
I. Introduction

Exploratory Governance in the Euro Crisis

MARK DAWSON, HENRIK ENDERLEIN, *and* CHRISTIAN JOERGES

Is the euro crisis over? Certainly, sky-rocketing bond yields—one of the main drivers of market panic—have by now receded to pre-crisis levels, even in some of the countries worst affected by turmoil in the eurozone. Also, few people today believe that the euro is still threatened in its very existence, and instead of the frequent changes to the institutional and legal framework seen during the height of the crisis (2010-2012), there is now an astonishing silence surrounding questions related to the functioning of the economic and monetary union (EMU). With major reforms to banking supervision and resolution either in operation or nearing completion, there is seemingly little appetite for a major move towards greater political integration in the European Union (EU).

In spite of this relative calm, even a cursory look at Europe's economy and society in early 2015 reveals a storm raging below. Unemployment remains stubbornly high, even in states where labour costs have decreased significantly. Youth unemployment in particular exceeds 50 per cent in

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Spain and remains over 40 per cent in Greece and Italy. Levels of popular trust both in national governments and in EU institutions continue to plumb new depths. In 2005, several years before the crisis, some 57 per cent of the EU population reported trust in the EU; by 2013, the proportion had declined to 42 per cent. Similarly, trust in national governments fell from nearly 40 per cent in 2005 to 31 per cent in 2013. The early 2015 elections in Greece that brought in an anti-austerity programme government attest to remaining discontent and uncertainty. At the same time, economic recovery seems to be halting, with institutions like the International Monetary Fund (IMF) warning of the possibility of a lost decade of low growth and declining living standards (Lagarde 2011). In short, the crisis is not yet over.

Where does Europe go from here? Two things seem certain. One is that perceptions of the 'end of the crisis' may foster dangerous complacency. As

the contributions to this Report will evidence, the present construction of the eurozone is fraught with risk, from its failure to deal adequately with economic and structural differences between member states to its inability to secure popular support and appropriate channels of political and legal control of EU-level decisions. Pretending that the EU may simply ‘muddle through’ its current predicament without further economic, institutional, and political reform runs the risk of deferring existing risks to the next generation.

A second certainty, however, is that reform carries a host of dangers of its own. Just as the creation of new institutions, such as for lending arrangements between EU states, have generated unexpected problems, so too will future innovations in EU governance give rise to multiple uncertainties in outcomes as well as in legal and political challenges to the implementation process. In simple terms, an EU moving towards greater fiscal and economic integration is engaging in an unparalleled experiment, lacking obvious historical or territorial precedents and with each reform fraught with contestation, risk, and uncertainty. Times are exciting but also precarious.

The purpose of *The Governance Report 2015* is to consider how EU governance has evolved since the onset of the eurozone crisis and to contemplate some of the options for the Union’s economic, political, and legal future.

How Do We Get It Right?

One key characteristic of the economic and monetary union—which became law when EU member states adopted the Maastricht Treaty—is its unprecedented set-up. The decision to bring together a dozen or more national economies within a single monetary space and with a single central bank setting a single interest rate is entirely unique. There was and still is neither a blueprint nor historical experience on which the institutional framework can be based. Policy-making thus needs to derive its orientation from one of three unreliable sources: (i) a rich but hotly debated theoretical corpus (mainly from economics), with little to no guarantee that resulting policy recommendations will produce the predicted effects; (ii) an extensive set of historical cases (for example, from fixed exchange rate regimes) that are so fundamentally different from the monetary union set-up that it will always be questionable as to what extent useful lessons can be drawn; or (iii) a very poor, almost inexistent set of monetary unions that are not at the same time fiscal federations (one of the few examples is the East Caribbean Currency Union of eight small island countries).

From a governance perspective, the lack of a blueprint makes studying the EMU incredibly fascinating, especially if looked at from an interdisciplinary angle. While economics has a tendency to rely on mechanistic theoretical assumptions and therefore risks overlooking the uniqueness of the case,

Box 1.1 The EMU and the Eurozone

Although the economic and monetary union (EMU) applies to all European Union member states, only 19 have reached the third stage of integration: use of the euro as an official currency and inclusion in the eurozone (also known as the euro area). All EU member states are expected to join the euro in the future and committed to this aim when joining the EU. Three countries, however, form an exception. The UK and Denmark chose to opt out of the euro: They may join the eurozone in the future but are not obliged to do so. Sweden is not part of the Exchange Rate Mechanism, which is a necessary prerequisite for joining the euro, but is obliged to become part of the eurozone in the future.

