The issue of Democratic Legitimacy in the Era of Fiscal Integration

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Abstract

While several countries still struggle to return to sustainable growth and Euroscepticism has shown its strength during the 2014 European Elections, there is little appetite in the European Union to proceed further on the path of fiscal integration. Against this background, this paper reassesses how legitimacy for the European project is provided and why the much-needed fiscal integration could represent a genetic change of the Union, analyzing the far reaching implications of the ongoing crisis. The first section of the paper is dedicated to theories of legitimacy in the EU; the second part focuses on the financial and economic crisis, pointing out why *some form* of fiscal integration is still required to achieve a sustainable solution; the third part of the paper sheds light on the interactions between democratic legitimacy and fiscal integration when the *no demos* thesis is taken into account, discussing the long term implication of the emerging trilemma.

The Issue of democratic legitimacy in the era of Fiscal integration

1) Introduction

The European Union is approaching a turning point. The endogenous process of integration, reignited by the introduction of the Single Currency, has triggered a functional, political and constitutional crisis of the EU. While its national leaders are struggling to find a sustainable settlement of the crisis, the process of integration has somehow accelerated towards uncharted territories. In the meantime, the rise of Euroscepticism in many countries, the implementation of often-contested austerity measures and the renewed role of inter-governmentalism at European level have stimulated, once again, the debate over the alleged Democratic Deficit of the European Union.
Against this background, the goal of this paper is twofold. First, it aims to shed light on the conceptual relation between Democracy (and Democratic Deficit), Legitimacy of political systems, and economic policy-making. Second, it aims to explore what challenges the European Union (and the Euro Area in particular) are facing today in light of the previous findings. It must be noted that, as an obligation exists for all member-states except for the UK and Denmark to join the Monetary Union, the paper focuses on the European Union as a whole, although the patterns individuated concern only the countries sharing the Single Currency in a given moment of time.
The paper is organised as follows: section 1 looks into the theoretical debate behind the issue of "democratic deficit", providing some empirical evidence at this regard; section 2 analyses the relation between the crisis and the concept of democratic legitimacy; section 3 explores the far-reaching implications of the previous analysis.

1. Democratic Deficit & legitimacy

The question whether the European Union is suffering from a Democratic Deficit has increasingly gained scholarly attention since the decision of the German Federal Constitutional Court (BVG) on the Maastricht Treaty in 1993. The BVG stressed, in that occasion, that democratic legitimacy "*is not to remain a formal principle of accountability*" (BVG, 1993:18); therefore, as long as a true public sphere does not emerge among the citizens of the European Countries, democratic legitimacy must be provided by each member state individually, thus introducing a formal limit to integration. Since then, this "Democratic Deficit" of the EU has been discussed under multiple perspectives, generating a lively debate.
Before analysing the features of this debate, however, it must be pointed out that, as rightly put by the BVG in 1993, *democratic deficit* and *legitimacy* are separated concepts. A political system may suffer of a democratic deficit but still being fully legitimised in front of its citizens, either because of its good policies, and/or because legitimacy is provided at a different level of representation. Thus, the claim that the EU suffers of a *democratic deficit*, as such, acquires a meaning only if (1) either we read it in a

forward-looking perspective (alongside the BVG that refers to this concept to identify a limit to *future* transfers of powers) or (2) we claim that no other vehicle of legitimacy is currently available.

So, investigating the alleged "democratic deficit" of the EU requires a two-steps process. First, it must be verified that the EU is precisely in need of the form of legitimacy that is *democratic legitimacy*; second, if this is the case, whether such *democratic legitimacy* exists or not. Thus, the first issue to be assessed is not whether the EU suffers from a democratic deficit but rather whether the EU must enjoy direct democratic legitimacy or not. If this is the case, then the eventual existence of a democratic deficit does represent a problem and must be addressed by policy-makers. If, differently, it can be concluded (as the BVG did in 1993) that no such need exists as long as member-states maintain their democratic stance *and* the perimeter of EU powers is limited, then existence of a democratic deficit concerns only our forward-looking view- whether further powers can be transferred or not.

