

## The Challenges of European Integration for Social Democratic Policy-Making

Mainstream research on European integration and European social democracy is unambiguously clear in asserting that, from the mid-1980s, the integration process has evolved to strengthen market forces and has effectively reduced national sovereignty in core areas of policy-making. This applies to the negative economic integration of the Single European Market (1987), but also to positive integration, namely Economic and Monetary Union (since Maastricht 1993) and the accompanying Stability and Growth Pact (1997). These integration steps have reduced the ability of the nation state to intervene in markets and to correct the unwanted results of increasingly liberalized capitalism.

This might be a desired outcome for liberal and neo-conservative parties. Even Christian democratic parties might accept it (Kersbergen 1995: 236f). However, for social democratic parties the "European path" taken in the 1980s and early 1990s severely challenges their model of economic regulation, policy-making, and social welfare.

Since Dahrendorf's depiction of the "end of the social democratic century" (Dahrendorf 1983) many authors have addressed the issue of whether social democracy is doomed to decline.<sup>1</sup> In support of this thesis the erosion of class-based voting, the declining importance of trade unions, socioeconomic changes, altered party competition and coalition opportunities, and the effects of globalization have been put forward. Thus, "Europe" might simply constitute another chapter in the literature on the "end of social democracy." However, European integration not only challenges tried and tested social democratic strategies, but may also provide opportunities for new political strategies to counterbalance the market-liberal orientation of negative integration and to regain the ability to act at the European level (supra-national and intergovernmental),

something which has been lost at the national level through globalization and Europeanization. The challenge for European social democracy is thus twofold: first, to explore and fully utilize what space remains for their political and social goals at the national level, and second, to "reconstitute a conception of collective political agency, aiming to use the EU as a complementary site for decisions and policy setting" (Ladrech 2000: 55).

However, this is a difficult task, and not only for social democratic parties. Realization of both aspects of it is impeded by the difficulties of positive integration:

*There are policy areas that are of crucial importance for the legitimacy of democratic welfare states, in which national problem-solving capabilities are indeed severely constrained by economic integration, whereas European regulation, or even policy harmonization, seems to be systematically blocked by conflicts within the underlying constellation of rational interests. (Scharpf 1999: 3)*

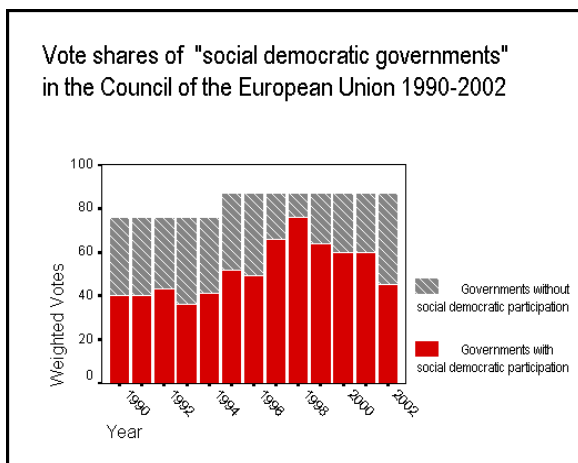
There are further major obstacles to such a strategy. First, substantial differences of opinion between social democratic or socialist governments have so far prevented them from correcting the clear free-market "bias" of European policies. Thus, social democratic governments do not form a cohesive actor at the European level in Tsebelis's sense (Tsebelis 2002). Second, in most member states governments are formed by coalitions. In many cases this limits social democratic room to maneuver. Third, realizing a "European strategy" may be electorally costly whenever it obstructs claims for credit for successful policies in national electoral competition. Finally, it is questionable whether social democratic governments would ever challenge the most fundamental and well defended principles of the Community, the four freedoms and competition law, because this might endanger the Community as a whole. However, it is exactly these sacred principles that constitute the greatest obstacles on the social democratic path to market correction.

Since the Confederation of Socialist Parties of the European Community (CSPEC) stated in 1990 that "democratic control of the future remains possible,

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1 See, for example, Przeworski 1985; Scharpf 1991; Merkel 1993; Kitschelt 1994, 1999; Pontusson 1995.

provided that those elements of sovereignty which can no longer be exercised in a purely national framework are pooled" (CSPEC 1990, cited in Ladrech 2000: 4), social democratic parties have, despite all obstacles, increasingly perceived the European Union as an opportunity. Many of them have abandoned Eurosceptical positions in favor of pro-European ones, despite internal party divisions (Ladrech and Marlière 1999; Notermans 2001). However, they had to wait some years until a window of opportunity for European social democratic policies opened up in the second half of the 1990s. Electoral successes in a number of member states, including the landslide victories in the United Kingdom (1997) and Germany (1998), demonstrated that social democracy was at least not electorally "doomed to decline," as many authors had previously declared. For the first time, the "big four" within the European Union were led by leftist governments, and in 1999 social democratic/socialist parties were leading or participating in 13 out of 15 governments.<sup>2</sup>



As a consequence, they also clearly dominated the Council of the EU, reaching a qualified majority and a qualified double majority. The German presidency of the EU in the first half of 1999 marks the height of this development. All this seemed "to present a rare opportunity to translate their [the social democrats'] concerns into action, that is, to influence the EU agenda in regard to its political-economic orientation" (Ladrech 2000: 116) and to counterbalance the market-driven asymmetry of the Community.

<sup>2</sup> The term "social democratic government" is meant to include single-party governments and coalition governments with social democratic or socialist participation. We define "social democratic parties" by applying the criterion of PES membership.

This article is a contribution to the question of whether there is a social democratic space in the European Union. It depicts opportunity structures and investigates whether the dominance of social democratic governments between 1998 and 2002 has had an impact on policies at the European level. We will examine four policy domains which must be considered core areas of social democratic policy-making because of their values, programs, and goals, and the particular interests of their electoral clientele: monetary, tax, employment and social policy.