The Eurozone

As of 1 January 2015, 19 of the 28 member states of the EU have adopted the euro as their currency and thereby form the eurozone. These countries share a common currency and coordinate their fiscal and economic policies. Eurozone members include: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia, and Spain. Just before Ecofin Council meetings, finance ministers from eurozone countries meet separately in the so-called Eurogroup to discuss matters relating to the euro.

The common currency was achieved in three stages, as recommended by the Delors Report:

Stage 1 (1990–1994):

This stage focused on completing the internal market and laying the institutional foundations for the broader EMU. By the start of the second stage, barriers to the free movement of capital were eliminated.

Stage 2 (1994–1999):

On 1 January 1994, the European Monetary Institute—the European Central Bank (ECB)'s forerunner—was established. This stage emphasised technical preparation and further harmonisation of member states' economic policies.

Stage 3 (1999 onwards):

The introduction of the euro and the fixing of conversion rates marked the final stage establishing the eurozone. Eleven countries began using the euro as 'book money' on 1 January 1999. Greece joined in 2001, and on 1 January 2002, the first coins and bank notes were circulated.

See:

http://ec.europa.eu/economy_finance/euro/adoption/euro_area/index_en.htm (2014)

https://www.ecb.europa.eu/ecb/educational/facts/euint/html/ei_004.en.html

the legal discipline is based on a set of generalisable rules and principles from which the uniqueness of the case would be normatively assessed. Political science, finally, focuses on the interest configurations of the actors involved and how those interests are aggregated within an evolving context of institutions as the set of norms, rules, and principles shaping their interaction.

During the height of the eurozone crisis, the lack of orientation of policy actors quickly became a fact of life. While economists proposed policy solutions on a nearly daily basis and ranging from one extreme (total eurozone break-up) to the other (full debt mutualisation) with literally hundreds of intermediate options, the legal debate focused on what was allowed under EU treaty and national constitutional rules, in particular in Germany. Any actual resulting policy changes can be described as mere 'quick fixes' (Quaglia 2013) generally derived from ad hoc decision-taking under considerable time pressure and often justified by the principle of 'there is no alternative' (TINA), which was even logically wrong, given the multitude of different policy alternatives under discussion. As decisions were by definition contestable, policy-makers attempted to justify them as the only viable solutions, claiming that they knew exactly what they were doing. It will be the role of future historians to explain why and how those crisis measures were decided upon, but what is most important from our perspective are the questions of how to move on and how to get it right in the future.

If the study of governance is the study of collective decision-taking, then the question of how the eurozone will evolve in the next decade is a key governance question that deserves our attention. How can policy actors get it right if there is little to no guidance on what to do? What would be the pre-conditions for successful decision-taking? How can success be defined?

Exploratory Governance

We suggest that the best approach for thinking about highly salient, highly contestable, and highly risky policy choices under extreme uncertainty is the concept of 'exploratory governance', which we define as ad hoc and stepwise policy-making under uncertainty with an aim of avoiding mistakes. This concept derives from a highly functional perspective of policy-making: New institutions are created to solve problems arising from within existing institutional frameworks. But in contrast to the traditional functionalist perspective of institutional change, exploratory governance puts a stronger emphasis on the totally unknown character of any newly adopted frameworks.

The EMU is a telling example: The single currency was created in response to the need for a credible fixing of exchange rates in order to allow the single market to function properly. The euro was a policy innovation that

derived from dissatisfaction with the previous, ill-functioning system of fixed exchange rates in Europe. No policy actor knew at the time of the EMU's creation what the real consequences of the single currency would be, but the creation went on, based on a tightly defined set of rules and coupled with the plan to make it work. Many theorists have criticised the creation of the euro as 'incomplete' or 'ill-designed' (Eichengreen 2012), whereas others, in particular policy-makers, expressed their satisfaction and trust in the new system.

