The Future of European Democracy

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That the euro crisis has done much damage to Europe's political democracies is undeniable. Confidence in the European project has eroded, centrist political parties have been weakened, and extremist parties, particularly of the far right, have been the primary beneficiaries. Less appreciated, but at least as important, is the damage that the crisis has done to democracy's prospects outside the narrow circle of euro zone countries. The sad fact is that Europe is no longer the shining beacon of democracy it was for other countries. A community of nations that is unable to stop the unmistakable authoritarian slide in one of their members – Hungary – can hardly be expected to foster and cement democracy in countries on its periphery. We can readily see the consequences in a country like Turkey, where the loss of the "European anchor" has played a facilitating role in enabling Erdogan's power play, and less directly in the faltering of the Arab Spring.

The members of the euro zone engaged in an unprecedented experiment. They tried to construct a single, unified market – in goods, services, and money – while political authority remained vested in the constituting national units. There would be one market, but many polities.

The closest historical parallel was that of the Gold Standard, under which countries effectively subordinated their economic policies to the requirements of free capital mobility and a fixed parity against gold. Under the Gold Standard, monetary policy consisted of ensuring the parity was not endangered. And since there was no conception of counter-cyclical fiscal policy or the welfare state, the loss of policy autonomy that these arrangements entailed had little political cost. Or so it seemed at the time. The Gold Standard would eventually unravel (starting with Britain in 1931) precisely because the high interest rates required to maintain the gold parity became politically unsustainable in view of domestic unemployment.

The postwar arrangements that were erected on the ashes of the gold standard were consciously designed to facilitate economic management by national political authorities. Keynes' signal contribution to saving capitalism was to recognize that it required national economic management. Capitalism worked only one country at a time, and economic interactions among countries had to be regulated to ensure they did not impinge too much on domestic social and political bargains.

The European single market initiative, and even more so, the single currency flew in the face of this understanding. It is worth considering the possible narratives under which such a leap into the danger zone could have made sense.

What were we thinking of?

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One theory, perhaps held most strongly by conservative economists, rejected the Keynesian perspective and re-enshrined the "self-equilibrating market" at the center stage of policy. In this worldview, the apparent malfunctions of markets – the boom and bust cycles in finance and macroeconomics, inequality, and low growth – were the product of too much government intervention to begin with. Do away with moral hazard in financial markets, institutionalized labor markets, counter-cyclical fiscal policy, high taxes, and the welfare state, and all these problems would disappear.

This free market nirvana had little use for economic governance at any level – national or European. The single market and currency would force governments into their proper role – which is to do very little. The creation of transnational political institutions were a distraction at best, and harmful at worst.

A second theory was that Europe would eventually develop the quasi-federal political institutions that would transnationalize its democracies. Yes, the single market and currency had created a significant imbalance between the reach of markets and the reach of political institutions. But this was a temporary phenomenon. In time, the institutional gaps would be filled in, and Europe would develop its own Europe-wide political space. Not only banking and finance, but fiscal and social policy as well would become EU-wide.

This image envisaged a significant amount of convergence in the social models that exist around the EU. Differences in tax regimes, labor-market arrangements, and social insurance schemes would have to be narrowed. Otherwise, it would be difficult to fit them under a common political umbrella and finance them out of a largely common fiscal pot. The British, with their own sense of uniqueness, understood this well, which is why they always pushed for a narrow economic union and resisted anything that smacked of political union as well.

It is interesting that neither of the two theories could be articulated too openly. Doing so would have raised a torrent of criticism and objections. The minimalist economic model had little attraction beyond a narrow group of economists. And the federalist model would run up against widely divergent views even among the pro-European elites about the political future of the union. That these opposing, but at least internally coherent visions could not even be widely discussed in polite company should have told us something: neither in fact offered a practical solution to the euro zone's institutional imbalance. Nevertheless, the absence of public discussion and debate meant that they would not be explicitly repudiated. So both justifications could linger on in the background, providing their adherents some comfort about the sustainability of the union's arrangements.

The euro zone's problems -- deflation, unemployment, and economic stagnation on the economic side, and voter dissatisfaction and the rise of extremist parties on the political – no longer allow such equivocation.

Solutions – short-term and long-term

The immediate problem is how to revive growth. Here, Germans and other creditor nations have clung far too long to the notion that the answer lies in structural reform: the liberalization of product and service markets and the flexibilization of labor markets. As desirable as these remedies may be in the medium- to long-run, they do very little to solve the short-run problem of inadequate demand. As recent enterprise surveys have shown, firms resist hiring workers and increasing production primarily because they are constrained on the demand side: they cannot find enough customers. Dealing with this problem through supply-side reforms aimed at increasing productivity is like pushing on a string. Making

it easier to fire labor or start new businesses has little effect on hiring when firms already have excess capacity. At worst, such reforms backfire: they add to the rolls of the unemployed. What is needed instead is some good old-fashioned Keynesianism: policies to boost eurozone-wide demand and stimulate greater spending in creditor countries, especially Germany.