A classical social democratic quadrangle would be: (i) to complement the rigid monetarist orientation of the European Central Bank (ECB) by also aiming at the economic goals of growth and full employment; (ii) to harmonize or coordinate national tax policies in order to avoid a competitive tax "race to the bottom" among member states and to secure a solid tax base for social policies which aim to achieve more equality of opportunity and compensate the undesired consequences of the market; (iii) to foster employment growth aiming at full employment and the reduction of unemployment; and (iv) to strengthen and reform the welfare state without dismantling it.

In our analysis we focus on the politics of the member state governments in the Council and the European Council. We first show "what has been done," assessing the impact of social democratic governments. However, we do not provide an encyclopedic overview, but spotlight the most important decisions. We then discuss which policies might be desirable for social democratic parties and which processes and "modes of governance" offer opportunities for realization.

## What Has Been Done?

### Employment Policies

Over the last ten years social democratic parties have urged "Europeanization" (a transfer of sovereignty to the European level and a coordination of national policies) mainly in the field of employment policy. However, not only have social democratic parties launched important initiatives such as the Larsson report in 1993, the French initiative for a *gouvernement économique* in 1997, impulses towards a European macroeconomic dialogue in 1998-99 and the Guterres report in 1999, but they were also successful in launching European employment policies with a social democratic profile at the end of the 1990s. This applies to the macroeconomic dialogue of the Cologne Proc-

ess and to European employment policies in a narrow sense, that is, the Luxembourg Process and the European Employment Strategy (EES).

The breakthrough of the European Employment Strategy can be clearly associated with the social democratic dominance in the European Union at the end of the 1990s, although its origins date back to the early 1990s when Jacques Delors launched the White Book on Growth, Competitiveness and Employment (1993). Like the Essen Strategy adopted in 1994, the White Book was a rather incoherent mix, a compilation of the different member states' approaches. It had no clear social democratic profile since the EU was predominantly conservative/Christian democratic. However, it did evolve into the main programmatic starting point of European employment policy. Many elements of the Essen Strategy, such as strengthening vocational training and lifelong learning, improving the efficiency of labor-market institutions, and measures for specific target groups, such as young people, the long-term unemployed and women, were given high priority in the EES within a few years.

The European dimension of employment policies rapidly gained relevance in the mid-1990s, mainly due to the following – interrelated – reasons: changes in the perception of problems by governments and public opinion, the effects of the 1995 enlargement, the discourse within the PES network, and the effects of compositional changes in some member-state governments.

The persistent unemployment problem increasingly put many EU governments under pressure. In addition, the perception of economic problems and of feasible cures changed. In the 1980s the predominantly liberal and conservative governments had assumed that the completion of the Common Market would help to solve essential employment problems simply by fostering economic growth and deregulating the labor market. In the 1990s, European integration was increasingly perceived as being biased: it stressed market and monetary integration, while largely disregarding social and employment policies. The legitimacy of the integration project came under threat. Thus, many member state governments increasingly came to believe that a more focused and active European employment strategy was necessary.

This altered perception was partly a result of governmental changes at the end of the 1990s, though it was not limited to political elites. At the same time, the political option represented by European employment policies increasingly attracted attention in national electorates. Eurobarometer data show that from the

mid-1990s a majority of Europeans preferred to fight unemployment not only on the national, but also on the European level (Eurobarometer 44.1, 1995). These developments coincided with a slight change in the strategic preferences of social democratic parties. By the end of the 1990s, the EU was viewed as “a potential asset and means by which to secure certain policy objectives” (Ladrech 2000: 79). Since Maastricht, the salience of the Europeanization issue in general has grown markedly, and social democratic parties have taken a clearer pro-European position. In particular, most social democratic parties call for European employment and social policies to counterbalance the Single Market and EMU (see, for example, Maurer 1998).

The enlargement of 1995 slightly shifted the EU's center of gravity. Sweden, Austria and, to a lesser extent, Finland had social democratic governments and were pursuing pro-welfare-state, active labor-market policies in their national arenas. The third enlargement thus seemed to make the new Community of 15 member states more “social democratic.”

Since the launch of the White Book, the PES has increasingly played a role in both designing a common social democratic employment strategy and implementing it at the European level despite clear divergences within the party family. During the intergovernmental conference it became evident that the social democratic party group did not fully agree on concrete employment policies but repeated contacts helped to overcome differences.

Finally, the change of government in some member states had a major impact on employment policy. At the end of the 1990s the European Parliament had a progressive social democratic majority, and social democratic parties dominated in 11 out of 15 member states. Up to 1997–98 the conservative/Christian democratic/liberal governments of Germany, France and the UK had been the major players vetoing the Europeanization of employment policies (Tidow 1998). They lost power in 1997 (UK and France) and 1998 (Germany).

After a long IGC, in June 1997 the member states finally settled on a compromise, in the form of the Treaty of Amsterdam, that included an employment chapter in the EC Treaty. At an extraordinary summit on employment in Luxembourg in November 1997, the member states reached agreement on the first employment guidelines. Thus, two important steps forward were taken in 1997: a coordination process was established and a European employment policy was given substance with the promulgation of the first guidelines.

The *coordination strategy* does not aim at the Europeanization of employment policies (EES) through a far-reaching transfer of sovereignty to the European level but at the coordination of national employment policies and “management by objectives” (Hodson and Maher 2001; Best and Bossaert 2002; Mosher and Trubek 2003). Member states are committed to attaining quantitative or qualitative employment goals laid down in employment guidelines and country-specific recommendations. However, this leaves considerable scope for them to pursue a whole range of different strategies proposed in the guidelines. The member states shall “take [the guidelines] into account” in their employment policies (Art. 128, 3) but no sanctions may be applied if they do not follow the guidelines and recommendations. The expectation of some social democratic governments that there would be compulsory rules was not fully satisfied. The German Christian-Democrat/Liberal government was able to water down this aspect of the regulations.