- *1.1 indirect legitimacy: main features.*

Legitimacy of the EU as a broader concept has been also object of intense debating. The idea the EU relies on indirect legitimacy has obtained a wide (although not overwhelming) scholarly consensus, and it is somehow related with both neo-functionalist and liberal-intergovernmentalist approaches. On the one hand, neo-functionalists share the idea that politicization of the EU is not needed, as the central institutions are endowed with new competences following the interests of economic and social forces in the member-states. From their perspective, politicization of the EU is not ultimately excluded (as instead suggested by early Functionalists like Mitrany [1975:114]), but must occur only at a later stage of the functional integration chain. On the other hand, realists, liberal-intergovernmentalists and rational-choice theorists share the idea that the EU, as an international organization, falls under the control of the National Governments in a Principal-Agent relation; being national governments legitimised, the EU is legitimised as well.

In particular, three complementary versions of "indirect" legitimacy have emerged. First, the "Regulatory State" argument of Majone (1997); the principal-agent framework reformulated by Moravcsik (2002); and the output-legitimacy argument made famous by Scharpf (1970; 1998).

The reasoning of Majone is enshrined in two cornerstones. First, Majone assumes that direct democratic legitimacy is required only when the policies enacted by the political system studied entail redistribution. However, according to the author, the EU is a political system dealing mainly with regulatory policies having very limited redistributive implications; provided that the EU deals primarily with regulatory policies, there is no need for direct democratic legitimacy. Second, Majone emphasises that, for regulatory bodies to work efficiently, these agencies shall have a non-majoritarian structure and shall be excluded by political decision making. In other words, the agencies must be "insulated" from the political conflict to be able to carry out their tasks properly, thus strengthening the credibility of commitments (1997:4).

This argument is shared by Moravcsik (2002), who considers the EU still an international organization whose competences are limited; similar to nation-states, where certain policies are insulated from the political pressure. The insulation of decision-making is thus justified, exactly like in nation-states, by the democratic stance of the principals, so as long as member-states preserve their democratic stance, the EU shall be considered democratic as well.

Finally, Scharpf's (1998; 2009) analysis of Easton's input and output legitimacy in the EU concludes that the only practical way to justify the EU is by output legitimacy (so by the effectiveness of its decisions on people's welfare) rather than by input legitimacy (so by the legitimacy of elected delegates). This because input legitimacy between delegates belonging to a plurality of constituencies creates "joint-decision traps" leading in turn to sub-optimal decisions.[1]

- *1.2 Shortcomings of indirect legitimacy: the classical views*

Overall, a comprehensive criticism of the different "indirect legitimacy" arguments can be grounded in four considerations.

First, as argued by Follesdal and Hix (2006), redistributive policies often entail distributive and redistributive effects. As argued by the authors, market openness may produce redistributive outcomes especially within single countries, where "*private producers for domestic markets are losers for the liberalization of trade in a single market"* (ibid: 11). In addition, the authors argue that the introduction of regulatory standards may produce winners and losers among social groups, as for the case of labour legislation. Finally, the authors note that the very existence of an EU-wide budget indicates that redistribution occurs not only between "net contributors" and "net beneficiaries" countries, but- again- within social groups.

Second, as noted by Raunio (1999), EU integration has changed the power-balance within nation-states in favour of the executives. While the acknowledgement of the role of the national parliaments as actors in the EU decision making process has increased over time, and many national parliaments have created specific committees for EU affairs in order to scrutiny the governmental action in the EU, the author notes that only three countries (Germany, Austria and Denmark) can give binding instructions to the competent ministers in view of incoming Council meetings. Still, competences previously object of parliamentary decision making are now matter of executive policy-making or, in the three referred cases, of parliamentary committees' decisions, thus decreasing the democratic scrutiny of the legislative process (Raunio 1999:191).

