procedure for examining these programmes and for monitoring their implementation. This procedure may result in a recommendation by the Council based on Article 99 (4) EC by way of 'early warning' against an excessive deficit in case of significant divergence of a State's budgetary position from the medium-term objective.[24] All of this constitutes the 'preventive arm' of the SGP. It consists of a strengthening of the multilateral surveillance procedure which, as said, includes all economic policies, including budgetary policy. The second Regulation forms the 'corrective arm' of the SGP. It lays down time limits, sets out how, in practice, the room for applying the EDP will be filled in, notably through interpretation of the qualifications of the budgetary criteria.[25]

After several years of unsatisfactory experience with the SGP, and a major stand-off in 2003,[26] the Pact was subject to a major *revision* in 2005. It now consists of the 1997 European Council Resolution, the two Regulations, as

23. Council Regulation (EC) No. 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, OJ 1997, No. L 209/1 and Council Regulation (EC) No. 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, OJ 1997, No. L 209/6.
24. *See* Article 6 (2) and 10 (2) of Regulation 1466/97.
25. Article 104 (2) EC makes it possible not to find an excessive deficit when 'the ratio of the planned or actual government deficit to gross domestic product exceeds a reference value [i.e. 3% of GDP, rs]' but '– either the ratio has declined substantially and continuously and reached a level that comes close to the reference value, – or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value'. Also, in respect of the debt criterion, overshooting the 60% norm does not have to lead to establishing that an excessive deficit exists when 'the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.'
26. When the Council did not adopt the measures recommended by the Commission in respect of France and Germany, which had both run persistent budget deficits, but adopted its own conclusions containing non-formal recommendations to both Member States (November 2003). This led to the ECJ judgment in Case C-27/04 (*Council* v. *Commission*, [2004] ECR I-6649), in which the Court acknowledged that lack of sufficient votes for a recommended measure may lead to the EDP being held in abeyance in practice. The ECJ also found that the Council could not deviate from the Treaty-given (Article 104) or self-imposed (SGP) constraints. Since it had effectively modified its previous recommendations to France and Germany without a fresh recommendation from the Commission to that effect, the Council had overstepped the limits of its discretion and its conclusions were unlawful.

amended,[27] plus the Ecofin Council Report of 28 March 2005 on the revision[28] and a Code of Conduct.[29] The revision implies a weakening in that the Community-wide budgetary objective of 'close to balance or in surplus' has been replaced by 'country-specific' norms and, also, because the time limits have been lengthened and the interpretation of the Treaty provisions loosened. Yet, it also contains elements of strengthening. First, for Eurozone Member States and those seriously aspiring to participate in the monetary union (i.e. the members of ERM-II), the budgetary objective is stricter than for other States.[30] I find further elements of strengthening in the new SGP introducing a 0.5 % of GDP benchmark for annual improvements in the budgetary situation on the adjustment path towards the medium-term budgetary objective, requiring stability and convergence programmes to be detailed and quantitative and demanding that reasons be given for deviations from the adjustment path towards the medium-term budgetary objective.[31]

7. The Asymmetry in EMU Exacerbated by Practice and by the Revision of the SGP

Overall, the SGP 'top-up' of the Treaty provisions on excessive deficits shows the good intentions to make budgetary policy oversight work effectively but, also, reveals the major institutional flaw in the system: it is based on political decision-making in the Council, composed of representatives of the very Member States whose behaviour is scrutinized. Especially, the unwillingness of larger Member States to subject a core element of their policies to continuous reporting to, and scrutiny by, the Community means that the EDP and the SGP are applied vigorously only in respect of the smaller States. Ironically, the incidence of their excessive deficits on the stability of the monetary union is much less than that of the three or four major national economies. Although

27. Council Regulation (EC) No 1055/2005 of 27 June 2005 amending Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, OJ 2005, No. L 174/1, and Council Regulation (EC) No 1056/2005 of 27 June 2005 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, OJ 2005, No. L 174/5.
28. 'Improving the implementation of the Stability and Growth Pact – Council Report to the European Council –', Annex II to the Presidency Conclusions of the Brussels European Council of 22 and 23 March 2005, at: <http://www.eu2005.lu/en/actualites/conseil/2005/03/23conseileuropen/ceconcl.pdf>, and at: <http://europa.eu.int/rapid/pressReleasesAction.do?reference=DOC/05/1&fo>.
29. Code of Conduct on the content and format of stability and convergence programmes, latest version endorsed by the Ecofin Council on 11 October 2005, *see*: <http://www.europa.eu.int/comm/economy_finance/about/activities/sgp/codeofconduct_en.pdf>.
30. Namely, between –1% of GDP and balance or surplus.
31. For an alternative view on the 2005 revision of the SGP, *see* Jean-Victor Louis, 'The review of the Stability and Growth Pact', (2006) 43 *Common Market Law Review* pp. 85–106.

