The Governance Report 2015

Executive Summary

The Governance Report 2015, prepared by a team of experts associated with the Hertie School of Governance, is the third in a series of annual reports, each highlighting particular governance challenges.

After years of ad hoc crisis management, is the European Union on the right track? How can stability in the eurozone and the full integration of the European single market be achieved? How have new consultation and decision-making methods influenced the legal and institutional framework of the EU? How could the European project restore or sustain its legitimacy? In short: Where does Europe go from here?

The euro crisis is far from finished, largely due to a long list of open political, legal, and economic questions on the functioning and fundamental structure of the economic and monetary union (EMU). Simply 'muddling through' the EU's predicament runs the risk of deferring existing risks to the next generation. *The Governance Report 2015* considers how EU governance has evolved since the onset of the crisis and contemplates options for the Union's future.

To understand political decision-making under extreme uncertainty and pressure, the Report introduces the concept of 'exploratory governance': ad hoc and stepwise policy-making with an aim of avoiding mistakes. The concept derives from a highly functional perspective: New institutions are created to solve problems arising from within existing institutions. But in contrast to the traditional functionalist perspective, exploratory governance underscores the totally unknown character of any newly adopted frameworks. It also emphasises that there comes a time when decision-makers must choose between a set of uncertain paths. The EMU is now at such a point.

Economic and Monetary Union: No Simple Answers

As Henrik Enderlein argues, the EMU is a functionally motivated, logical step in the process of European integration–an arrangement intended to solve policy problems at the time of its adoption, but also one prone to instability, as evidenced by the eurozone crisis. In effect, the root cause of that crisis lay in the contradiction between a single supranational currency and the continuation of nation-state based economic policies. The quick fixes enacted at the height of the crisis prevented the system from collapsing, but failed to permanently stabilise it.

One could argue that the EMU needs as much additional integration (or fiscal federalism) as necessary for its appropriate functioning, but no more. As at the EMU's inception, there continues to be no consensus on the correct balance. The first challenge in finding this balance lies in resolving the tension between a key

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factor in European integration—the internal market—and the structural differences within Europe. The second major challenge lies in balancing the trade-off between independence in the area of fiscal and financial policy and coordination within a monetary union. How far does a country's national sovereignty over its own budget policy extend when other member states in the currency zone will be impacted? What kind of fiscal federalism can be envisaged for a Union of member nations that want to preserve their domestic identities and political cultures, but at the same time be interconnected on the basis of a common market and therefore a single currency? An appropriate governance framework for the European Union will need to combine elements of the old nation-state environment with more innovative forms of supranational governance.

The Transformation of EU Law and Politics

If the crisis has established new EU authority, it has not (yet) established the mechanisms of control needed to render EU economic governance legally and politically accountable.

The European Union's decision-making framework has always been frustratingly complex, reflecting a series of compromises between EU institutions, member states, and non-governmental and private interests. As Mark Dawson notes, the eurozone crisis and the new functional demands placed on the EU have brought about fundamental shifts in those existing legal and institutional structures. While previous EU decision-making tended to take place 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 blended these two decision-making types in novel ways. The new 'coordinative method', as Dawson calls it, combines highly centralised supranational intervention, particularly in budgetary policy, with intergovernmental control of key political decisions. In short, governments have demanded 'more Europe', but not at the cost of national decision-making control, a level of control that—it should be noted—is greater for debt-free states than for debt-ridden ones.

Another critical shift can be detected in EU accountability structures. Whereas previous methods of EU decision-making carried distinct mechanisms to render EU decisions accountable, either legally or through parliamentary scrutiny, the coordinative method tends to make traditional mechanisms of judicial review and parliamentary control obsolete without substituting new models in their place. If the crisis has established new EU authority, it has not (yet) established the mechanisms of control needed to render EU economic governance legally and politically accountable.

The Legitimacy Problématique

Rather than insisting on more uniformity, EU integration politics should instead focus on compatibility, hence moving towards the 'united in diversity' vision.

As Christian Joerges argues, even if the EU's legitimacy was once derived primarily from Europe's break with a bellicose past, its legitimacy in the wake of eurozone crisis management has been sorely tested. From early on in its history, the European integration project has relied on law to harmonise policies and promote greater unity. But as structural diversity increased with enlargement and despite a single monetary policy, the notion of 'one-size-fits-all' faded to the reality of 'one-size-fits-none', as revealed by the eurozone crisis. The new modes and mechanisms of economic governance adopted since the crisis began disregarded the principles of enumerated powers and competences, took up individualised scrutiny that leaves little room for democratically legitimated choices, and established an executive apparatus outside democratic politics. If the EU were to merely normalise its recently adopted policies, the legitimacy of the integration project would remain precarious.