Third, as noted by MacNamara (2002) and Follesdal and Hix (2006) insulation of non-majoritarian agencies from political pressure may be costly in term of democratic deficit if the policies carried out by those agencies reveal to have redistributive implications, thus needing direct democratic legitimacy- the referred case is the European Central Bank. MacNamara, in particular, collects

[1] In later studies, Schaprf concludes that output legitimacy is increasingly less achieved in the EU, as the institutional set-up is biased towards neo-liberal policies. Nevertheless, the author maintains that the output dimension of policies is the criterion to keep in mind while seeking legitimacy for European Union's action.

evidence against (1) the notion that monetary policy has no redistributive effects (MacNamara 2002: 54), and (2) the notion that Central Banking independence provides better outcomes in fighting inflation than democratic control over monetary policy.

- *1.3 is there a need for democratic legitimacy? Theoretical insights and empirical evidence*

Overall, the three arguments reported above seem to be not convincing enough to demonstrate the idea that the EU as a whole requires direct democratic legitimacy and it is thus suffering from a democratic deficit. In particular, Hix's claim concerning distributive effects of regulative policies does not take into account the reality of EU policy-making. As noted, among others, by Scharpf (2009) the decisions undertaken at European level should not be considered individually but rather as parts of larger packages of regulations which aim to put every participating country better-off with respect to the whole agreed regulative package. So, while individual regulations may make certain countries worse-off, this effect is counter-balanced by the negotiation of additional measures more favourable to the given country. And if the whole country is better-off in each round of negotiations, this also implies that it disposes of resources to compensate –if it wishes so- the social groups that individually find themselves worse-off. Whether it does happen or not is purely a matter of domestic preferences: when the country as a whole is better-off, the national parliament is empowered to redistribute the gains to make each group better-off, if it democratically decides so. Also, while it is true that the European Union disposes of a budget having net contributors, the very limited size of the budget (around 1% of the European GDP) and the particular system of negotiations and rebating transfers implies that the real transfers between countries are only a small fraction of the 1% budgetary figure; in addition, the European Parliament is endowed with particularly strong powers in budgetary negotiations.

Against Rauinio's argument, it must be said that it is not the EU as such that strengthens the executives *vis à vis* domestic parliaments. In fact, countries wishing to provide a stronger level of scrutiny of executives' decisions by domestic parliaments are not prevented to do so in any way: as rightly pointed out by the authors, certain countries have gone so far to empower national parliaments' committees to adopt binding positions for their ministries in the Council. When necessary, the national Constitutional Courts can intervene to protect parliamentary rights, as done in 2012 by the German Federal Constitutional Court's decision on the ESM which clearly stated that, in matter of fiscal policy, the general assembly of the parliament and not any special committee must be empowered to vote. It follows that it is again a matter of national preferences to adopt such procedures, not an institutional feature of the EU.

Finally, as noted already by Moravcsik (2002: 614), it is indifferent whether independent central banking has redistributive implications or not: what really matters is that when the ECB was established, there was a clearly expressed social preference in favour of central banking independence that was autonomous from the process of European integration.

In sum, on the basis of the first three approaches, the idea that the European Union was in need of direct democratic legitimacy before the crisis is theoretically rather weak, but the fall in legitimacy suffered *during the crisis* is instead well grounded in theory.

Euroscepticism: electoral versus attitudinal- Empirical evidence seems to support this conclusion. While a truly precise measure of EU legitimacy can be hardly provided, information concerning legitimacy of EU institutions and adherence to the project of European integration can be extrapolated by existing data series. In particular, two approaches can be followed. On the one hand, one can look to *electoral hard-Euroscepticism* (In accordance with the definition of hard Euroscepticism developed in Taggart and Szczerbiak, 2004) by pursuing analysis of electoral cycles in the attempt to identify leading factors behind the rise of Eurosceptic and anti-European forces. This has been attempted elsewhere by several authors; (for example, Serricchio et al. 2013; Nicoli, 2014). The latter finds hints about the role economic performance *and* integration policies in shaping votes for Eurosceptic parties.[2] More in detail, financial assistance is highly correlated, *ceteris paribus,* with lower Eurosceptic consensus, while the introduction of the Treaty on Stability, Coordination and Governance, alongside the Six pack and the Two Pack, seem to have generally lifted Eurosceptic parties upwards; this in turn has an upward effect, *ceteris paribus,* on electoral participation, in accordance with recent models of electoral behaviour (Hobolt and Spoon, 2012).