even Greek, or Dutch, or Portuguese, deficits contribute to an undermining of confidence in stability-oriented economic policy EU-wide, the actual impact of deficits in Germany, France, Italy and Spain is much larger. Therefore, compliance with budgetary discipline in these States is even more important. Beyond the immediate impact on the single currency, the uneven application of the same rules is undermining the very foundations of the Union. With new and prospective (Turkey) Member States looking closely at how smaller States are treated, indifference by the larger ones about their compliance is threatening the EU's cohesion. When an aspiring Member State is barred from adopting the single currency because its inflation rate is 0.07% over the ceiling (the average of the three best-performing States),[32] while the two largest participating Member States have run excessive deficits of (more than) 1% over the threshold (of 3% of GDP) for many years, the uneven application of EMU law becomes blatant.

Going back to the economic consequences, it is not that budget deficits have a direct negative impact on the single currency's stability but persistent or recurring large deficits are bound to undermine the financial markets' confidence in its stability. Moreover, the prospect of a graying population will make it harder for governments to balance their books in the future with increased social security and pension spending, thus requiring even greater efforts at fiscal prudence now. For, if budget deficits are excessive these days, they are bound to become even worse with the ageing of Europe's population. Practical experience thus far has shown a worrying lack of adherence to fiscal prudence and an astonishing neglect of the consequences of belonging to a currency union. It is as if the participating States still think they can externalize their incoherent or unstable tendencies while confidence in their own – joint – currency is undermined by them. Furthermore, the 2005 revision is a sign of the times: after the proposed EU Constitution had not resulted in major strengthening of the economic union element of EMU[33] and was defeated in two founding Member States, the SGP is now more heavily tilted towards national implementation and the importance of the States as actors. The Ecofin Council Report leading to the amendments emphasizes 'national ownership' of the budgetary objectives. Giving up a common medium-term objective is a bad omen for future economic policy coordination.

32. I refer to Lithuania, whose inflation rate overshoot threatens its commitment to adopt the euro as from 2007. For the convergence criterion on inflation, *see* Article 121 (1), first indent, EC, and Article 1 of the Convergence Criteria Protocol attached to the EC Treaty. The percentage point overshoot is from *Het Financieele Dagblad* of 28 April 2006 ('*Balten boos over strenge euroregels*'). *See*, also, 'Lithuania faces eurozone bid rejection', *Financial Times*, 1 May 2006, which gives the same figure: inflation at 2.7 %, just above the 2.63 % threshold.
33. For an assessment of the Constitution in terms of EMU, *see* René Smits, 'The European Constitution and EMU: an appraisal', (2005) *Common Market Law Review* 42, pp. 425–468.

Yet, the Treaty, although flawed in the basic structure of EMU, based as it is on the misconception that enlightened self-interest will ensure coordination of economic policies and make the participating States put them on a stability-oriented footing, contains provisions which could be put to use to achieve more, and better, coordination. Even when I consider that a Treaty change in the area of economic union would best serve the long-term goals of monetary union, I submit that the present provisions' potential has not been fully used.[34] Publicly announced adherence to the principles of economic union, scrupulous adherence to the provisions and procedures prescribed by the Treaty[35] and, additionally, imaginative use of the underused provision on Community economic policy measures (Article 100 EC) may greatly enhance the effectiveness of policy coordination and the credibility of the project of the single currency. Recent calls for underpinning the monetary union with a more political union[36] are correct in their assessment that the present-day backward slide towards economic nationalism is incompatible with a single currency. Bundesbank Vice President and prospective ECB Executive Board member Jürgen Stark was right when he said during his confirmation hearings before the European Parliament:[37]

> [monetary union needed to be] 'lined politically in the direction of conversion to political union, though this would mean that the intergovernmental approach in other areas of policy would have to be superseded by a supranational approach'.