Notice how the absence of EU-wide democratic accountability plays into this economic misdiagnosis. As long as the costs of deflationist policies are borne primarily by the debtor countries with high unemployment, there is little prospect that the German electorate will change its mind and give up on austerity. The lack of transnational politics aggravates the economic crisis, which in turn poisons domestic politics in the high-unemployment countries further. There is no mechanism that forces German policy makers to internalize the costs of their decisions on the rest of euro zone. To be sure, austerity policies are short-sighted even from the perspective of Germany's own economic interest. But the fact remains that it is not Germany that bears the bulk of these cost.

For the longer run, the German argument for structural reform does make a lot more sense. Ultimately, a workable European economic union does require greater structural homogeneity and institutional convergence (especially in labor markets) among its members. EU countries need to look more like one another if they want to inhabit the same house for the long haul.

It's important to understand the reason behind this need for structural convergence. It does not derive, as many economists presume, from the inherent superiority of any particular economic-social model. It is based, instead, on the idea that legitimacy is essential to the functioning of a common, unified market. It becomes increasingly difficult to maintain legitimacy when market outcomes appear to reflect structural differences – or what is called, in common parlance, a lack of a level playing field. I may grudgingly accept my fate when my losses are the result of my competitors' thrift, hard work, or ingenuity. But I am likely to think the fault lies with the system itself when these losses are the product of weaker labor standards, larger government subsidies, or poorer enforcement of regulations under another sovereign. I may be willing to bail out others when they fall into hard times, but not when it looks like I would be thereby underwriting their "irresponsibility" or "inappropriate" economic policies – their economic and social arrangements that differ from mine. To some extent, cross-national solidarity may ameliorate this sense of unfairness, especially when the beneficiaries in other countries are poorer (and to that extent more "deserving"). But it is unlikely that solidarity – such as there may be – can bear the full weight of the burden that large institutional differences place on markets.

This is an argument for institutional convergence in an economic union that goes significantly beyond integration in the fiscal and financial domains. If one has any doubts that economic union in fact calls for such far-reaching convergence, one has only to look at the extent to which the European Central Bank found itself micromanaging Spanish labor market reforms during the crisis.

But this argument leaves open the question of what shape those common institutions should ultimately take. It certainly does not suggest that other countries should converge to Germany's social arrangements. What the European Union's common set of institutions should look like is a question that requires democratic deliberation and decision-making.

Here again, we confront the need for EU-wide democracy. The more such questions are settled by fiat or under duress, in moments of relative weakness of indebted countries, the greater the future risk. One danger is that some of the countries will commit to institutional arrangements that have poor fit and will be eventually repudiated. Another is the likelihood of backlash when reasonably normal times return. A

third is that the union will lack mechanisms of review and revision, and lock itself into arrangements that outlive their usefulness.

Hence the absence of transnational democratic mechanisms creates vicious cycles in both the short term – how do we get out of the present economic crisis? – and long term – how do we create durable EU-wide institutional arrangements?

Sovereignty, economic union, and democracy

A precondition for the creation of a true European political space is the transfer of sovereignty to supra-national entities. Nobody likes to give up national sovereignty, neither politicians of the right nor politicians on the left. Yet, by denying the obvious fact that the euro zone's viability depends on substantial restraints on sovereignty, Europe's leaders have been misleading their voters, delaying the Europeanization of democratic politics, and raising the political and economic costs of the ultimate reckoning.

Simply put, the European integration project has hinged on restrictions on national sovereignty. If its future is now in doubt, it is because sovereignty stands in the way once again. In a true economic union, underpinned by union-wide political institutions, the financial problems of Greece, Spain, and the others would not have blown up to their current proportions, threatening the existence of the union itself.

Consider the United States. No one even keeps track of, say, Florida's current-account deficit with the rest of the country, although we can safely guess that it is huge (since the state is home to many retirees living off benefits that come from elsewhere). When Florida's state government goes bankrupt, Florida's banks continue to operate normally, because they are under federal rather than state jurisdiction. When Florida's banks go belly-up, state finances are insulated, because the banks are ultimately the responsibility of federal institutions. When Florida's workers become unemployed, they get unemployment checks from Washington, DC. And when Florida's voters are disenchanted about the economy, they do not riot outside the state capital; they put pressure on their representatives in Congress to push for changes in federal policies. Nobody would argue that US states have an abundance of sovereignty.

Not all restrictions on the exercise of sovereign power are undemocratic. Political scientists talk about "democratic delegation" – the idea that a sovereign might want to tie its hands (through international commitments or delegation to autonomous agencies) in order to achieve better outcomes. The delegation of monetary policy to an independent central bank is the archetypal example: in the service of price stability, daily management of monetary policy is insulated from politics.