On the other hand, one can look at Eurobarometer time series to extrapolate information about *attitudinal Euroscepticism* and the general stance towards the EU. Analysis of Eurobarometer data shows that, until 2009/2010, only a small minority of European citizens was against EU membership. Figure 1(A,B,C,D) show the pattern of two indicators provided by Eurobarometer: *opposition to EU membership* and *mistrust in the EU*. In order to have a more refined measure of legitimacy the Eurobarometer data-series have been weighted with the country-share of the total (EU, EA, and non-EA) population, adjusted according with the evolving composition of the different blocks.

Open opposition to membership has been, overall, rather low. It achieved the highest value in 2010, at 18% of the EU population, both in the Euro Area (EA) and in the EU. In the EA the trend is particularly striking: two clear episodes identify growing opposition to membership, the eastern enlargement and the Euro-crisis.

As data for membership-opposition have not been coherently collected after 2011, the second indicator (*mistrust in the EU*, fig. 1B) can help in refining the picture. The trend shows a strong increase in the EA after 2010, where the mistrust towards the EU is today even higher than outside the monetary union. Interestingly, while the trend in the two indicators follow similar patterns, between 2004 and 2011 only a fraction of citizens mistrusting the EU were against the membership, suggesting that outcome-performance (more reflected in the second indicator) is only a factor explaining the legitimacy of the EU. This is further validated by looking to elasticity data, which suggest that decreases in mistrust in the EU translate in opposition to membership only when the first indicator is

[2] the model adopted in Nicoli (2014) is a random-effect regression on over 90 electoral episodes across the EU between 2009 and 2014.

particularly high.[3] In sum, analysis of attitudinal euroscepticism suggests that: (1) while mistrust in the EU is widespread, this does not imply that the EU is not legitimate; (2) however, when mistrust becomes excessively high, we observe that mistrust seems to translate in open opposition to the EU; (3) both indicators have substantially increased during pivotal points of recent EU integration history- the eastern enlargement and the outbreak of the crisis. Coupled with econometric analysis of electoral Euroscepticism carried out in Nicoli (2014), these data further strengthens our views on the alleged democratic deficit of the EU. In the previous section we dismissed three theoretical arguments supporting the idea that the EU requires direct democratic legitimacy could be dismissed. However, a fourth-one arises here. In fact, it can be argued (alongside the 1993 BVG ruling) that what really matters when looking at the need for democratic legitimacy is the range of policies enacted at European level. The next sections show that while no need of direct democratic legitimacy existed before the European economic crisis, the policies enacted so far –and the policies that the Monetary Union will need to introduce in the future- imply a substantial leap forward in integration, thus generating a democratic deficit if no additional democratic legitimacy is provided. The next sections will look into the details of the correlation between the economic crisis and the legitimacy of the EU, in the attempt to shed some light on the far-reaching implications of the Eurocrisis.

2. The impact of the crisis

- *2.1 The economic crisis: an overview*

Since 2010, a wide number of institutional improvements has been achieved under the pressure of the economic crisis, aiming to increase the effectiveness of supervision over national finances, achieve a better economic policy coordination, as well as ensuring financial stability of the Euro Area.

The finality of these initiatives is to heal the shortcomings of the European Monetary Union as they have appeared since the beginning of the crisis. From a theoretical perspective, it has become increasingly clear, over the last few years, that the Euro Area institutional framework was missing the institutions, procedures and economic flexibility needed to deal with such a crisis.