In contrast to “hard” European law the process is not based on coercion. It is intended to encourage the transfer of successful national policies to other member states. It may induce learning effects, enhance knowledge of alternative strategies and increase the pressure on national authorities to carry out a change of policies through benchmarking and the help of a “peer review program.” Empirically, the impact on national labor market policies remains unclear. At least in some cases major changes of policy have been induced and backed by the EES (Ostheim and Zohlnhöfer 2003).

The member states differ widely in respect of their employment problems, welfare state institutions and labor market regulations. Perceptions of the causes of persistent unemployment and low employment rates and of feasible cures also vary. This has led to the introduction of heterogeneous guidelines which have only partially met social democratic goals and strategies in the last five years.<sup>3</sup> Despite their heterogeneity the guidelines embody a specifically European way in terms of employment and labor market policies characterized by modification of the “neo-liberal” project of European integration. They are particularly compatible with “third way” policies (Adnett 2001; Aust 2000b; Tidow 1999; Mosher and Trubek 2003). Demands for improved employability through “lifelong learning,” tax relief for those on low incomes, working-time

flexibility and policies benefiting the socially excluded are examples of this approach (Adnett 2001: 359).

The strategy underlying the employment guidelines has been called “recommodification” (Aust 2000a: 24), in contrast to Gösta Esping-Andersen’s (1990) preference for decommodification. However, this does not imply mainly recommodification through tightening means testing and limiting benefit entitlements. The vital point is the improvement of employability through preventive measures, lifelong learning and activation actively fostered by the state at different levels, reflecting Giddens’ concept of recommodification (1998). This orientation of the EES was already on the horizon in the first half of the 1990s. It has gained importance mainly because the concept of activation is generally compatible with both social democratic “third way” policies and the “neo-liberal” policies of non-social-democratic governments, although both positions emphasize very different aspects.

Since 2000, the Lisbon Strategy has set a new target with the intention of enabling the EU to re-establish the conditions for full employment and to strengthen cohesion: the Union shall “become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion.” The guidelines were revised completely in 2003. They now aim at the “three overarching and interrelated objectives of full employment, quality and productivity at work, and social cohesion and inclusion,” pointing to the importance of equal opportunities and gender equality.

The EES has been designed predominantly by social democratic governments – but not by social democratic governments alone. However, reviewing the last five years, the new European employment policy can be regarded as a success from a social democratic point of view. First, after the installation of the employment chapter and the EES the European agenda looks remarkably different. By laying down the principles of the coordination process in a treaty, social democratic governments have been able to anchor it firmly against the political tide. Employment has remained a central goal of the Union.

Remarkably, the character of the guidelines mentioned above was not watered down in 2002–2003 (2003/578/EC), although social democratic parties lost their dominant position in the European Union. On the contrary, the EES today looks even more social democratic: the Union aims explicitly at full employment, a goal that many social democratic parties had silently given up; equal opportunities, social cohesion and inclusion are laid down as further overarching goals.

3 All employment guidelines can be found at [http://europa.eu.int/comm/employment\\_social/employment\\_strategy/guidelines\\_en.htm](http://europa.eu.int/comm/employment_social/employment_strategy/guidelines_en.htm)

Many strategies recommended in the guidelines confirm this interpretation. All this could be read as indicating a change in political discourse that took place in the late 1990s.

One might object that this “soft” process does not really matter. However, soft coordination fosters cooperation where positive integration is not (or not yet) possible, and the open method of coordination (OMC) may be only transitory and could in the end lead to “positive integration” (Hodson and Maher 2001; Linsenmann and Meyer 2002). Furthermore, it can be seen as an adequate answer to the question of how to deal with the great institutional variety of welfare states and labor-market regulations among the member states. From a social democratic point of view the flexibility of the process cannot be judged a disadvantage. Uniform, binding European employment policies would not only ignore differences in the nature of employment problems in member states, but also rob social democratic parties of an electorally important issue (see Ladrech 2003: 119–20). The existing EES may help to lower the unemployment rate and enhance the employment rate and thus allow (national) credit claiming but to some extent it may also allow (European) blame avoidance strategies.

Finally, European employment policy has redistributive components because the European Social Fund directly refers to the EES (1262/1999/EC, Art. 1–2), though they are moderate at the moment.

However, there must be some reservations because the *substance* of the policies pursued with the open method of coordination can be diluted or even abolished with a qualified majority by changing the employment guidelines. Coordination will work only as long as governments generally agree that it is desirable. Otherwise, they may ignore demands or block the whole coordination process. Furthermore, the new coordination process tends to enhance the political importance of the (European) Council and to circumvent the European Parliament, national parliaments and the European Court of Justice. It is questionable whether this would be desirable for social democratic parties.

### Macroeconomic Coordination and Monetary Policy

There can be no doubt that Economic and Monetary Union was not a social democratic project, although many social democratic and socialist parties supported the project of a single currency from its launch at the end of the 1980s (Notermans 2001). The institutional

core of EMU, the European Central Bank (ECB), is primarily committed to price stability. It is the ECB’s philosophy that sustainable economic growth can be achieved only on the basis of price stability. Budgetary discipline, safeguarded by the provisions of the Treaty and the Stability and Growth Pact, forms the second part of this “sound money and finances” paradigm. However, the ECB has defined “price stability” more rigidly than the US Federal Reserve Bank, thereby hampering economic growth in the short and medium terms. At least, this is the interpretation of neo-Keynesians and some social democratic governments.