However, even if selective limitations on sovereignty may enhance democratic performance, there is no guarantee that all limitations implied by market integration would do so. In domestic politics, delegation is carefully calibrated and restricted to a few areas where the issues tend to be highly technical and partisan differences are not large. Similarly, a truly democracy-enhancing globalization respects these boundaries. It imposes only those limits that are consistent with democratic delegation, possibly along with a limited number of procedural norms (such as transparency, accountability, representativeness, use of scientific evidence, etc.) that enhance democratic deliberation domestically.

But what about subsidiarity? Doesn't this principle simultaneously allow local self-rule and a single market, by restricting the competencies of the union only to those that need to be transnationalized? There is nothing wrong with the idea of subsidiarity per se. But the crisis has clarified how narrow the room for national sovereignty really is when we talk about European economic integration. It is no longer a matter of open borders to goods, services, capital, and people. A single currency and unified financial markets also require harmonization of labor-market rules, banking and financial regulations, bankruptcy procedures, and a good deal of fiscal policy as well. The nation states of the euro zone may not disappear as a result. But they would become largely empty shells from a political/policy standpoint, requiring compensation through an expansion of a transnational political space.

The EU's institutional reforms to date following the crisis (banking union, stricter fiscal oversight) fall far short of what is needed. It is understandable that these efforts have gone into the areas most immediately implicated by the crisis. But in many ways, the reforms have deepened the democratic deficit of the union. They have made union-wide arrangements more technocratic, less accountable, and more distant from the European electorates. In the one uniquely European space of politics, the European Parliament, the voice of anti-EU groups has in fact become louder, in part as a result of the growing democratic deficit.

Stark choices

As the American example illustrates, it is possible to give up on sovereignty – as Florida, Texas, California, and the other US states have done – without giving up on democracy. But combining market integration with democracy requires the creation of supranational political institutions that are representative and accountable. Otherwise, the conflict between democracy and globalization becomes acute as economic integration restricts the domestic articulation of policy preferences without a compensating expansion of democratic space at the regional/global level. Europe is already on the wrong side of this boundary.

This is what I have called the political trilemma of the world economy: We cannot have globalization, democracy, and national sovereignty simultaneously. We must choose two among the three. Nowhere is this trilemma clearer than in Europe. If European leaders want to maintain democracy, they must make a choice between political union and economic disintegration. They must either explicitly renounce economic sovereignty or actively put it to use for the benefit of their citizens. The first would entail coming clean with their own electorates and building democratic space above the level of the nation-state. The second would mean giving up on monetary union in order to be able to deploy national monetary and fiscal policies in the service of longer-term recovery.

Those who propose to save democracy in the euro zone with intermediate solutions – a little democracy at the national level, a little more democracy at the EU-level – ignore the extremity of economic union. Such intermediate solutions might work with limited or managed economic interdependence; they are inadequate when individual countries essentially give up economic management wholesale – as they must with economic, financial and monetary union.

The longer this choice is postponed, the greater the economic and political cost that ultimately will have to be paid.

It can be reasonably argued that what the crisis has shown, unequivocally, is the absence of a European "demos" on which a pan-European democracy can be erected. After many decades of economic integration, political communities remain largely national, rather than transnational. Citizens of Germany, Spain, Greece, and so on do not feel sufficiently European – and, more to the point perhaps, do not want to feel European. There are two possible responses to this, one hopeful and the other less so.

The hopeful response is that a demos does not necessarily arise endogenously and needs to be actively constructed. Historically, the creation of nation states was an elite project, just as the European project itself. The narratives and symbols of a pan-European polity have to be supplied by its architects. On this account, if a European demos has not arisen, it is in large part because political leaders have not invested in it. What makes this a hopeful take is that it suggests the deficiency can be remedied by a change in political strategy.

The less hopeful perspective is that it has become too late to contemplate something of this sort. The crisis has so deepened national divisions that it is pie-in-the-sky to think political allegiances can be transferred to EU-wide institutions. This is so even if the euro zone were somehow to shrink to a smaller set of countries, excluding possibly even Italy. And constructing a workable institutional relationship between this politically integrated euro core and the larger and looser EU would be a nightmare

If this is the correct diagnosis, then it carries serious implications for the economic strategy of the EU. Instead of deepening integration, policy makers must look for ways of undoing it selectively, opening up policy space for national governments in money, finance, and regulation. Under the scenario, the future of monetary union looks particularly bleak, as it is hard to see a single currency can be reconciled with multiple (democratic) polities.

To put it bluntly, it may be time to give up hope that economic union will be eventually compatible with democracy as it may be reconstituted in some distant European future and ask what is the extent of economic integration that is compatible with democracy as it is presently constituted.