The Optimal Currency Area Theory (OCA) provides a useful framework to understand the challenges faced by a monetary union. A monetary union is particularly vulnerable in case of asymmetric shocks: in these situations the effectiveness of centralised monetary policy is limited. In short, a functioning

[3] More in detail, figure 1D in the annex shows that the elasticity of opposition to membership in respect to a change in mistrust ($\Delta o/\Delta m$) is above 1 only in 2005 and 2010, suggesting that in these particular phases, a change in mistrust has been paired by a more-than-unitary change in opposition to membership- in other words, mistrust in the EU is more likely to translate into open opposition to membership. Similarly, the average elasticity ($\Delta o/\Delta m$) is closer to 1 (0.95) when the absolute value of mistrust (m) is high (>40%), suggesting that, above a certain threshold, further decrease of trust in the EU translates in a nearly-equal increase in opposition to membership.

monetary union requires a set of (a) economic conditions in place in member-states, or (b) an institutional setting enabled to fill the lack in economic flexibility. These two general conditions are required both to *prevent* the emergence of economic and fiscal imbalances, and to *correct* fiscal and economic shocks.

Economically, the countries participating in the labour market must have a sufficiently integrated labour and capitals markets (Mundell 1960; 1961) or, alternatively, the salaries in each country should be flexible enough to absorb the asymmetric shocks. If these conditions are not respected, institutions are needed to supply the missing part (De Grauwe 2007).While there is a wide range of possible institutional options that can achieve such a goal, they all must fulfil two basic functions: *prevention of asymmetric and fiscal imbalances,* and *correction of asymmetric and fiscal shocks.* Unfortunately the Euro Area labour market was not integrated enough to absorb the crisis (Dhéret *et al.* 2013) and the nominal salaries weren't flexible enough neither in core nor in peripheral countries. Capital integration in addition revealed to be somehow counter-productive, fuelling the engine of the crisis instead of slowing it down. (Farhi and Werning 2012 A; Bonatti and Fracasso, 2013).

On the preventive arm, common institutions must deal with the coordination of economic policies and the prevention of excessive deficits. On the corrective arm, institutions must ensure credibility of economic policies agreed to overcome the crisis, preventing a capital and deposit flight, and eventually providing fiscal transfers (temporary or permanent) in exchange of the implementation of the agreed policies. Eventually, a common central bank could extend a guarantee on national debt; such possibility however is not admitted in the European Union frame Failure in implementing such institutions would trigger, sooner or later, the collapse of the common currency. As shown by Merler and Pisani-Ferry (2012 B) the solution to the crisis must include either a proper fiscal union, or a full-fledged banking union, or a central bank with a large mandate.

However, as shown by several authors (Sinn, 2011; De Grauwe, 2011; De Grauwe and Yuemei, 2013; Pisani-Ferry and Wolff, 2012), the three options all require a degree of fiscal integration; no credible solution excludes it. In other words, a leap towards fiscal and economic policy integration is required in order to ensure the stability of the area: failure in proceeding with some degree of fiscal integration may trigger the collapse of the single currency. As shown below, the dismantling of the monetary union will have huge implications on the short, medium and long run. In the short run, the financial cost might be very high, especially if the collapse of the currency occurs in an un-coordinated way. In the medium run, the EU without a single currency may help the weaker countries to regain part of their competitiveness, however at a cost of higher inflation and more costly imports. Finally, on the long run, monetary instability may further weaken the European construct, challenging, in particular, the stability of the Single Market (Meade 1957).However, a step towards fiscal integration would represent a major change in the scope and the reach of the Union itself, with important implications concerning its legitimacy and democratic stance.

- *2.2 Legitimacy and the Crisis*

Economic studies have provided evidence in support of the fact that fiscal integration is somehow required to deal with the crisis without dismantling the single currency, However, fiscal integration touches the very core of democratic systems.