The informal Pörschach summit in the fall of 1998 seemed to mark a paradigm shift in European politics. The European Council, dominated by social democratic leaders, called for a reduction in interest rates and the introduction of more demand-side measures. The German and French ministers of finance, Dominique Strauss-Kahn and Oskar Lafontaine, explicitly called for lower interest rates with a view to fundamentally transforming monetary policy (Lafontaine and Strauss-Kahn 1999; Lafontaine 1999: 211–13). After the change of government in Germany<sup>4</sup> (Heise 2001: 390) the member states agreed the macroeconomic dialogue of the Cologne process in June 1999. It may be regarded as a reaction to the Stability and Growth Pact and is inspired by “eurokeynesian” (Aust 2000a) ideas. The intention behind it is to enhance coordination between the Europeanized monetary policy of the ECB and member states’ fiscal and wage policies through meetings of representatives of the Council, the ECB, the social partners and the Commission, to take place twice a year.

The turning point in the EU’s agenda which supposedly manifested itself at Pörschach can be traced back directly to the influential discourse of the PES network (Ladrech 2000: 127). However, today the process has been condemned to insignificance (see Heise 2001), and not only because of the difficulties of multilevel coordination (Hall and Franzese 1998) and the declining proportion of social democratic governments in the Council (see Figure 1). Even social democratic parties have not paid much attention to the formalized macroeconomic dialogue in recent years. Furthermore, direct attacks on the ECB’s monetary policy have become rare since 1999. The change of policy of 1998 seems to have been revised not only in Germany (see Ostheim 2003: 354–56) but also within the social democratic party family as a whole.

4 The new Social Democrat/Green government even restructured some ministries in order to underpin Lafontaine’s European economic strategies (see Ostheim 2003: 354–56).

*National fiscal policies under the SGP regime*

In recent years, criticism of the European monetary and fiscal regime has focused largely on the Stability and Growth Pact. Since twelve countries have entered EMU, social democratic governments rarely cast doubt on the general rationality of the Stability and Growth Pact because "the idea of a stability pact was by no means alien to them" (Dyson 1999: 202). Instead, a debate on an adequate interpretation of the rules has evolved since it became evident in the second half of 2002 that Germany and France would miss the 3% mark. Unsurprisingly, the new conservative French government and the German government were the main driving forces both proposed to adhere to additional criteria in the deficit procedure. In 2002, the SGP was formally kept intact by extending the date – from 2004 to 2006 – by which Germany and France had to balance their budgets.

However, criticism of the SGP continued in 2003 although the Council decided in March that, while taking "reasonable account of specific situations," there was "no need to change either the Treaty or the SGP, nor to introduce new budgetary objectives or rules" (Council of the European Union, 6913/03). Chancellor Schröder stressed that the Stability and Growth Pact should be applied "in both of its aspects." The French government followed suit, outdoing German criticism and refusing to observe the deficit recommendations. In the meantime, Silvio Berlusconi entered the field, claiming an exemption and questioning the ECB's commitment to price stability in times of recession or stagnation.

Other member state governments seem increasingly worried about unsound finances. Hence, disagreement concerning the SGP has grown dramatically since 2002. Denmark and the Netherlands have complained about indulgence of France's failure to meet previously agreed requirements. This was the first time that member states had refused to approve a decision under the excessive-national-debt procedure. In light of these developments, it is not surprising that in November 2003 the ECOFIN-12 Council decided against sanctions by a majority, while four smaller states (Austria, Finland, the Netherlands and Spain) voted in favor of the Commission's proposal.

The core commitment to keep budgetary positions "close to balance or in surplus" seems to have been replaced by a more indulgent attitude towards the 3% criterion by the governments of the three largest members of the Eurozone. A partial reinterpretation of the "sound money and finances" paradigm seems set to make possible more flexible fiscal policy in times of

stagnation. In the meantime, ministers have spoken in favor of a reinterpretation of the criteria in the majority of the EU-12 countries.

This policy development exhibits no clear political orientation, although some of the arguments put forward in the discussion have been somewhat misleadingly traced back to social democratic policy initiatives (see Ladrech 2003: 121). Social democracy has indeed formulated the political discourse, but the SGP never came under systematic and coordinated attack from social democratic governments, and social democratic parties have not been collectively opposed to the SGP's macroeconomic regime in the last few years. In fact, the alliance formed against it transcends the left-right economic cleavage. Particular national paths have had a much stronger influence on public deficits.

**Tax policies**

Projected EU integration of capital markets would constitute a significant restriction of national autonomy. Within integrated capital markets governments have to compete for investment with attractive taxation (Tanzi 1995; Dehejia and Genschel 1999). As a result, member states can no longer autonomously determine their taxes. From a theoretical point of view, this leads to tax competition and a "race to the bottom" (Ganghoff 2000; Genschel 2000). This effect is strongest for taxes with a mobile base, including business taxes and tax on interest income. We shall concentrate mainly on the latter: first, because the tax base of other taxes, such as value-added tax, is less mobile and so they do not challenge social democratic policies to a comparable extent; and second because the most important decisions at the European level have been taken on the taxation of interest incomes, although the "Code of conduct to eliminate harmful regulation of business taxation" is clearly of relevance to social democratic policies.

Within the European Union, different designs of national tax laws lead, among other things, to tax evasion because some member states make strategic use of bank-secrecy laws. Member states do not inform the country of residence about incomes, but neither do they impose a withholding tax on interest incomes. This development can be said to be harmful from a social democratic perspective. First, it reduces tax revenues in countries with high tax rates and undermines the public expenditure base, hitting costly redistributive social policies. Governments intending to reduce public expenditure might welcome this effect. However, for social democratic governments such a development

would be worrying. Second, it has unwanted redistributive effects if the tax burden increases on wages compared to capital incomes because taxation on wages and social security contributions cannot be easily avoided. The different levels of mobility of wage and of capital income, pressure to reduce capital taxes and tax evasion opportunities may thus aggravate voluntary "exclusion at the top" (Giddens 1998). Correcting the defects of tax competition, which violates the first principle of the ideal social democratic tax system (see Merkel 1993: 164f), should thus be a priority issue for social democratic parties (with the possible exception of those who profit from the status quo). In fact, the PES manifesto for the 1999 European elections demanded "better policy coordination to prevent harmful tax competition in the form of unfair tax breaks and hidden subsidies" (PES 1999: 9). The PES EcoFin Group also pointed to the necessity of an "OECD-wide approach to tax policy" to reduce capital outflows (PES 1998: 6).