When the eurozone crisis hit, a debate started on whether the original system had lacked certain features and thus been flawed from the very start, or policy actors had violated the rules and thus destroyed a system that would have functioned properly had the existing rules been respected. Those two views then broadly converged in the perspective that the EMU was 'incomplete'—

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either because it lacked important features or because it had allowed violations of key rules. During the crisis, the debate on what to do was largely informed by those differences in perspective. Decisions taken were thus derived from 'exploration'—assessing the policy context, addressing immediate policy challenges, and coping with both short-term time constraints and uncertainty. If the EMU was the result of exploratory governance responding to the functional need to complete the single market, policy measures during the crisis have been the result of exploratory governance responding to the need to keep the euro alive. What lies ahead of us is yet another round of exploratory governance to complete a 'genuine' EMU as proposed by the Report of the Four Presidents of 2012 (van Rompuy et al. 2012) and a multitude of other proposals.

Many straightforward challenges arise in the context of a process of exploratory governance. First, initial proposals to adopt innovative governance structures are likely to be met with fierce opposition due to their untested character. Second, the adoption phase of new governance structures will generally be based on a strong analytical projection of the 'beneficial effects' of the innovation. Third, new governance structures have to be reconciled with existing constitutional and legitimacy commitments. Exploratory governance shares certain features in common with another framework often used to explain innovation in EU governance: democratic experimentalism (Sabel and Zeitlin 2008, 2012). However, while experimentalism is based on the idea of deliberation and bottom-up participation as a means of compensating for gaps in transnational democracy, new forms of EU governance have often been adopted without significant reflection on their accountability implications. For example, EU ambitions in the fiscal field have not been accompanied, for largely political reasons, with extensive changes in the EU's treaty structure (see Appendix for brief descriptions of the main EU treaties). Exploratory governance may face a contested gap between what is constitutionally permitted and new EU-level tasks.

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Fourth, there is a high likelihood of unintended effects after the introduction of a governance innovation or, more generally, mismatches between the projected and observed effects. Fifth and finally, the nature and magnitude of the unintended effects will play a significant role in determining whether the new governance structures will be discontinued in favour of the old governance structures, will remain in place, or will remain in place but undergo significant changes, such as bringing in new elements of exploratory governance. As a process of exploratory governance is generally based on the motives of problem-solving and avoiding error, determining which of the three scenarios (discontinue, continue, or amend) will be most likely requires a comparison of the costs of going back to the initial policy problems with the costs of continuing the chosen path and the costs of further governance exploration. Obviously, the choice will be strongly linked to the perspective from which the scenario itself is derived: An economist would likely take a different stance compared to a legal scholar, a sociologist, a political analyst, or a philosopher.

An Interdisciplinary Perspective

In this Report, we bring together three different perspectives in order to develop a consistent approach towards exploratory governance of the EMU. By combining different disciplinary perspectives, this Report aims to go beyond much of the existing work by exploring changes in EU governance through three distinct stages, each with a significant bearing on the viability of the others. Chapter 2 summarises the main considerations from the discipline of economics, outlining the main ‘knowns’ and ‘known unknowns’ in the debate on the future of the EMU. The chapter’s key objective is to assess the main functional needs for the future development of the EMU that would allow the single currency to function properly. Chapter 3 then uses the lenses of law and political science to consider how new functional demands have been reconciled with the EU’s existing legal and institutional structures. The key objective is to explore the institutional limitations that have shaped and altered EU decision-making since the onset of the crisis, creating in its wake severe challenges in rendering decisions under EU economic governance legally and politically accountable. Chapter 4 focuses on the law-politics relationship and its importance for the legitimacy of European rule. It argues that the reliance on law, which characterised the formative period of the integration project and which contributed to the precarious construction of the EMU, has to be replaced by a reconfiguration in which democratic political processes are structured by procedural prescriptions and safeguards, not by substantive rules or administrative decision-making.

Getting the economics right: What is required to complete the economic and monetary union?

