

ECONOMIC CONSEQUENCES OF INTEGRATION AFTER THE BIGGEST ENLARGEMENT OF THE EU

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The scenarios for the future of EU public policies: the perspective of the theory of public goods

Abstract: Starting from the economic theory of public goods the author builds a framework for an analysis of the ways European public goods are identified and provided. The specific aim of the paper is to discuss the criteria for designing an adequate institutional framework of the provision of public goods and to explain why there is a tendency for a misalignment between the citizen's expectations and EU public policy outcomes.

Keywords: public goods, public goods provision mechanisms, institutional design, European governance.

JEL codes: H87, F55.

Introduction

The European Union enlarged from 15 to 28 member states constantly raises doubts about its capacity to provide and implement efficient public policies

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and to provide the citizens of its member states with decisive arguments about net benefits generated by the ongoing process of European integration. This situation leads to the perception that the existing institutional arrangements or even the fate of the whole organization is threatened. In sum the project of European integration seems fragile.

In academic literature the European integration is explained by two dominant themes: economic arguments in favour of integrated (single market) markets indicating the expected efficiency gains to market actors [Padoa-Schioppa 1987] and political arguments calling for institutional solutions that bind European nations together, prevent them starting wars against each other again and project their aggregated power outwards [Delors 1992]. Both types of arguments are however rarely linked and at times they can counter each other. Thus, for instance, the gains from the single currency usually evidenced by lower interest rates on government bonds have been overshadowed by political conflicts over fiscal adjustments in the countries most strongly affected by the crisis – specifically in the case of Greece. There is thus a need to integrate both types of arguments and identify their limits, conflicts or synergies. In this article I will try to show the usefulness of the theory of public goods to link the economic and political arguments and thus explain when and why economic arguments harmonize with political ones and when and why they might lead to opposing conclusions. The paper is divided into four sections. The first section constructs theoretical links between the theory of public goods and the theory of optimal integration, the second section shows the impact of the increase in the number of club members on the identification and homogeneity of public goods, the third section discusses the mechanisms for the provision of public goods and the fourth section examines the distributional implications of public goods' provision. In the conclusion it is shown that the misfit between the theoretical characteristics and actual public policies in the European Union is a very likely policy outcome.

1. Public goods and the theory of optimal integration

The history of the EU's development does not follow from the implementation of any general theoretical model, on the contrary, for decades the institutional changes introduced by politicians were justified ex-post with mostly ad hoc theories [Majone 2009]. Current EU institutions and procedural rules have predominantly been developed and modified gradually, responding to the

needs arising at a given point in time [Musiałkowska, Sapała & Wróblewski 2012]. Some of them have proven stable and beneficial, others however have been questioned as inadequate or detrimental.

It seems reasonable to expect that future EU institutional developments will be less driven by “a trial and error” approach and more by a clear recognition of the integration’s goals and a better design of instruments and mechanisms that increase the likelihood of reaching such goals.

A useful point of departure is the identification of goods that cannot be supplied by individual states and, hence, they require institutionalized cooperation (integration) since they will not be provided spontaneously. Such goods are called (pure) public goods and are usually defined by two features. First they are in *joint supply*: this means that one state cannot be supplied without supplying others, and that the consumption of the good by one state does not reduce the consumption of other states. This condition is also called one of *non-rivalry*. Second they are *non-excludable*: that is if the good is produced no state can be excluded from enjoying it, which also implies that no one can be charged for its use.

Table 1. Typology of goods

Exclusion	Rivalry	
	yes	no
no	pure public goods	common pool resources
yes	club goods	private goods

Source: Elaboration based on: [Samuelson 1954; Kaul, Grunberg & Stern 1999].