When social democratic parties attained a dominant position in the Council, discussions between member states on prevention of tax competition had been going on for more than a decade without significant results. France and Italy had been particularly worried about tax competition and the French socialist government even threatened to block the directive on liberalization of the capital market. However, the first commission proposals (COM (89) 60) failed (Genschel 2002: 141–48; Bernauer 2000: 227f). At the end of the 1990s the Commission launched a new attempt to coordinate national policies on the taxation of interest income within the framework of a "package to tackle harmful tax competition." Its proposal for a "co-existence model" (1997) was intended to introduce an information system forwarding information about interest incomes to the tax authorities of the country of residence. Member states that did not agree to this would instead impose a minimum withholding tax of 20% on the interest incomes of all EU citizens. In June 2000 the member states in principle agreed to the co-existence model (European Council 2000), which is based on the Helsinki Principle that "all citizens resident in a member state of the European Union should pay the tax due on all their savings income" (European Council 1999), but the crucial details of the regulation were still to be worked out.

In November 2000 the Council agreed a future directive concerning the minimum taxation of interest (13555/00/EC) in an attempt to address concerns that a European "solo player" in terms of taxation might endanger the competitiveness of European financial markets: international regulations in terms of bilateral

and multilateral agreements were assigned as conditions for an adjustment. However, only in January 2003 did the Council reach agreement. The directive on "taxation of savings income in the form of interest payments" was adopted on 3 June 2003. According to this directive automatic exchange of information concerning tax audit tracer notes will be set up by 2005 in 12 EU countries in order to ensure taxation in the country of residence. A withholding tax of 15% will be raised in Austria, Belgium and Luxembourg, rising to 20% in 2007 and 35% in 2010; 75% of the revenue from these taxes will go to the country of residence.

European governments were thus able to reach consensus on this greatly disputed issue. However, it is a consensus based on the lowest common denominator: for the first few years of the transitional period the rate of the withholding tax in Belgium, Luxembourg and Austria is quite low. In addition, it is an unconvincing package due to decision-making procedures that allow the beneficiaries of the previous regulation to exercise a veto. In fact, the outcome is more symbolic than real. Nevertheless, the directive will facilitate social democratic policies in moderating tax competition to some extent.

But can this favorable result be traced back to social democracy? Before the final decision was made, the chances of an agreement being reached were enhanced by reasons other than party influence. Some member states had become more aware of the problems of "harmful tax competition": among other things because taxpayers were increasingly using Luxembourg as a tax haven (Genschel and Plümper 1999: 260–62; Dehejia and Genschel 1999: 413). However, this does not mean that there was no social democratic impact. An agreement would have been more difficult without the change of government in the UK in 1997. Other social democratic parties also seemed to be more inclined towards reaching agreement than their liberal, Christian democratic and conservative predecessors. The German "red-green" coalition had explicitly called for "common and binding measures against tax dumping" in their coalition agreement (SPD/Bündnis 90/Die Grünen 1998). The French Socialist Party made the most far-reaching proposals concerning the taxation of interest income. In the negotiations the French government tried to exploit its occupation of the EU presidency, proposing measures that exceeded even the Commission's proposal.<sup>5</sup> Finally,

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5 The French government not only proposed a withholding tax of 25% in the transition period and a percentage of 90% of the transferred withholding tax, but also the inclusion of "debt claims of every kind" (see 13555/00).

Ladrech points out the contribution of discussions within the PES network (see Ladrech 2000: 124).

However, the tax directive is not exclusively or even primarily a social democratic project: specific developments in the member states determined the result much more than partisan differences.

### Social policies

In recent years, the cumbersome EU social protection policies have shown little evidence of social democratic governments being able to overcome the problems we have described. No breakthrough has been made in social policy since the integration of the Social Charter in the Treaty of Amsterdam and its extension to the UK. However, some decisions can be seen as improvements from a social democratic point of view: for example, changes in the decision-making rules in Nice, decisions taken on European social policies as part of the social policy agenda and the introduction of the open method of coordination in social policies (pensions, poverty and social inclusion).

The most important challenge for social democratic policies in the EU is the status of provisions promoting social democratic goals in employment and social policy. While the four economic freedoms, competition policy and, to a lesser degree, the ECB's monetary policy have quasi-constitutional status and are protected by the ECJ and the Commission, many provisions regarding social and employment policies or the regulation of public services either have a lower status or remain rather vague.<sup>6</sup> This bias could be compensated for only by the inclusion of social protection principles in the treaty. However, treaty reform of this kind would obviously require the unanimous consent of all member states. A window of opportunity opened with the establishment of the "Convention on the Future of Europe" to discuss a future EU constitution. Some social democratic members of the Convention clearly saw this as an indispensable precondition of social democratic policies in Europe (see PES Members' European Convention 2002a). Indeed, basic social rights and objectives have been included in the draft treaty establishing a constitution for Europe. According to Article 3 of the draft,

*The Union shall work for the sustainable development of Europe based on balanced economic*

*growth, a social market economy, highly competitive and aiming at full employment and social progress. ... It shall combat social exclusion and discrimination, and shall promote social justice and protection, equality between women and men, solidarity between generations and protection of children's rights. It shall promote economic, social and territorial cohesion, and solidarity among Member States.*

Some important rights have also been laid down in the EU Charter of Fundamental Rights included in the draft constitution. This is clearly a success from a general social democratic standpoint: although the draft does not contain concrete social provisions which are as enforceable as the market freedoms or the competition rules the Constitution will partly adjust the strong bias of the old Treaty towards market integration. However, after the disappointing December summit the complete failure of the constitutional project seems possible. This would represent a major blow for social democratic parties.