34. Without going into detail, I note in passing that several proposals have been put forward recently, such as the acceptance by the States of the loss of sovereignty in respect of the size of their budget deficits, although not of their power to decide on individual budget items (De Nederlandsche Bank (Netherlands Central Bank)'s President Dr. Wellink in the 2003 Annual Report of *DNB*; *see*: <http://www.dnb.nl/dnb/bin/doc/ar03_tcm13–39878.pdf> and the imaginative proposals on agreeing on an acceptable monetary/fiscal policy mix put forward by the European Economic Advisory Group in their Report on the European Economy 2006, March 2006. *See*: <http://www.cesifo-group.de/pls/guestci/download/EEAG%20Report%202006/EEAG-2006.pdf>.
35. Recent experience makes me less positive about 'the power of peer pressure [which] should not be under-estimated' than the *Financial Times* in its editorial 'Europe suffers from a muddle in the middle', 17 April 2006.
36. For instance by Belgian economist and one-time ECB Executive Board hopeful Paul de Grauwe, quoted by EU Observer on 24 April 2006 ('Economists call for political union to prevent euro collapse') as saying that '[a] political union is the logical end-point of a currency union'. De Grauwe warned that '[i]f political union fails to materialise, then in the long term the euro area cannot continue to exist'.
37. As quoted in the *Financial Times* of 19 April 2006: 'EU urged to boost political dimension of eurozone'.

II. Some Proposals For The Contents Of Aligned Economic Policies

1. Improved Coordination is Possible under Current Rules

The previous exposé may have made it clear that the Treaty obliges Member States to coordinate their economic policies to an extent beyond what is commonly admitted and with a level of commitment that the States rarely live up to. Thus, there is scope for better alignment of policies and a stronger economic union pole of EMU even within the current provisions.

2. Some Areas Call for Immediate Action

This conclusion remains formalistic: legally, stronger coordination and better embedment of national policies in a Community framework are required. This does not address the actual contents of economic policy. Going beyond the legal realm and, for once, expressing some ideas on the contents of economic policy, I submit the following ideas for policymakers.[38]

3. Free Movement of Persons

First, to remain close to the area of EMU, I plead for an overhaul of the rules in the field of free movement of persons. The EU has formally established free movement of workers and freedom of establishment for self-employed persons, and even free movement for those who are not economically active.[39] Yet, it is widely admitted that labour mobility is much lower in this currency union than it is in the United States. One of the factors explaining this gap is language, on which I will say more later on. Another is the lack of ease with which setting up in another Member State is still associated. Manifold are the stories about bureaucratic hindrances and unnecessary obstacles that confront those who seek work or otherwise want to live in another Member State.[40] I suggest that part

38. Stopping short of proposals on a joint tax base to fund the Community budget. This necessary step to establish proper federal governance requires unanimous political agreement and, possibly, Treaty revision. Tax reform to acknowledge the realities of the internal market may also be required for industry to take truly advantage of it.
39. Directive 2004/38/EC of the European Parliament and of the Council of 29 April 2004 on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States amending Regulation (EEC) No 1612/68 and repealing Directives 64/221/EEC, 68/360/EEC, 72/194/EEC, 73/148/EEC, 75/34/EEC, 75/35/EEC, 90/364/EEC, 90/365/EEC and 93/96/EEC, OJ 2004, No. L 158/77. This Directive should be implemented by 1 May 2006.
40. The Commission itself acknowledged this in its 2002 Communication 'Free movement of workers – achieving the full benefits and potential' (COM(2002) 694 final, 11 December 2002, at: <http://europa.eu.int/eur-lex/en/com/cnc/2002/com2002_0694en01.pdf>, in which it stated:

of the difficulties arise from the application of national legislation which, even though adapted to take account of formal EU requirements,[41] is still based on the distinction between nationals and non-nationals. This gives rise to 'foreigners' being subject to a set of rules that is inherently restrictive in nature, and often suspicious in origin, if not in wording. No other State may go as far as the Netherlands, where politicians and press incessantly refer to '*allochtonen*' ('those from elsewhere', or 'migrant population') to denote everyone, of Dutch or other nationality, whose background is not home-bred.[42] The National Statistics Office (*CBS*) even put a news item on its webpage which mentioned that, among those eligible to vote in this year's municipal elections that were '*allochtonen*', the majority were Germans who live there under Community law freedoms![43] But many States will act similarly as the Dutch in applying (sections of) their equivalent of the '*Vreemdelingenwet*' (Aliens Act) to fellow EU citizens. I consider this to contradict, if not the rules on, then the spirit of European citizenship.[44] More seriously, it makes for formalities and frequent confrontations with authorities who, perhaps reflecting the popular mood, are not always welcoming or even polite to those seeking stamps, certifications, tax rulings and the like. Moreover, the sheer bureaucracy involved in moving to another State must repel quite a number of people who would otherwise have done so.