If the root cause of the eurozone crisis was the contradiction between a supranational currency and nation state-based economic policies, then the right exercise in the discipline of economics today should be to conduct an assessment of the steps towards further integration that are indispensable for the functioning of the EMU. The basic principle of this exercise could be 'as much additional integration as required for the functioning of the eurozone, but as little as possible'. However, there is no consensus on how that principle should be implemented.

During the first 15 years of its existence, the eurozone has been characterised by high structural heterogeneities between countries, high inflation differentials, the absence of optimum currency area criteria, and the absence of functional equivalents (such as a common budget, common taxes, or automatic cyclical stabilisers such as a common unemployment insurance or a cyclical shock insurance). At the same time, there are many reasons to believe that the structural features of many eurozone economies put an efficiency cost on domestic economies and the eurozone as a whole.

Against this background, three challenges need to be taken up in parallel:

- Structural convergence needs to be built between countries to allow for better functioning of the single currency, in particular since it would provide a better monetary policy transmission mechanism and an enhanced price transmission (or real exchange rate effect).
- For the same reasons, the single market needs to be completed to end a situation in which economic developments are to a very large extent shaped by domestic and not eurozone factors.
- Structural reforms in domestic economies need to continue to allow for an increase of potential growth and high employment rates.

Even if the assessment on overall reform needs might be quite straightforward, the exact content and degree of structural reforms to reach an optimal level of convergence and enhance growth are the subjects of considerable debate.

Different reports and studies come to different results on these questions (cf. Four Presidents' Report, Blueprint by the Commission (European Commission 2012), Report of the 'Tommaso Padoa-Schioppa Group'). The report of the Padoa-Schioppa Group (Enderlein et al. 2012) for example describes a combination of key elements that would complete the EMU while preserving a high degree of national policy-making autonomy. The 'sui generis fiscal federalism' that it proposes includes a deepening of the single market, a cyclical shock insurance fund, the equivalent of a European Monetary Fund, and the completion of the banking union.

Such lists are just illustrations of what might constitute the right degree of further integration for allowing the eurozone to work more effectively. The debate needs to be about which elements are essential. Some observers believe that the current state of integration with banking union in place is already sufficient. Others propose even more elements than are put forward here, including a much larger EU budget, a full-fledged eurozone fiscal capacity, EU taxation, and a fully developed hierarchical model of fiscal federalism.

Depending on the answers to the questions above, there are different legal and political implications. It is often unclear which proposals would require treaty change—and if so, then which variant in the large array of possible forms of treaty changes and treaty change procedures. It is also often unclear how new elements could be anchored in appropriate democratic control mechanisms in order to ensure their legitimacy. The question of possible participation by national parliaments is often raised in that respect. Answering these questions is the purpose of the next two chapters of this Report.

New institutional arrangements, new challenges

It is clear that the EU that has taken shape since the eurozone crisis began has heightened economic and political ambitions. The EU has moved from a limited project focused on the establishment of a transnational market to a wide-ranging institution that reaches into almost every area of national policy. What do these heightened ambitions mean for the institutional, political, and legal structures through which EU policy-making is conducted?

Answering this question is the focus of the third chapter of this Report. As the chapter will argue, the radical increase in the EU's tasks brought about by the crisis has transformed EU governance, leading not only to the establishment of new institutions (for novel tasks such as banking supervision and lending) but also to a shift towards a new model of delivering EU policy. While previous EU decision-making tended to be agreed upon either through the supranational 'Community method' or through intergovernmental agreements controlled and implemented by national governments, economic governance after the onset of the crisis has tended to blend these two decision-making types in novel ways.

The third chapter therefore introduces the idea of a 'coordinative method' of EU decision-making as an ideal type within which to understand these changes. Drawn from the Open Method of Coordination (OMC) established in the field of social policy in the late 1990s, the coordinative method represents an attempt to retain national control of key EU-level decisions, channelling the decision-making process through intergovern-

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mental bodies such as the European Council and Eurogroup. It combines intergovernmental decision-making, however, with heightened EU capacity to intervene in and supervise national policy-making. A key example is the newly established European Semester, the strategic goals for which are set by the European Council, but which also allows an unprecedented degree of supranational intervention in the setting and coordination of national budgets. The coordinative method can be understood as an attempt to centralise or create 'more Europe' and, at the same time, maintain national control over decisions of strategic importance. Finally, the coordinative method envisages a fragmentation of obligations between states, with states subject to heightened obligations and supervision depending on their budgetary position. In simple terms, under this method, balanced budget states retain greater levels of sovereignty under the new EU economic governance than their more debt-laden neighbours.