### What Should Be Done?

Today, the political priorities of European social democratic parties seem less clear than they did five years ago. Several goals have been achieved in terms of European employment policy, the Convention has completed its work and all important decisions concerning enlargement have been taken. Social democratic parties have not only lost many elections and thus their dominant position in the Council, but they have also had to accept defeat in the euro referendum in Sweden. Furthermore, congruence in European politics seems to be diminishing as different positions on the "excessive-deficit procedure" and discussions on the draft constitution emerge. This opens up new policy options, but also threatens a number of significant achievements. What, then, remains undone and what are the feasible goals and strategies for social democratic parties at the European level?

#### *Employment policies*

Social democratic parties have discovered Europe as a political space as far as employment policy is concerned. Defending the achievements of recent years against a rollback requires that employment be kept at the top of the agenda, that the constitutive processes continue to work properly and that the integrity of the

<sup>6</sup> However, some parts of social policy, including the transferability of social security entitlements, come under the four freedoms and thus promote the pro-integration thrust of the Commission and the ECJ.



EES be maintained. Within the framework of the European Employment Strategy, social democratic parties should further support integrated policy approaches and a “coherent policy mix,” that is, reviewing, utilizing, coordinating and enhancing the employment-creation potential of other policies. Policies should propose socially acceptable best practices of labor-market deregulation which meet the multiple targets of job growth, labor-market inclusion and amelioration of the insider–outsider problem without creating an Anglo-Saxon-type working poor. Measures should be taken particularly on the micro-supply side of employment: training programs, partly cofinanced by the EU, for specific problem groups, such as the long-term unemployed and the young unemployed. Within the Union these are feasible options even under the changed composition of the Council. However, the elements of the European Social Model should be more clearly defined. This would help to identify the elements of the European welfare state that must be protected from erosion while allowing for necessary reforms in the future.

#### *Fiscal criteria and EMU*

Differing interpretations of the costs and benefits of public debt and budget deficits make it difficult for social democratic parties to reach a common position. On the one hand, a persistently high public debt is not guaranteed to promote social democratic goals. Deficits may allow public spending in pursuit of social democratic goals, but they restrict the fiscal base of future public expenditure. Social democratic parties should avoid the trap of being forced to make radical cuts in public expenditure counter to their spending preferences. On the other hand, the existing monetary and SGP regime can plausibly be criticized for its deficiencies. It is not strong enough to ensure fiscal consolidation in times of strong economic growth and gives too little leeway in times of stagnation. In addition, the Union’s goals of growth and employment are subordinate to the goal of price stability, at least as far as the ECB is concerned. Finally, social democratic governments face a dilemma in fiscal adjustment: although expenditure-based adjustments that rely on cuts in transfers and public wages are more effective and sustainable (as induced by the SGP), they tend to generate more income inequality. Revenue-based adjustments, in contrast, have been less successful in terms of economic growth, but create less income inequality (Mulas-Granados 2003).

Social democratic parties can therefore defend the SGP by reinterpreting the criteria, paying more attention to the business cycle; instead of adhering rigorously to the 3% deficit criterion, they should keep the option open of reflatting the economy in periods of economic downswing.<sup>7</sup>

They might also compromise in terms of a moderate shift in monetary policy. This could even mean a discretionary use of European monetary policy in a moderate neo-Keynesian manner. This implies, in particular, a more equal balance between the three macroeconomic goals.

Some authors have proposed the amendment of other ECB goals. Notermans (Notermans 2001) declares that this might be the best solution for the growth problem as it would change economic expectations regarding future growth, thus positively influencing investment. This strategy is intended to facilitate real investment. This might involve enforcing the fiscal goals of the Stability and Growth Pact more strictly in order to prevent increasing interest rates that might cancel out monetary policy measures. However, this partial change of the EMU regime does not seem feasible at the moment.

#### *Tax policies*

In recent years, harmful tax evasion and tax competition within the Union have been curbed. However, large loopholes still exist. Social democratic parties should insist that they be closed and that taxable income be more successfully controlled. It is very important that the information system be extended to all member states as quickly as possible. Renegotiation of the tax directive to enhance its scope and make the “code of conduct” enforceable is a desirable, but not a particularly feasible option.

The harmonization of income taxes might be a self-defeating strategy for high-tax countries since such harmonization would be imposed – if at all – only at a lower level. Continental social democrats should therefore follow the Scandinavian model of raising VAT. In times when capital income and the personal income of non-wage earners are increasingly difficult to tax, VAT could compensate progressive tax evasion perpetrated by those on higher incomes. VAT at least cannot – easily – be evaded and government revenues would increase. The unavoidable regressive distributional effects of a flat-rate tax appear to be the lesser evil.

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<sup>7</sup> Although this goal is already laid down in the SGP, it is mostly ignored.

*Social policy*

“Redistributive social policies” on the European level cannot be expected in the foreseeable future. The EU will continue to focus on a “regulative social policy.” Harmonization of national social welfare systems should not be expected due to major institutional differences and the heterogeneity of welfare claims and benefits within member states. However, social democratic parties should try to strengthen the compulsory aspect of the European treaties and European secondary law concerning minimum standards of social protection. Above all, they should do everything to safeguard the social goals of the Convention draft.