Therefore, I propose to abolish national laws on fellow EU citizens' rights and obligations. Instead, the EU should adopt a single regulation setting forth the legal framework for moving to another State in as transparent language as possible. The Commission, which is very good in organizing consultations, should open a public consultation on the kind of restrictions nationals from other Member States are still confronted with, even after the 2004 Residency Directive took effect, before it proposes a draft for this measure.[45] Of course,

'many practical, administrative and legal barriers still prevent citizens of the Union from exercising their freedom of movement.' and later continued, in respect of residence and expulsion, as follows: 'The Commission still receives large numbers of complaints from citizens required to produce documents (such as tax returns, medical certificates, salary slips, electricity bills etc) other than those permitted under Community law (identity card or passport and proof of employment).'

41. Notably, Directive 2004/38/EC mentioned in footnote 39.
42. Whatever that may mean in a society that has traditionally been composed of immigrants, from the tribes coming down the rivers to settle in the Delta at the beginning of the Common Era, to Jewish and Huguenot refugees, Chinese, Italian, German and Belgian immigrants over the ages, not to mention those from Indonesia, Surinam, the Dutch West Indies and, more recently, Morocco and Turkey, as well as refugees from Vietnam, Iran, Iraq, Somalia and Afghanistan and many other parts of the world.
43. *See*: <http://www.cbs.nl/nl-NL/menu/themas/overheid-politiek-bestuur/politiek-bestuur/publicaties/artikelen/2006–1891–wm.htm>. Among 12 million eligible voters, 2.2 million were '*allochtoon*' (i.e. migrants), of which 320,000 were Germans.
44. Articles 17–22 EC.
45. Just as these lines were written, a consultation was announced on the functioning of the internal

a single legislative framework at Community level is no panacea. No amount of legislation will make Europeans as mobile as their transatlantic neighbours. Yet, it is my hypothesis that, other things being equal, substituting a single legal instrument for national legislation in the area of free movement of persons would stimulate labour mobility. Since all economists agree that a single currency area needs labour mobility to absorb asymmetric shocks between a monetary union's regions,[46] this will sustain the proper functioning of the EMU. Of course, this proposal fully acknowledges that even a common piece of legislation will have to be implemented by national agencies and civil servants, thus making for diverse application in practice of the same rules. My point is that when, at least, the rules are the same and can be known Europe-wide by reading one single legal document, one major hindrance has gone.[47]

Further elements of labour market flexibility should preferably not be touched upon at the Community level so that each State remains free to experiment[48] and establish best practices, also when looking across the borders at what the neighbours do. The present difficulties in exploring new methods of flexibility show that progress is best made, if at all, at the State level.[49]

4. Education

Many are also in agreement about the need for better education in Europe if it wants to compete with upcoming markets like India and China. Europe requires an impetus to Research & Development (R&D) spending.[50] It also

market. *See* the 'Public consultation on the future of the internal market' at: <http://europa.eu.int/comm/internal_market/strategy/docs/consultation_en.pdf>. This consultation is wider in scope than the free movement of persons. It does not specifically solicit views from those affected by the hindrances to this most fundamental European economic right. Also, without posting flyers at employment agencies, tax offices, police stations and other official entities dealing with people making use of their right to move their residence, and advertising such a consultation on radio and TV, chances are that it will miss those who are most affected.

46. Although Richard Layard, on whom more is said below, has cautioned against the side effects of wider mobility.
47. Of course, tax and pension discrepancies are also major obstacles to an effectively free movement of persons.
48. Perhaps by following recent advice by researchers who propose to introduce individually tailored insurance schemes instead of the present collective ones. *See* 'Insurance plans could halve Europe's jobless' in the *Financial Times*, 18 April 2006.
49. And reforms require overcoming insiders' vested interests. *See* John Kay, 'Europe's insiders will never vote for a reform agenda' in the *Financial Times,* 18 April 2006, although his conclusion ('Europe's economic problems are real, intractable and not very serious. They are the product of democracy and prosperity.') fails to acknowledge the impact of the present-day economic conditions on the disadvantaged and on the prospects for the internal market and the single currency, whose legitimacy may be undermined by these problems.
50. *See* Guideline No. 17 in the 2005 BEPGs, mentioned in footnote 13 above.

requires proper education and schooling that is geared towards a society whose technical requirements and social fabric require certain skills – not only computer skills,[51] but also social skills plus emotional and spiritual intelligence to cope with a multi-cultural and multi-religious environment. This is a matter for Member States, with help from the European Union and mutual assistance from other States in developing our educational systems. Yet, Europe could, and should, do more.