The purpose of introducing the coordinative method as an 'ideal type' is both to understand changes in EU governance and to unpack the dilemmas these changes have brought. The primary dilemma is one of securing appropriate avenues of political and legal accountability under the coordinative method. Whereas previous models of EU decision-making sought to secure political and legal accountability—either supranationally through institutions like the European Parliament or nationally through the ability of national parliaments and judiciaries to scrutinise EU-level decisions—the coordinative method may make both political and legal review of EU-level decisions more difficult.

At the political level, this difficulty concerns the danger of marginalising the traditional role of parliaments in scrutinising budgetary decisions. At the national level, the European Semester both increases the level of supranational control over national budgetary processes and provides a heavily compressed timetable within which national parliaments can hold their executive's spending decisions to account. At the supranational level, meanwhile, the coordinative method has been a bastion of executive control, with the European Parliament given little say in the adoption of key EU-level decisions, either over general EU fiscal policy or for the adoption of recommendations addressed to specific states.

Similar problems present themselves at the legal level. Nationally, strong constitutional courts like the German *Bundesverfassungsgericht* have defended the prerogatives of the German parliament by insisting upon strict conditionality for loan assistance to southern European debtors. In the very act of doing so, however, they may have limited the ability of other constitutional courts to defend rights to equality, social assistance, and employment as guaranteed under national constitutions. Supranationally meanwhile, the coordinative method is often elaborated through 'soft law' or vague, indeterminate economic benchmarks that are unamenable to judicial review. Just as parliamentary scrutiny of EU governance has become more difficult, ave-

nues for legal control of EU economic governance have also become increasingly scarce.

The third chapter concludes with some recommendations on closing EU governance's new 'accountability gap' and focuses on strengthening the dialogue between European and national courts and parliaments, easing coordination problems between eurozone and non-eurozone states, and re-engaging the European Parliament in the economic governance of the EU. Securing appropriate links between new EU tasks and general political processes occurring at the national and transnational levels will be a key task for EU decision-makers in the decade to come. This legitimacy dimension of new forms of EU governance is the key concern of the next chapter of the Report.

Regaining legitimacy

The fourth chapter then addresses the legitimacy of the European project in jurisprudential perspectives. The focus on law is not accidental: As Walter Hallstein, the first President of the European Commission wrote, the Community is a creation of law, a source of law, and a legal order (Hallstein 1979: 3). 'Integration through law' was to become the trademark of the European project in its formative phase, although the original understanding of the functions of law was of course to be modified.

From early on, the European Economic Community (EEC) was understood as in need of constant adaptation in respect to the integration project. Among the most significant transformations were the new regulatory tasks that had to be addressed since the late 1980s in the course of the completion of the internal market and after the turn to governance initiated by the Commission in 2001. As integration deepened, the functions of law had to be redefined. After the widening of EU competences and the growth of EU governance, a deliberate constitutionalisation of European law was supposed to ensure the law's legitimacy-mediating functions. Though the Draft Constitutional Treaty was rejected, the debate on EU constitutionalisation did not and could not come to a standstill. Responses to the legitimacy requirement must already address the integration process so that it 'deserves recognition' (Habermas 2001). Chapter 4 seeks to capture the functions of an exploratory type of EU governance and at the same time to develop a legal framing of these functions. The challenges, however, are considerable.