Probably 90% of goods that we know and use are private: rival and excludable. Even such goods such as roads or television signals are excludable and rival since one can force users to pay for them (and hence be able to exclude non-payers) by setting toll-gates or encrypting a television signal and charging for the television reception. Pure public goods are, on the other hand, extremely rare as most goods are either rival in consumption or excludable. Non-rivalry in consumption is a very restrictive condition since even clean air is nowadays a good consumption of what happens to be rival and excludable as the spread of oxygen bars in cities such as Tokyo witness. Club goods in turn require designing ways to exclude non-paying users and impose pay-

Table 2. Concepts of public, European and good

Public	Refers to <i>the public</i> (general population), with <i>the European public</i> including states, citizens, corporate actors. Public goods are visible goods that are in the public domain and may concern all people. What is public can be defined by expert judgements based on technical criteria but sometimes it is a matter of political choice; the character of a good can change over time. Public goods can be, but need not be, produced by the state
European	Means trespassing borders. European includes local, regional and national levels. It does not necessarily imply centralization or top-down europeanization
Good	Means “thing” (including a legal framework) or “condition”. Understanding their architecture and production path is critical to ensuring adequate provision

Source: Modified from: [Kaul, Grunberg & Stern 1999].

ments even if an increase of use will not lead to immediate congestion. Legal and technological changes make such exclusions possible and feasible. In turn common pool resources require the creation of instruments to protect a good that can be depleted when the use is too intensive or too frequent since no one can be excluded from its consumption. There is thus a need for credible, enforceable ways to protect it, to set the rules of use or to restore the use to a durably sustainable state.

In the context of international issues national goods (domestic public goods) can be considered “private goods” as they do not impose negative externalities on neighbouring countries. Thus the problems of solid waste management is a local (subnational) problem and of the inhabitants of Krakow or Naples and even if an international body expresses its opinion on the topic this is a matter of symbolic influence not a real participation in solving a local problem. To goods which might be public (by political choice) but are chiefly national and should be provided at a national level, one can include access to broadband internet, if a government convinces people that the good can be financed publicly although it is knowledge and information which are purely public goods and not a broadband internet itself. In fact the technical criteria which clarify the nature of a good in practice often succumb to politics, that is to a political decision which might make goods which are otherwise not public into public goods but prohibiting exclusion (or abolishing payments).¹ The political will however does not alter the technical nature of a good and this might lead to various kinds of perverse effects which undermine the “sustainable publicness” of such goods. Thus in most European countries health

¹ The project to distribute elementary school textbooks for free in Poland is a case in point.

care is considered a public good (service), although it is essentially a private good (excludable and rival). The free public provision of this good suffers however from excess demand, rationing and low quality. Even if researchers recognize the power of politics (the strength of political will), it is useful to make an analysis and examine the characteristics of a good, since it permits the uncovering of possible practical problems when “politics” apparently changes the nature of a good.

The theory of public goods allows the identification of cases which are especially interesting for an empirical analysis. It states that we should be surprised when a public good is provided although the theory assumes the provision of public goods is paralysed by the collective action problems (or “free riding”) [Olson 1965]. Knowledge and information is undoubtedly a public good. But it is not a naturally free good: it needs to be collected, digitalized and made available. Thus somebody has to finance its publicness: the launch of website: www.europeana.org, which is a multi-lingual, online collection of millions of digitized items from European museums, libraries, archives and multi-media collections is an example of a good made public by financing from the sources of the European Union and its member states, is a clinical proof that pure public goods are provided. The digitalization of libraries is a means to make knowledge and information a pure public good.

A similar argument can be demonstrated in the case of military expenditure which are means to assure peace (another pure public good). It can be argued that if military defence is provided collectively it will be cheaper and hence more efficient. But despite the theoretical reasons and political attempts to centralize military spending and provide security collectively the European Union members states are reluctant to provide security as a European public good and they keep delegating the defence to an external organization – namely to NATO.