First, it should ensure that education is available which is relevant and that measures are taken against early drop-out, malaise and *anomie* among young people, especially immigrants and lower-income groups. National policy measures based on a common approach are suitable.

Second, Europe should foster early understanding of a second language and, possibly, further languages. Generalised teaching of English, from a very early level onwards, will help Europe bring up generations who can compete with well-educated English-speaking Indians,[52] and who can speak with one another in a common language. Thus, a 'European space' is created in which the Union-wide political and cultural debate can take place. Of course, this may increase the predominance of English, much feared by the proponents of these other widely spoken languages.[53] It may also imply calling a spade a spade and actually fostering the use of English as the first second language, without forgetting the importance of a third and, possibly, fourth language. The Community legislator nowadays goes to great lengths to describe English without naming it.[54] It might continue to do so and, for political sensitivities' sake, agree that States should ensure teaching of 'a' second language from a young age onwards and leave it to the market to see which one(s) are selected. My guess is that the outcome would be the same.

I also plead for language education in French and German (for obvious reasons, notably in the United Kingdom and Ireland) and other widely spoken languages.[55] It goes without saying that less spoken national or regional languages need fostering, as well, as they are part of the daily lives of millions of Europeans and of our cultural heritage. The ability to communicate in these at

51. And 'a sufficient supply of qualified researchers by attracting more students into scientific, technical and engineering disciplines', as aforementioned Guideline No. 17 in the 2005 BEPGs states.
52. And, may I add, well-educated Chinese who have mastered English in a far less Anglophone environment.
53. *See* recent initiatives against English dominance in the EU reported by the on-line EU Observer news service on 21 April 2006 ('Berlin sees red over English dominance in Brussels').
54. A recent example is Article 4 (3), fourth indent, of Commission Decision 2006/288/EC of 30 March 2006 setting up a European Securities Markets Expert Group to provide legal and economic advice on the application of the EU securities directives, in which these experts are required to be 'proficient in a language which is customary in the sphere of finance' (OJ 2006, No. L 106/14).
55. Spanish, Portuguese and Italian.

the Union level of government, and the availability of all legislation in all EU languages, should be preserved and protected, too.

Third, an expansion of exchange programmes, both the SOCRATES/ERASMUS programmes and further programmes aimed at exposing even younger students to meetings and regular contacts (direct and over the internet) with fellow Europeans, should be high on the list of policy-makers. Far more of the EU budget should be spent on these kinds of investments in our common future, than towards agricultural subsidies and regional grants.

Let me be clear that these proposed measures would not imply making education policy a Community competence beyond what is nowadays provided for in Articles 149–150 EC. The Member States should be able to mould their own education systems and set their own priorities but common objectives and policies, to be implemented by each State itself, could well be agreed upon along the lines described.

5. Energy

Another element of material economic policy should be energy policy. Here, we already have quite a few building blocks, from energy-saving measures to liberalization of the national markets to an opening of ownership of national industries by investors or competitors from neighbouring States[56]. Nevertheless, several elements are lacking, as became clear this Winter and was discussed at the recent European Council Spring meeting[57] on the basis of the Commission's Green Paper on Energy.[58]

First, the single market is balkanized, with liberalized national energy markets not only shielded from true cross-border competition by lack of interconnecting capacity for electricity transport but, also, because of national

56. Although the level of interpenetration varies markedly, notably because of the closing off of the French market and the late regulation of the German market, both contrary to at least the spirit of EU-wide agreement on liberalization of the gas and electricity markets by July 2007. Although the ECJ was right to find recently an Italian decree limiting voting rights in Italian energy companies of investors from companies which themselves were not publicly quoted (i.e. against takeovers from France) to be against the free movement of capital (Article 56 EC), one cannot help sympathizing with the Italian authorities who strove to head off takeovers of Italian companies by *Electricité de France* and *Gaz de France* without *ENEL* being able to make incursions into the French energy market. *See* Case C-174/04 (*Commission* v. *Italy*), judgment of 2 June 2005, [2005] ECR I-4933).
57. *See* the section devoted to energy policy at the Austrian Presidency's website on the 24–25 March 2006 meeting of the European Council: <http://www.eu2006.at/en/The_Council_Presidency/europaeischer_rat/energy.html>.
58. 'A European Strategy for Sustainable, Competitive and Secure Energy', Green Paper, COM(2006) 105 final, at: <http://www.europa.eu.int/comm/energy/green-paper-energy/doc/2006_03_08_gp_document_en.pdf>.

regulation and liberalization. What we see here, as we see in telecom and retail banking, is a drive towards liberalization which is initiated in Brussels but implemented in national capitals, thereby creating 25 free markets with nominal connections but mainly through companies from one State owning those of others, not through consumers entering into transactions on a truly common market. We need further harmonization and a sharper focus on interconnection between national and regional markets. This may require the integration of Transmission System Operators (TSOs) into one or more regional TSOs or a common EU-wide TSO.