Rather than insisting on more uniformity, EU integration politics should instead focus on compatibility, hence moving towards the 'united in diversity' vision of the Draft Constitutional Treaty of the European Convention. While law cannot prescribe the alternative to normalisation of crisis measures, it can operate as a catalyst for actively dealing with conflicts and trade-offs and thus help the Union return to legitimacy.

Governance Indicators

The Governance Report 2015 indicator dashboard, assembled by Liam F. McGrath's team at the Hertie School, traces whether EU countries have been moving closer together or farther apart in terms of key macroeconomic and public opinion indicators, and the extent to which related governance challenges are more pronounced within specific groups of countries. In addition, associations between macroeconomic trends and aggregate public opinion are measured in order to better comprehend issues of legitimacy and trust. Key findings include:

- Although the unemployment rates and long-term government bond yields of EU member states converged up to 2007, divergence since the onset of the crisis has been driven primarily by eurozone countries–especially the five (Greece, Ireland, Italy, Portugal, and Spain) that have experienced the crisis most severely.
- Variation in trust in the European and national parliaments has increased by approximately 100% across the eurozone compared to before the crisis. This variation has been largely driven by collapses in trust in the aforementioned countries–noteworthy as these countries had the highest levels of trust in the European Parliament in 2004, yet have reported the lowest levels of trust since the crisis.
- Rising unemployment has correlated with declining trust in EU institutions within the five hardest-hit eurozone countries. However, the same cannot be said for non-eurozone countries with similar levels of unemployment. Hence, as economic and monetary integration deepens within the eurozone, issues of legitimacy become more pertinent: Blame for economic failures is related to declining trust in the EU, which is not the case in less integrated countries.
- Whereas high unemployment is associated with declining trust in national governments across EU member states, declining trust in the EU from within the five eurozone debt crisis countries is not symptomatic of a Union-wide trend. Rather, responses to the crisis have led to a decline in legitimacy that is more pronounced in the five eurozone countries with the highest unemployment rates.

These and other findings are examined in greater detail in the Report. The full dashboard, dataset, and methodological notes can be downloaded at **www.governancereport.org**

Recommendations: Where Do We Go From Here?

Mark Dawson, Henrik Enderlein, and Christian Joerges suggest that EU law and policy-making should not shy away from addressing the conflicts generated by the crisis but should instead provide fora for contestation among EU citizens, political actors, and society. They recommend:

1. Enhance structural convergence. Structural convergence between countries would allow for better functioning of the single currency. Furthermore, completion of the single market would end a situation in which economic developments are to a large extent shaped by domestic, and not eurozone, factors. Structural reforms in member countries' economies must continue to allow for growth and high levels of employment.
2. Enhance cyclical convergence. As long as cyclical heterogeneities are high and labour mobility is low, a fiscal stabilisation mechanism is needed to act towards synchronising business cycles.
3. Rethink the relationship between solidarity and conditionality. The EU needs a scheme that ensures a lender of last resort without creating incentives for irresponsible fiscal policy. Further work is needed to make the balance between solidarity and conditionality more transparent, predictable, and legitimate.
4. Close the political accountability gap at the supranational and national levels. Closing this gap calls for stronger parliamentary involvement in economic decision-making on both levels. The European Parliament should engage in an 'economic dialogue' with other EU institutions and carry a decision-making veto over key instruments of fiscal governance. The EP should regard national parliaments not as threats but rather as crucial allies in holding executive decision-makers accountable.

5. EU and national courts should open pathways for individuals to challenge economic decision-making. Both national and supranational European courts should not shy away from examining links between economic governance and other parts of EU law. Regular interactions between national courts and the Court of Justice of the European Union, as well as judicial networks between national constitutional courts, are crucial for ensuring that national courts seek more dialogue.

6. Reject normalisation of crisis governance. EU crisis management instruments can be subject to either 'normalisation', i.e. readiness to accept new realities as circumstances to which we must adapt, or 'contestation', i.e., the search for a renewed constitutional condition. We should take the integration project's exposure to political contestation as a given and focus instead on the modes of contestation and the potential to regain legitimacy.

7. Embrace contestation as an opportunity for constructive innovation and allow for more diversity. Involving new actors and strengthening cooperative structures may foster a return to a greater variety of institutional configurations and practices. Contestation has innovative potential and can reveal new insights and perspectives. More institutional diversity can be economically beneficial rather than detrimental.

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For more information, visit
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