The core problem related to the provision of public goods (European, national or local) is in respect of the distribution of costs and benefits. Any public good needs some costs (C) to be paid for (provided) and it generates some benefits (B). The costs can be distributed amongst N subjects and the same might happen with benefits. But such distribution might take various characteristics. Thus, for instance, the benefits to a country A (B_a) might exceed the total costs of providing the good (C). In such a happy situation country A will provide the good for all (this situation is indicated in the table below as the Single Best Effort mechanism). It might be also that all countries need to make a contribution of at least minimum size since without it a public good will not be produced and provided. This situation is called a “weakest link”

Table 3. Forms of public goods provision

Type of provision mechanism	Description
Single best efforts	A country is willing to cover all costs of the provision of a public good since its share in its benefits exceeds the costs of provision
Weakest link	A country has to participate in joint efforts even if it is not able or willing to pay the costs. Other countries need to subsidize such a country (pay for it)
Aggregate efforts	Many countries need to simultaneously contribute without a clear leader willing to bear the costs of public good provision
Mutual restraint and coordination	Countries just need to agree on the way to behave and such a choice is indifferent to them. They might also need to mutually credibly abstain from certain actions

Source: Based on: [Barrett 2007].

provision mechanism. In different conditions all countries need to contribute to a similar degree and this situation is called the “aggregate effort” provision mechanism. In yet another situation the countries do not need to do anything actively but just credibly commit to not doing. This situation is called the “mutual restraint” provision mechanism.

This brief discussion of provision mechanisms has to demonstrate that the key issue related to public goods is an ability to create an institutional setting able to sustain the participation of many actors (states) to durably cooperate under the conditions of persisting incentive to free ride.

The problem of institutional design is also important for two other mixed type situations the case of club goods and common pool resources. Euro – the single currency of the EMU area, can be classified as a club good where the benefits are restricted to the club’s members. To benefit from club goods a candidate has to pay a membership fee (to surrender its monetary policy) and has to take on some duties (for instance to meet the Maastricht criteria) and those that do not are excluded from the rights (participating in the formation of the monetary policy) and benefits. But the production of a club good might lead to distributional conflicts as well. Thus in January 2014 air traffic controllers from Italy and France went on strike to counter their governments’ plans to change the rules governing European airspace. Thus an integrated traffic control for the EU countries – a potential EU wide club good that might help to make flying more harmonious, less costly and more efficient encountered fierce opposition stemming from a private assessment of

benefits and costs by the trade union of the air traffic controllers.² Numerous environmental problems illustrate the problems of protecting common pool resources. For example overfishing is a problem in all regional seas in the EU. It is estimated that in the EU 39% of the fish stocks in the North East Atlantic are overfished. In the Mediterranean the situation is even worse. According to an analysis by the European Commission 88% of fish stocks in the Mediterranean are overfished.

In summary if we agree that the main goal of any collective organizational structures (including local governments and the European Union) is to provide various types of public goods it is clear that this becomes a formidable task which in consideration of the incentives to take advantage of others (free ride) requires skillful institutional engineering.

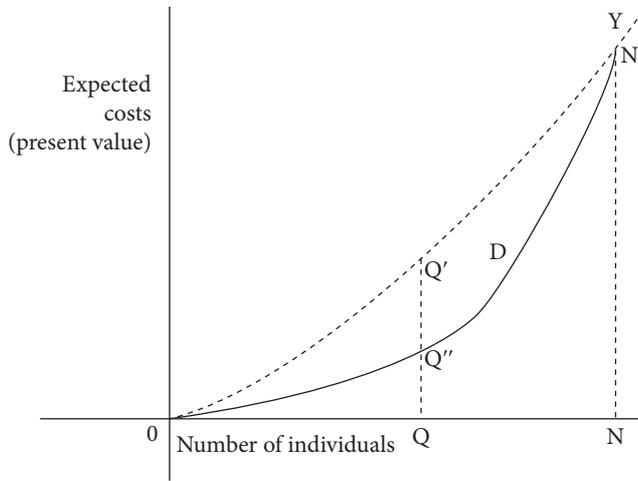
2. Public goods and the increase in the number of member states

The EU's history is a history of enlargement (in numerical terms, starting from a group of 6 founder states to 25 and 28 member states in 2014. In political rhetoric at any given time of enlargement in the past the enlargement was to be fully compatible with the deepening of integration with an increase of the number of public goods provided jointly and with a stronger centralization of the provision mechanisms.