Second, a truly common approach towards third countries from which we import gas (and oil) is called for. The fact that some of these markets are governed by less than fully democratic regimes reinforces the need that Europe speaks with one voice. Energy should be part of our common commercial policy and, where necessary, of a truly advanced state of CFSP.[59]

Third, an alignment of regulatory policies and practices is necessary. The Commission's proposed single regulator proved a step too far, for now, but should remain the ultimate goal. Diverse and dispersed regulation and supervision are the hallmark of the European Union in areas supposedly harmonized and liberalized. Let me quote the reason the *Financial Times* attributed to Citigroup's lack of interest in acquiring banks in Western Europe. On 5 April of this year, it reported that our region was considered to be 'uninviting' because of 'balkanized' regulatory regimes.[60] If this is a foreign investor's judgment on the state of *financial services* regulation in the EU, beware of their assessment of the state of play in the *energy* sector. Yet, the experience with the Lamfalussy method of aligning supervisory implementation of common regulation of the financial services sector may be a model to follow for energy regulation.[61] After all, the fruit of the simplified methods of adopting and implementing Community-wide rules has been a close alignment of supervisory regimes even though stopping short of joint supervision. It would not be necessary, or desirable, to transplant the entire framework of four-level regulation to the energy sector to take advantage of the committee cooperation in the financial services sector. Notably, the common approach to supervision being developed within the Committee of Securities Regulators (CESR[62]) may be transpos-

59. Common Foreign and Security Policy pursuant to Articles 11–28 of the EU Treaty.
60. 'Citigroup cleared for big acquisitions as Fed lifts ban', *Financial Times*, 5 April 2006, p. 1.
61. The Lamfalussy approach stands for a four level approach to financial sector regulation. Principles of financial sector regulation are agreed at the level of the Council and the European Parliament (first level), leaving details to be decided at a second level by the Commission with the assistance of representatives from national departments and supervisory agencies, and the actual implementation being coordinated by the latter (third level). The fourth level consists of increased scrutiny of implementation by the Commission.
62. *See* the Commission Decision of 6 June 2001 establishing the Committee of European Securities

able to energy regulation as a precursor to the ultimate creation of a single EU energy regulator. For the immediate future, it would seem wise for the energy regulators' groups, ERGEG[63] and CEER,[64] to study the experience of their financial services counterparts and see what elements of their cooperation can usefully be taken over.

Further investigation is necessary to see whether the proposed measures can be based on current rules. The Green Paper already proposes to make use of Article 100 EC for the establishment of similar reserve building capacity for gas as exists for oil.[65] New competences may be necessary. In the meantime, action based on Article 308 EC may be contemplated.

6. Public Health

Public health seems to be an area where major strides can be made towards cost-saving and better service. Present-day policy in many Member States seems to favour introducing market elements. This may imply bringing bureaucracy into health services when standards need to be measured and conditions for government subsidies fulfilled. Or, it may raise questions on the compatibility of the new regimes with Community law on the freedom to provide services. Here, as elsewhere in regulated areas of economic life, the national approach taken always has a tendency to shield the market from outside competition: almost every extra State rule is an additional hindrance for non-national providers to explore the health market there. I have two suggestions for policy makers, which may reduce costs and improve performance:

1) ensuring that new systems of health care provision minimize bureaucracy and focus on what health care should be about, i.e. the improvement or restoration of physical and mental well-being, while keeping the national markets as open as possible for out-of-State providers

2) looking into methods to abolish setting of prices by States, which leads

Regulators (2001/527/EC), OJ 2001, No. L 191/43. *See*, also, CESR's website, at: <http://www.cesr-eu.org/>.