The erosion of the legitimacy of the original 'integration through law' project did not occur out of the blue in the eurozone crisis, but has roots that reach back to the design of the integration project. That legitimacy was derived primarily from Europe's break with a bellicose past, but the integration project understandably did not address the political dimensions of the economy. Chapter 4 starts with a reconstruction of the two most important answers that were provided by the jurisprudence of the European Court of Justice and the

concept of economic constitutionalism borne from the ordo-liberal school of thought and defended by influential German officials. It proceeds to the institutionalisation of economic rationality under the Delors Commission's internal market programme and then argues that the project of economic governance by rules ended de facto with the establishment of the EMU, which is characterised as a conceptually incoherent compromise with very limited regulatory potential. The socioeconomic diversity of eurozone members and their fiscal and economic policies caused tensions that could not be sustainably resolved by the eurozone's monetary policy and weak coordination powers over fiscal policy. Equally corrosive was the 'second pillar' of the post-war consensus on legitimate governance, namely the promise of social justice institutionalised by EU member states in a variety of welfare regimes. That legacy was confirmed through the commitment to a 'highly competitive social market economy' in Article 3(3) TEU but not supported by robust legislative or regulatory competences. The Maastricht Treaty did not consummate the project of integration through law but contributed instead to its erosion.

The chapter next analyses economic governance as reconfigured since 2010. When measured against the inherited yardstick of democratic constitutionalism, Europe's crisis management is deplorable. Economic stability was preserved only in the northern member states while the southern periphery experienced economic instability and exposure to austerity politics. However, Europe's crisis management is not criticised as a deliberate assault on the premises of the European project, but is rather understood as a response to emergencies. These responses have to remain transitory, however. If the EU were to merely normalise its recently adopted policies, the legitimacy of the integration project would remain precarious. The

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effort to overcome the present economic and social crises will have to consider the reasons for the non-convergence of economic and social conditions in the EU. In view of the resistance of that diversity, it is submitted that EU integration politics should cease to insist on ever more uniformity and instead focus on compatibility, hence moving towards the 'united in diversity' vision of the Draft Constitutional Treaty. That move could correct the main flaw of the integration through law agenda. It should be complemented

by a reconfiguration of the law-politics relationship in which law would help to civilise contentions, stabilise constitutional accomplishments, and give voice to democratically legitimated actors, in particular the EP and national parliaments. In the process, the design and objectives of structural reforms should be reconsidered, and command-and-control practices be replaced by projects of cooperative problem-solving. Law could further contribute to the strengthening of Europe's legitimacy by a renewed emphasis on the protection of human and social rights through national constitutional courts.

Governance Indicators

To these three perspectives we add a fourth that seeks to depict selected key trends in Europe in order to inform policy analysis and action. As with previous editions of *The Governance Report*, this year's team assembled a broad set of variables related to the focal topic: namely, the economic and legitimacy challenges facing the EU. Chapter 5, then, presents a sampling of the results of analyses of the extent of convergence (or divergence) of EU member states over time in terms of key economic and public opinion indicators. The analysis shows signs of convergence among EU member states in, for example, unemployment rates and long-term government bond yields until the financial crisis began, followed by increasing divergence since then. Closer examination then reveals that the divergence in economic outcomes was driven largely by eurozone member states and, among the eurozone members, by five of the countries (Greece, Ireland, Italy, Portugal, and Spain) that experienced the crisis most severely.

The data tools illustrated in the chapter (and on the Report's website: www.governancereport.org) can also be used to go beyond these basic descriptive indicators to address many analytical and policy-related questions that will inevitably arise in the process of exploratory governance.

Conclusion

A small library full of books, articles, and reports has been written about the causes of the euro crisis and the various economic, political, and legal developments in its wake. Included among these works are our own publications, as well as a chapter on the challenges of financial and fiscal governance in the first edition of *The Governance Report* (Clark et al. 2013). The ambition of our *Report* is not to provide 'the' solution to the complex problem constellation that the euro crisis has generated. Indeed, we do not always agree entirely with each other's diagnoses or recommendations. What we want to document, however, is the potential for economic analyses, legal analyses, and jurisprudential deliberations to join forces in an interdisciplinary effort to cope with the contingencies of an unsettled situation and to explore avenues out of Europe's unsustainable present dilemmas.

Exploratory governance is not a recipe that will guide us into a secure future. Given the uncertainty of any rescue operation, exploratory governance is conceptualised rather as a search process. Neither economic functionalism, nor the EU's institutional structure, nor law can be expected to pre-programme this search. EU law and policy-making should not shy away from addressing the conflicts generated by the crisis but should rather provide fora for contestation among EU citizens, political actors, and society.