Structural impediments, legal entitlements and the scarce financial resources of the poorer member states prevent harmonization of social welfare systems at the European level. However, European regulations could be used to prevent ruinous competition among member states’ social regulatory and welfare systems. Fritz W. Scharpf (1997: 33) suggested some years ago that EU member states should make a binding agreement according to which all countries must avoid welfare retrenchments which would push overall social expenditure below a certain threshold. (The threshold would be defined in terms of the countries with the lowest share of social expenditure in total public expenditure.) Such a minimum standard would prevent some countries from using welfare cuts to enhance their international competitiveness and attract more investment at the expense of social protection. Such a rule could be complemented by an agreement defining the minimum share of all taxes in capital and business incomes. A competitive “race to the bottom” in terms of tax and social dumping could thus be avoided. Similarly, though more demanding, quantitative standards could be set for education spending. The trend from social consumption towards social investment could be strengthened to create more equal opportunities and life chances for children from poorer families. Both goals would be acceptable to modern social democrats committed to more effective social justice than has been achieved by continental and Anglo-Saxon welfare states alike (Merkel 2002).

**How Should It Be Done?**

Coordination or harmonization of member states’ tax policies, reform of the welfare state and social deregulation of the labor market in high unemployment countries seem inevitable. However, these reforms must be realized in the context of a great variety of

highly institutionalized welfare states providing social security benefit entitlements. Social democratic governments therefore tend to focus on the national arena and often neglect using “European space” to pursue their political goals. But which instruments could be used successfully to attain social democratic aims at the European level?

*Methods and degrees of Europeanization*

Basically, “Europeanization” policies can be differentiated with respect to two “methods” and three degrees of Europeanization: “hard” European law – that is, directives and regulations – are obligatory and can be enforced, while “soft” European methods are based on recommendations, guidelines and communications. These methods can be used to attain different degrees of Europeanization: harmonization of policies, convergence of outcomes while allowing for different strategies – for example, with obligatory minimum standards or the less committed “management by objectives” of the open method of coordination – and, finally, strengthening, activating and informing national reform debates, for example, with “best practices” and peer review without binding objectives.

Generally, we cannot say which method and which degree of implementation best fits social democratic interests. It depends on the policy domain, the institutions involved and the concrete constellation of actors. Where regulation of the four economic freedoms or market competition are at stake “hard European law,” obligatory directives and harmonization are the rule. However, as far as core social democratic objectives are concerned, such as employment or social policy, in respect of which social democracy has a distinctive identity compared to conservatives (and to a lesser extent compared to Christian democrats) and liberals, the open method of coordination, minimum standards or best practices in the form of non-obligatory guidelines dominate.

Taking into account the impact of “constitutionalized” market freedoms and competition rules on economic and social welfare in the member states, social democratic parties ought to try to counterbalance the strong trend towards deregulated markets<sup>8</sup> on the level of the Treaty or even that of the constitution. The convention draft can thus be regarded as a definite step forward. However, the general bias towards free

8 Of course, the Common Agricultural Policy is the very antithesis of free-market liberalism. However, the heavily regulated common agricultural market serves neither social justice in general nor social democratic aims in particular.

markets and economic liberalism will not change in the near future as agreement is unlikely to be reached on changing the core principle of free markets in the treaties or the "constitution".

Closer cooperation between some members will presumably not help to overcome the constitutional asymmetry of pro-market "hard" law and market correcting measures. As Fritz W. Scharpf (2002) has argued, such closer cooperation between some member states must respect the *acquis* and so cannot simply be used to curb or correct any of the negative effects of the *acquis* on the four freedoms and competition law.

At least in some areas further steps towards majority voting seem possible. This might open up the way for more substantial regulations in the field of regulative social policy or tax policy (taking into account the draft constitution) backed by the Commission and the ECJ against future erosion.

However, it is questionable whether social democratic parties should follow a strategy of harmonizing social and employment policies. This would imply far-reaching changes to national welfare states and deprive social democrats of core policies with which electorates tend to associate them, risking electoral decline. In pursuit of these policies, social democrats thus ought to pay more attention to strategies aiming at minimum standards and "management by objectives." The "corridor" model (Busch 1998) has been proposed as an alternative (for example, Frenzel 2003) to precisely defined minimum standards. According to this model, three or four "corridors" with different minimum standards should be established, allowing for differences in economic prosperity.<sup>9</sup> However, such a harmonization strategy, with hard, enforceable but differing targets, does not seem to be a feasible option in most policies.

To overcome these problems Fritz Scharpf (2002) has proposed relatively general rules (called "framework directives"), a combination of the open method of coordination and "hard" Community law, that would also pay attention to differences in countries' economic situation and institutions. This would allow some flexibility while changing the asymmetry between hard law that is mostly pro-market and the market-correcting substance of some soft coordination processes. Therefore, the treaty has to be amended: directives setting minimum standards have to be issued

not only for employment, but also for social inclusion and social security systems.

However, it seems unlikely that such a new procedure can be established successfully. First, it is highly questionable whether unanimity will be reached as regards amending the treaty. Second, member states might still block effective "framework directives." In addition, from a social democratic point of view it is questionable whether the party composition of member-state governments will give rise to framework directives that foster social democratic goals.

Although their impact on national policies is restricted, this again points to the importance of "open methods" for social democratic strategies in respect of which coordination with "hard" governance is not possible. However, we have shown that a strong and direct impact is not always a preferable option for social democratic parties for electoral reasons. The open method of coordination is normally more flexible than European secondary law and thus allows for necessary variation between member states' policies. Furthermore, from a social constructivist perspective, fostering "learning" and "policy transfer" strategies seem to be a valuable and effective instrument. Thus, OMC processes may in the long run help to overcome the fact that social democratic parties still diverge on most policies. Finally, the open method of coordination does not necessarily have to end in "neoliberal" competition and deregulation, but may also help to propagate successful social democratic goals and strategies. The PES members of the Convention have thus plausibly claimed that "policy coordination should be introduced into the treaty," using the established open method with common aims, benchmarking and the formulation of guidelines (PES Members' European Convention 2002b).