63. The European Regulators Group for Electricity and Gas. *See* Commission Decision of 11 November 2003 on establishing the European Regulators Group for Electricity and Gas, OJ 2003, No. L 296/34. *See*: <http://www.ergeg.org/portal/page/portal/ERGEG_HOME/ERGEG>. For its recent initiative to form regional clusters of energy regulators, *see* 'Fresh EU move to open gas markets' in the *Financial Times*, 25 April 2006.
64. The Council of European Energy Regulators, a group of energy regulators organizing themselves and established as a Belgian not-for-profit association. *See*: <http://www.ceer-eu.org/portal/page/portal/CEER_HOME/CEER_ABOUT>.
65. In para. 2.2 of its Energy Green Paper, the Commission proposes '(…) **a new legislative proposal concerning gas stocks** to ensure that the EU can react to shorter term emergency gas supply disruptions in a manner that ensures solidarity between Member States, whilst taking account of the different potential for storage in different parts of the EU.' (bold in original, rs).

to a fragmented market for medicines and parallel trade instead of a truly open single market in pharmaceuticals. Doing away with the current extremely varied regulation of prices and admitted (or insured) medicines across Europe could give the internal market (in pharmaceutical and other health care products) a boost, alleviate State budgetary strains[66] and make health care cheaper for patient and taxpayer alike.[67]

7. Happiness

Finally, a word of caution. A joint common economic policy covering several areas, or much closer alignment of individual economic policies in such areas, is a necessity in a single market and for the single currency. Yet, a single-minded focus on economic growth is not. The statistics that we are constantly being bombarded with may show Europe lagging behind the United States and being, or becoming, morose compared to vibrant economies such as India and China. Some authoritative voices militate against focusing too much on these figures and argue that a different view of these may reflect major societal differences, at least between Europe and America. Including other figures, or other ways of looking at the same, results in a markedly brighter picture for Europe.[68] Also, leisure time is not seen as productive in these comparisons. The figures may thus reflect different choices by Europeans, something we should take pride in instead of lambasting our own backwardness as if other societies are the pinnacle of the pursuit of happiness. Yes, I quote from the American Declaration of Independence,[69] on purpose, for this relentless pursuit, when taken economically only, does not seem to enhance human happiness.

Let me recall a few recent examples of voices against too much emphasis on growth, always acknowledging that States should not ensure their citizens' happiness but should pursue policies that may enhance the latter's chances of succeeding in making themselves happy: the responsibility lies clearly on each individual. To quote an authority:[70]

66. Thereby contributing in an imaginative manner to compliance with the Treaty and the SGP.
67. This was touched upon briefly in my annotation of the judgment of the ECJ of 31 May 2005 in Case C-53/03, *Syfait and Others* v. *GlaxoSmithKline plc and GlaxoSmithKline* AEVE, [2005] ECR I-4609: 'On Parallel Trade and Preliminary Issues – a Healthy Approach to Competition Law Enforcement?', *Legal Issues of Economic Integration* 33(1): 61–83, 2006.
68. Mark Leonard, in his 'Why Europe Will Run the 21st Century' (Fourth Estate, 2005), makes the point that comparing unemployment figures between the USA and the EU should reflect the fact that almost 1% of the American population is in prison.
69. 'We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness'.
70. The Dalai Lama in the first chapter of his book 'The Art of Happiness – A Handbook for Living'

> 'I believe that the very purpose of our life is to seek happiness. That is clear. Whether one believes in religion or not, whether one believes in this religion or that religion, we are all seeking something better in life. So, I think, the very motion of our life is towards happiness…'.

Without becoming too philosophical, let me only quote economists or social scientists. For instance, Samuel Brittan, who opined in the Financial Times in February 2006:[71]

> '(…) this obsession with GDP growth is among the most frequent grumbles of the educated public against the whole economic policy world. There is a strongly embedded view that, without our continuing striving for more and more, the economic machine would collapse. This position is, in fact, wrong. (…)'

Quoting a recent OECD study on the limitations of GDP growth as a measure of welfare,[72] Brittan proposes that we should focus more on absolute levels rather than on rates of change. Considering that:

> 'there is an extremely loose connection between income and reported life satisfaction',

Brittan concludes:

> 'We should occasionally let the vehicle slow down and ask where we are rather than how fast we are traveling.'

On a more academic level, the work of another Britton, Richard Layard, is important. His blending of traditional economics with recent results of psychology has put the fact on the map that happiness has not increased in the developed nations, on either side of the Atlantic, in the past 50 years. Happiness does not even show a positive correlation with income above GDP per capita levels of USD 20,000 (EUR 18,000, GBP 14,000). Layard calls for major efforts to increase happiness by relying on different aspects of our societies (such as mental health care and family life). During a debate on the issues raised in

(co-authored by Howard C. Cutler, Coronet Books, 1998), entitled 'The Right to Happiness'. He continues by stating that happiness can be achieved through training the mind.