Its full introduction in the sphere of the European politics, either in the form of a strengthened cooperation or with a full transfer of competences, does not represent a marginal incremental change in the EU competences: rather, it constitutes a paradigm shift in the nature of the EU and in the way the EU legitimates its decisions.

However, the three theories of indirect legitimacy concisely presented above describe a European Union dealing mainly with regulative policies, insulated institutions, and limited distributional effects. In other words, indirect democracy may well apply when the competences object of coordination/integration do not represent essential features of contemporary democracies. The idea that a "ranking" of competences exists within democracies as also been affirmed by the jurisprudence of the BVG. In the 2009 Lisbon Judgement. The court proposes, in fact, a list of fields of competence that *determines* the content of Democracy:

> *"Particularly sensitive for the ability of a constitutional state to democratically shape itself are decisions on substantive and formal criminal law (1), on the disposition of the monopoly on the use of force by the police within the state and by the military towards the exterior (2), fundamental fiscal decisions on public revenue and public expenditure, the latter being particularly motivated, inter alia, by social policy considerations (3), decisions on the shaping of living conditions in a social state (4) and decisions of particular cultural importance, for example on family law, the school and education system and on dealing with religious communities (5)"* (BVG 2009 par.252 italic mine).

A loss of parliament's decision making rights in these fields would not represent a marginal transfer of competences towards an institution legitimated through a classic principal-agent relation, but would instead constitute a true deprivation of substantial democracy for the concerned constituencies. As Fabbrini notes, fiscal and economic policy decisions are substantially adopted today by intergovernmental decision making, while *"the legitimacy of decisions taken on behalf of the EU cannot be a derivative of the legitimacy enjoyed by the governments of its member-states"*(Fabbrini 2002:24). As a consequence (and in absence of a body truly representative of the European people) the transfer of these competences would spoil the effectiveness of the political rights to vote of citizens.

So, fiscal and economic policy decisions lay at the very core of the democratic process. According with Kroger and Friedrich (2013:4), "*Political procedures and practices are democratic if they are firmly based on political equality as the 'foundational idea' of democracy*". This implies that decisions shall be collectively binding and achieved by majority-voting: the EU needs a shift "*from input to output legitimization*" (Habermas 2011).

However, in order to define a democratic polity, democratic decision making is not required for each single competence or decision. Some competences represent the essential features of democracy and object of electoral politics, while other competences may be delegated or insulated without true losses of the democratic stance of the system.

If we accept (alongside the BVG (2009), Menendez [2000] and De Grauwe [2010]) that an elected assembly shall control tax collection and expenditure (the famous *"no taxation without representation"* principle) to qualify a political system as democratic, then fiscal integration definitively concerns the first group of competences. We could even argue that, provided parliamentary control on fiscal issues is essential for democracy, when no parliament controls fiscal policy we are outside of a democratic framework: the famous *adagio* may then become "*no true representation* (i.e., no true democracy) *without taxation* (i.e., without controls on fiscal issues). Not only fiscal and economic policies have, by definition, redistributive implications, but they have always represented the core of democratic decision making. In principle, then, that fiscal integration may endanger the democratic stance of the EU: transferring fiscal powers to the EU without strengthening its democratic legitimacy would deprive the European citizens of the decision making power over an issue absolutely essential for democracy, as noticed by the German Federal Court.

Of course, different forms of fiscal integration might require different forms of democratic legitimacy - but regarding fiscal matters, they all require *input* legitimacy, as defined by Scharpf.[37] Any form of indirect legitimacy on fiscal issues violates the democratic conditions of political equality; however, the introduction of input legitimacy can hardly be handled without raising problematic issues.