#### *Pragmatic European policies instead of a Europeanized PES*

The EU's decision-making rules mean that new decisions that are unwanted by some member states can easily be prevented while existing provisions of primary and secondary law are difficult to change. Given the changing majority in the Council (and the European Parliament) it can be concluded that the window of opportunity has already closed – even for policies that require only a qualified majority. As a consequence, social democratic governments have both to reach agreement within the social democratic party family and to establish alliances with parties of a different political orientation. Demands for uniform European so-

<sup>9</sup> An upper and lower limit of social expenditure ("corridor") should be determined for each member of this group. The percentage of employers' social contributions should be the same in all member states. Within these corridors member states can decide on the level of social expenditure and how it should be distributed.

cial and fiscal policies and a fully “Europeanized” PES (for example, Frenzel 2003) are utopian. The realization of such strategies is unlikely as a consequence of the variance of national institutional contexts and the different programmatic positions of social democratic/socialist PES member parties, and the diverging interests of parties in government/opposition and of single party/coalition governments. In addition, a transformation of national party systems into a European party system has not yet taken place and will not take place in the foreseeable future, although the European level is increasingly important in most policies (Ladrech 2000). Thus, although European policies have started to play a more prominent role in national elections there is no room for a Europeanized party in national party competition.

#### *Search for allies at the European level*

Coalitions that rely primarily upon social democratic actors have poor prospects not only because of European decision-making rules and the consequences of numerous electoral defeats in the last three years that have drastically changed the composition of the Council. In addition, the end of the long-standing collaboration with the EPP has changed the role of the PES in the European Parliament. Furthermore, social democratic parties have fairly heterogeneous preferences on many issues and this will only get worse with enlargement.

Social democrats should try to forge coalitions with different actors and multiple institutions in the EU’s multi-level system of governance. In the past, the European Parliament, and to some extent also the Commission, turned out to be “natural” allies. Prima facie, the Commission has “the potential to seriously interfere [only] with those parts of the national economies that are not predominantly structured by market principles,” and it has acted as a strong defender of these rules. However, its policies can be traced back to its competences regarding market liberalization, not to an ideological commitment (Schmidt 2000: 45). A closer look shows that the Commission may also be an ally of social democratic parties: it is – like the European Parliament – not only theoretically biased towards further integration for the purpose of enhancing its own competences (see Schneider and Werle 1989), but also has tried to promote market-correcting rules (for example in its initiatives within the framework of the EES seeking more concrete and binding measures – see Ostheim and Zohlnhöfer 2003 – or its tax policy

proposals, as already mentioned). The social partners, who have gained in importance in European politics, might be another ally. Although the search for allies at the European level will generally not help to solve the electoral dilemma of social democratic parties, the involvement of these social partners may offer a “distinct and positive role for organized labor in the regulation of economic and social relations” that is the precondition for ties between leftist parties and unions (Howell 2001: 9). This might help to moderate the opposition of “veto players” (see Tsebelis 2002) and make inevitable reforms less electorally costly.

### **Social Democracy and the European Union in the Future**

At the end of the 1990s a window of opportunity seemed to have opened for social democracy. Social democratic parties led the governments of 12 of the member states and constituted a majority in the European Parliament (until 1999). Excessive social democratic expectations of conquering European political space, and so compensating for the loss of national sovereignty in policy-making, proved to be an illusion. Nevertheless, a number of decisions have been taken which can be regarded as “social democratic” successes: the European Employment Strategy (EES) can be attributed to social democratic dominance at the end of the decade. Based on the principle of soft coordination, the EES introduced an institutional arena in which best-practice diffusion can be organized, mutual learning processes strengthened and pressure on national employment policies enhanced through indicative guidelines, benchmarking and peer review. Less visible progress has been made in tax policy. However, a first step was made in 2003 to avoid unfair and harmful tax competition among the member states, after long and complex negotiations. The directive on “taxation of savings income in the form of interest payments” took further steps to establish an automatic system of tax audit tracer notes between 12 countries to curb tax evasion. Furthermore, it paved the way for implementation of a withholding tax in Austria, Belgium and Luxembourg to minimize the unfair taxation practices of some countries. Although the directive is oriented towards the lowest common denominator, it may trigger further spillovers in the direction of better coordination of taxation within the European Union. No major successes can be reported in European social policy since the Social Charter was introduced into the Treaty of Amsterdam and extended to the UK. Only some additional protective regulations for EU migrant

workers, "gender mainstreaming," safety in the workplace and increased expenditure on the European Social Fund have been implemented (Falkner 2000). However, the Office for the Protection of Competition (OPC) opened up a new arena in which national regulatory social policies can "infiltrate" European rules at all levels and ultimately contribute to diminishing the strong market and free competition bias of the European Union. This may take place in the context of an overarching "social policy agenda." The open method of coordination in particular could open up new ways of strengthening the coordination of social and employment policies beyond the treaties and "hard" European laws – OMC spillovers can be expected in the future.

However, in comparison with the impact on European and national policy-making of the Single European Market, European monetary policy and the Stability and Growth Pact these are very minor steps. The Office for the Protection of Competition cannot compete with hard European law which protects the four economic freedoms and liberalized markets (with the exception of the Common Agricultural Policy). The imbalance between negative and positive integration remains unchallenged. Eastern European enlargement will prevent further deepening in many policy areas. It cannot be regarded as a "social democratic project" to the extent that it prevents or at least decelerates the deepening of the EU. Reaching the necessary consensus or even compromises for reregulating fiscal, social and employment policies at the European level will become more complex and difficult in a more heterogeneous Union. Despite some progress in "socially democratizing" some fields and methods of policy making, the trend towards a more market driven and less political Union continues. The failure of the first attempt to pass the draft constitution could be "the writing on the wall" as far as the further deepening of political Union is concerned. If this is true, social democratic strategies which seek to make the European Union more "social" should look to a "two-speed Europe" as the most promising "social democratic option" for the future.

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