71. 'Time to put away the league tables', *Financial Times*, 24 February 2006, at: <http://www.samuelbrittan.co.uk/text239_p.html>.
72. Presumably, Economic Policy Reforms: Going for Growth 2006, which contains a chapter ('Alternative Measures of Well-being') that assesses if GDP per capita can serve as a reasonable proxy of overall well-being. *See*: <http://www.oecd.org/document/7/0,2340,en_2649_201185_35995079_1_1_1_1,00.html>.

his book 'Happiness: Lessons from a New Science',[73] he rightly focused on the importance of how leaders set the tone for what people think matters in life. He mentioned the continuous focus on 'getting ahead', i.e. competition and getting ahead of each other, rather than contributing to the happiness of other people and of themselves. I would like to add that many leaders' uninspiring and single-focused repetition of the idea that Europe is lagging behind the United States, and is in competition with aggressive globalization from Asia, does nothing to instill a positive tone. Focusing on what we have achieved and on how we can use our increasing wealth to benefit our European society and the world at large may unleash creative powers among the citizens to work in that direction. Our leaders have a responsibility to help shift our focus and gear policies towards greater happiness rather than increasing growth. My guess is that this may surprisingly help improve not only well-being, but wealth, as well.

I would like to add the cautionary words by American sociologist Barry Schwartz who, discussing the 'paradox of choice'[74] argues that, beyond a certain level, greater choice diminishes rather than increases well-being. Without going into the explanations,[75] his admonition to policy makers that increasing choice in areas which are crucial to well-being, such as public utilities and pensions, may not serve the citizens is worth recalling in an environment of liberalization[76].

Of course, these cautions should not be taken to their extreme.[77] Notably, Layard's research[78] does not mean we should spend less on bridging the gap between the rich and the poor, as happiness does increase with income when

73. *See* 'A Brookings Briefing: Happiness: Lessons From A New Science – Presenter: Richard Layard – Panelist: Stanley Fischer (formerly of the IMF and Citigroup, presently Governor of the Bank of Israel, rs) – Moderator: Carol Graham, Wednesday, February 9, 2005', at: <http://www.brookings.edu/comm/events/20050209happiness.pdf>.
74. 'The Paradox of Choice: Why More is Less', HarperCollins, 2004.
75. Which have to do with increased anxiety over proper choice-making when there is such a variety of options and a feeling of insufficiency when the one choice made out of so many does not live up to expectations.
76. His, and others', ideas on default options governments should set for citizens as a way of benign paternalism, was mentioned in the *Financial Times* of 29 April 2006 ('The sirens learns a seductive new melody').
77. Although following in the steps of Bhutan and emphasizing Gross National Happiness as a goal of governmental policy, always respecting the individual's own responsibility, may not be that far-fetched. *See*: http://www.globalpolicy.org/socecon/develop/devthry/well-being/2003/0224bhutan.htm.
78. And that of fellow economists. *See* John Lloyd's somewhat critical article 'What price happiness? How economic is learning to lighten up' in the *Financial Times*, 1 May 2006. The *Times* of the same day mentions, in its obituary for John Kenneth Galbraith, that this just deceased economist wrote in his *The Great Society* (1997) that happiness (...) did not require an expanding economy. I thank Phebe Miller for drawing my attention to this.

income is extremely low. When 1.2 billion people live on less than USD 1 (EUR 0.80, GBP 0.55) a day, there is ample scope for spending on happiness by fostering GDP growth. This brings me to another economist who has been advocating major policy choices in favour of attaining, in ten year's time from now, the Millennium Development Goals.[79] Jeffrey Sachs' arguments[80] may not convince all, but his book inescapably argues the case for ending global poverty soon, one way or the other. This is another reason, beyond the well-being of its own citizens, why the European Union should make more work of its economic policy coordination and contents. A strong and open EU will be best positioned to provide assistance and guidance to eradicate the malnutrition, utter poverty and avoidable illnesses that affect many millions of our fellow human beings. Their plight undermines both their and our security and leaves us no calm mind with which to enjoy the fruits – monetary and otherwise – of Europe's integration.

79. *See*: http://www.un.org/millenniumgoals/.
80. In 'The End of Poverty – Economic Possibilities for Our Time' (Penguin, 2005).

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