On one side, following Scharpf's *"joint-decision trap*" argument, we can observe a trade-off between effectiveness of decision making processes and input legitimacy when elected delegates are voted in multiple different national constituencies to represent national interests, especially when national delegates enjoy veto powers.[38] On the other side, as noted by the German Federal Court in 2009, the simple transfer of fiscal power to the European Parliament would not preserve the political equality criterion, as the European Parliament is elected on the basis of geographical constituencies with a regressive proportionality principle, and there is no second federal chamber where the equality of states is represented. (BVG 2009, par. 274 and following.)

- *2.3: The "no demos assumption" and its implications*

More importantly, the transfers of economic and fiscal powers at a supranational assembly (even respecting the criteria laid down by the German Federal Court, for example by creating a federal bicameral parliament where people are represented both as citizens of a state and as individuals) would be hardly satisfying as long as we maintain that identity is a precondition for democracy when democracy has redistributive implications. The idea that democratic redistributive implications require a sense of collective identity has noble fathers in political philosophy; it can be perceived already in

David Hume's theory of morality as described in the Treatise, which assumes that one's feelings intensity for other human being increases as their proximity to the individual strengthens (Cohon 2010, para. 7) , thus justifying stronger redistributive policies within nations than between. Ferdinand Tönnies' *gemeinschaft* concept also reflects the idea of societies built upon shared community beliefs rather than upon rational contractualism. In the second half of the twentieth century the debate over the societal boundaries of democracy and redistribution has revamped on both sides of the Atlantic. In North-America the renewed discussion addressed the issue of the origins and limits of redistributional justice, being marked by contributions like Rawls' *A theory of Justice* (1971), MacIntyre *After Virtue* (1981) and Walzer's *Spheres of Justice* (1983); in Europe, the debate focused on the limits to the construction of an European identity and to democracy as the organizing principle of a truly supranational Union. Among others, Kielmansegg (1994; 1996) Weiler (1996; 2000) and Zürn (2000) develop the so-called no demos thesis.

As Zürn writes, the foundation of the no demos thesis is that "majoritarian decision-making is hardly achievable beyond the national level since it requires some form of collective identity that includes trust and solidarity" (2000:195); this view is shared also by Joseph Weiler, for whom a true majority-voting system, and as a consequence, a true democratic system, is only possible within one given demos; in his own words, "democracy does not exist in a vaacum(..)if there is no demos, there can be no operating democracy" (Weiler, 1995:523). In Weiler's vision, by ethnical, linguistic and cultural boundaries, which produce sufficient solidarity among their members to proceed to redistribution through majority voting. Outside the demos, these boundaries disappear, making the deployment of a working democracy logically impossible. Moreover, in Weiler's reconstruction of the no demos argument, the nature and the ultimate goal of the European constitutionalconstruct (its "telos") is not to proceed towards the creation of a European demos, but rather to preserve and peacefully protect the different demoi: "Europe is not yet a Demos in the organic national-cultural sense and should never become one" (ibid:528). As a consequence, a true majority-voting democracy at EU level is not possible, and the departure from unanimity vote occurred with the Single European Act coincides with the beginning of the crisis of the European construction. "no matter how close the union, it is to remain a union among distinct peoples" (Weiler, 2000:14). Although Weiler does not go as far as explicitly saying that majority-voting democracy is not possible at European scale, this is the only logical corollary to his reasoning, and it does match well with his strong defense of the Union's institutional and constitutional status quo at the beginning of the 2000s'.

The No Demos argument, as reconstructed by Weiler, is composed by a positive statement ("Europeans are not a *demos"*) and a normative claim ("Europeans shall not become a *demos"*). While only few people may subscribe the normative claims of Weiler, many citizens (including convinced Europeans) and many political leaders would likely agree with the positive analysis. For example, the German Federal Court pointed out in its 2009 ruling that "*The democratic fundamental rule of the equality of opportunities of success ("one man, one vote") only applies within a people, not in a*