The political rhetoric is however in a strong contrast to two factors indicated by our theoretical analysis. First factor results from a recognition that a growing number of members usually leads to a growing diversity of tastes and preferences thus reducing (and not broadening as the deepening of integration thesis claims) the scope of issues which can be considered common (public, shared) by a larger and more diversified group of members). The second factor has been identified in the pioneering analysis made by James Buchanan and Gordon Tullock regarding an increase in the costs of decision making when the number of actors (states) required to agree increases (see Figure).

The combination of these two factors leads to a prediction that enlargement and a deepening of integration have to be seen as mutually conflicting

² See: <http://www.bloomberg.com/news/2014-01-29/european-travel-hampered-as-air-traffic-controllers-start-strike.html> [access: 26.02.2014].



Expected costs relative to the change in the number of persons required to agree within a total group of defined size

Source: [Buchanan & Gordon 1958]

processes and would lead either to the internal differentiation of a previously homogenous club or to a lessening of integration.

In fact the tendency to internal differentiation becomes apparent in recent EU institutional development and it should be considered natural if we take into account earlier theoretical insights. For instance the creation of the European Monetary Union (EMU) and the introduction of the single currency was accompanied with the assertion of the right of some member states to opt out from these initiatives which otherwise remained binding for other member states. The right of Denmark and Great Britain to opt out from the EMU was thus the formal assertion of such “variable geometry” in the construction and functioning of the EU.³

Paradoxical as it may sound the institutional structure of the EU can maintain its capacity to produce public goods if it remains supportive of integration understood as an increase in the variety of smaller clubs and flexible modes of cooperation among self-selected actors of the integration process.⁴

³ The conceptual affinities between public goods theory and optimal currency area theory can easily be noticed.

⁴ Arguments supporting the idea of European integration which fully respects and take advantage of Europe’s internal diversity can be found in the work by Bruno S. Frey [2002].

3. Governance mechanisms and the provision of public goods

The basic economic efficiency principle says that public goods should be provided by the governance area where benefits from a given public good are concentrated since only then it is possible to reduce the tendency to “free ride” on the provision of a public good by others. If benefits from a public good “leak out” from a given area there is a threat of underfinancing and undersupply of a public good.

The above general principle must be translated into decisions about the allocation of costs and a specific design of a mechanism for the provision of a public good. In other words it has to be translated into decisions as to which policies should be centralized (made European) in order to provide uniform public goods and which should be left in the hands of national and local public governments.

In principle we can distinguish between two modes of providing European public goods: the centralized one and a decentralized one. In the former case member states agree on the identification of a public good but delegate its provision to the supranational level (to the European Commission, for instance). Through such a decision the agent receiving delegation has the right to manage a given issue, to conduct a policy aimed at the production and provision of a given public good. The delegation of responsibility for the provision of a public good has to be aligned with appropriate financing. Financial resources might be transferred to such an agent or might be generated directly thanks to the delegation of the right to impose contributions or taxes.⁵

Another form of cooperation in the production of a public good, functionally equivalent to delegation, is a decentralized mechanism of public goods’ provision. It requires however a credible commitment of cooperating parties to selected norms of behaviour as a public good’s provision is expected to be the product of decentralized activities (and decentralized financing) by cooperating parties. This kind of mechanism is suitable chiefly when a public good provision requires imposing constraints on member states (the case of mutual restraint).

⁵ The European Union and public goods it provides are financed by transfers from member states. But the European Commission has been calling for the creation of its own EU resources by imposing taxes for instance on transborder flows: financial transfers and air passengers are named as the most obvious objects of taxation.

But a credible commitment might not be sufficient for the elimination of negative externalities of an informal interaction between many agents. To prevent such an eventuality it is necessary to introduce certain forms of formal coordination (institutionalization of cooperation). Informal coordination can be thought of as the coordination of expectations (for instance through the exchange of information and experience) or as activities agreed voluntarily. The formal coordination requires the setting of binding rules and agreeing on their enforcement. Informal coordination such as coordination of expectations is a soft form of coordination. This form is likely to be effective only in conditions of strong axiological homogeneity and in an environment characterised by a high density of information. In an enlarged European Union such a situation seems to exist only in sub-regions and in restricted problem areas.

In most cases there is a need for a formal coordination of activities which requires the adoption of certain institutional solutions in order to facilitate its practical implementation, Itt also requires the provision of a formalized framework for the division of roles and tasks.

Where there are no negative externalities, where the activities of actors do not generate negative consequences for others, there is no need to delegate tasks, resources or responsibilities for a particular action, or to coordinate the activities undertaken. These are the areas of autonomous operation of particular actors.

The choice of a method for providing a public good should conform with the goals of a given policy action. The existing literature distinguishes between various functions EU policies can play and in particular between stabilization redistribution and regulation [Majone 1996].

Macroeconomic (and financial) stability is a club (public) good and in the EMU (a subgroup of countries of the EU) means chiefly low inflation, little variance in interest rates on public bonds and the stability of financial institutions (in particular banks).

Redistribution means transfer of resources between states and regions with direct and indirect implications on the income of individuals.

Regulation consists of activities aimed at increasing the efficiency of markets through preventing monopolistic tendencies and decreasing barriers to entry or diminishing health risks arising from environmental pollution or contaminated foodstuffs.

The EU public policies can be mapped using the criteria of methods of provision (centralized/decentralized) and the functions performed by them. The table below locates selected EU public policies on such a table 4.

Table 4. Typology of EU economic policies according to the method of assigning responsibilities and function performed

	Stabilization function	Redistributive function	Regulatory function
Centralized	monetary policy for EMU	common agricultural policy	competition policy trade policy
Decentralized	national budgetary policy	social policy	tax policy

There appears to be a strong correlation between the type of public good, the function performed by a given policy and the allocation of responsibility for conducting this policy. Redistribution-based policies are typically producing private goods and they belong to the competences of autonomous member states since they require political decisions regarding the amount and direction of public spending. Stabilization-oriented economic policies are club goods and they are likely to be delegated to the bodies performing these functions on behalf of the members of a monetary union.

From the above discussion a conclusion is that the extension of EU policies beyond stabilization and regulatory⁶ issues leads to controversies and disputes about the distribution of costs and benefits since the broadening of EU own policies leads to an increasing flow of private benefits.

4. Public goods and redistributive policies in open economies

If the objective of the European Union is not merely to create a common framework for a cooperation between member states and to build a common market but to pursue state-like European policies:⁷ from guaranteeing specific social rights (entitlements) to citizens, to conducting common foreign and security policies, such a move becomes the subject of political controversy and the rise of “Eurosceptic” movements calling for an exit from an over-restrictive organization.

⁶ Regulatory policies are suitable for the protection of European common pool resources.

⁷ These intentions were certainly part of the agenda of the European Commission presided over between 1985–1995 by the French socialist politician Jacques Delors [1992].

The direct spending from the EU's own budget tends to be a divisive instrument and to the extent to which it gains a broad approval amongst economists and European public opinion at large, it is subordinated to the removal of trade barriers. Thus Henrik Braconier's and Mauro Pisu's document on missing international road connections in the EU and calls for an increased effort to build or improve European roadways because this could substantially raise gains to trade in an area since "more than 70% of merchandise trade amongst European countries is transported by road the effect of poor international road links could be particularly harmful for inter-European trade" [Braconier & Mauro 2014].⁸

Distributional policies are at the core of modern welfare states. All existing welfare states are national welfare states and as Alberto Alesina and Francesco Giavazzi pointed out existing empirical evidence shows a strong correlation between ethnic uniformity and a willingness to redistribute which means that multi-ethnic societies have less developed social protection systems [Alesina & Giavazzi 2008]. Thus it is highly controversial to expect the implementation of the European wide welfare state even if some political forces argue that such a model is a distinctive trait of being European and that it is necessary to insure European citizens against the risks arising from the vagaries of economic globalisation.

In the light of these empirical and theoretical arguments one can conclude that the chances for the implementation of the European welfare system are very small and that even if there is a window of political opportunity to implement such a model it might turn out to be unstable.

Due to the diversity of values and perceived ethnic differences the extent of social rights guaranteed throughout the EU may be only of minimum character. In addition such rights might not be linked to any spending but they should have an exclusively a regulatory character. Thus, for example, the principle of non-discrimination of wages in respect to gender was accepted as an implementation of article 119 of the Treaty of Rome (article 141 of the Treaty of the European Union), which states that men and women should receive equal pay for equal work. This regulation was introduced as a result of demands from France which had previously guaranteed such a right in its legal system. In France women's wages were relatively higher than in other founding member states of the European Union therefore France feared the loss of its competitive advantage in the industries which employed large numbers

⁸ This type of recommended spending is not controversial at all in the light of this article's discussion, it only raises a question why "first things have not been first so far".

of women, whilst the broad adoption of the equal pay for equal work principle was seen not merely as a universal ethical postulate but also a tool of protecting the national textile industry [Sapir 1996]. Abstract and general free movement principles may also gain in importance as a result of the evolution of judicial interpretations. The principle of equal treatment included in the Treaty of Rome provided grounds for court decisions reinforcing changes in administrative regulations to facilitate citizens of the EU Member States settling in other Member States, with the transfer of rights to social benefits previously incurred.⁹

It seems a dominant opinion among the theorists of European integration that as long as European integration remains at the stage of so-called *negative integration*, i.e. as long as it consists of removing the barriers for the free movement of capital, goods, services and persons, it would only marginally affect social rights and social policies of the Member States [Majone et al. 1996]. Negative integration (“removing the barriers”) is in tune with the idea of providing public goods such as macroeconomic stability or regulatory protection of environmental commons.

Conclusions

When asked about their judgements about the EU most citizens accept its existence but when asked about particular benefits stemming from the functioning of the EU they list as the basic achievements: peace among the nations, freedom of movement or the student exchange system Erasmus. Better informed citizens add the right to challenge their own state’s decision in the European Court of Justice or joint research work undertaken in basic physics. These are not trivial achievements but once they have been gained they are taken for granted and their significance dwindles in people’s minds.

But although theoretical arguments state that expectations towards the European Union should be rather low if considered in terms of capacity to solve practical policy problems, citizens do expect from the EU visible, direct and individualized effects. Thus each year, especially before elections to the European Parliament, European institutions try to generate a list of EU specific achievements as if the EU was supposed to act in almost every mat-

⁹ Amongst other things it made it possible for German pensioners to settle in the south of Spain. They reside there permanently whilst they receive their pensions from Germany.

ter important to citizens. The document “Europe: What’s it all about?” lists 10 examples which should make the EU relevant. The list says that: (1) the EU increases the number of jobs since it created a European single market; (2) it makes phone calls cheaper, since it enforced the reduction of roaming fees; (3) it makes flying “reasonably priced” since it abolished national monopolies and permitted competition in air transportation; (4) it forced “doorstep sales” to permit the cancellation of deals; (5) it extended the warranty period for consumer products up to 2 years; (6) it introduced compulsory European quality standards for the air we breathe and (7) it did the same for drinkable water; (8) it eased travel in Europe thanks to the Schengen Agreement; (9) it permitted people to work wherever they wish and induced member states to mutually guarantee health insurance cover to its citizens [EC 2013, pp. 6–7].

All these achievements fall into categories of goods made public and provided through mostly regulatory means. None belongs to the category of redistribution policies so citizens do not see their impact directly as they see benefits when a local government builds a road, school or a recreational space.

The above situation is hardly surprising if we re-examine what has been said before. In a heterogeneous group of 28 states policies that can be unambiguously classified as providing truly European public goods are few and they contribute mostly to macroeconomic stability (such as ensuring low inflation rates or stability of exchange rates) and to the removal of barriers for the integration of markets (the means of the so-called negative integration) [Martin, Mayer & Thoenig 2012].

The idea of centrally providing goods which are not European public goods, generates a risk of creating an explosive situation of heightened expectations that cannot be met due to the lack of adequate means [Majone 2009]. But such ideas do emerge and re-emerge and if implemented endanger the existing European structure as it is vulnerable to inadequate institutional designs and misplaced expectations.

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