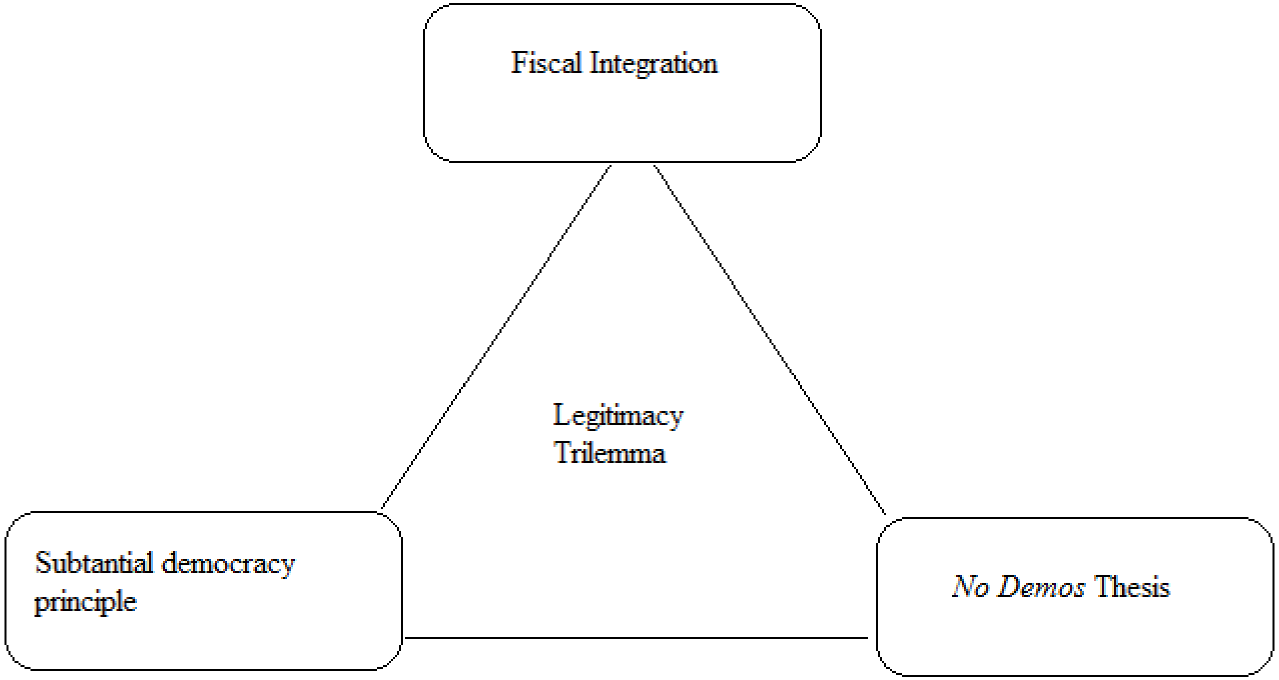
supranational body of representation, which remains a representation of the peoples linked to each other by the Treaties." (German Federal Court 2009, paragraph. 279, italic mine).
However, the Lisbon Ruling does not simply take the No Demos Assumption as an incontrovertible fact. In particular, the central issue individuated by the Federal Constitutional Court concerns the representation of citizens in the European Parliament. In order to have a true supranational democracy, the Court argues, there must be a representative institution in charge of representing the interests of the single European Demos. Within a Demos the principle of electoral equality holds, so the difference in the relation between voters and elected members of the Parliament shall approximate in each constituency. The European Parliament elected today adopts an electoral system based on "regressive proportionality" that attributes proportionally more electoral power to citizens belonging to smaller constituencies, thus violating the principle of electoral equality. In this sense, the Court continues, the European Parliament is not a chamber representing the single European People, but rather a chamber representing the different European Peoples, thus inspired by the principle of national equality rather than by the principle of electoral equality. The introduction of a properly federal system, where a second Chamber is in charge of representing the interests of the different Demoi (thus fulfilling the criterion "one nation, one vote") and a first Chamber is in charge of representing the interests of individuals as members of the European Demos (thus fulfilling the criterion "one head, one vote") would address the issue of democratic legitimacy of the EU.

The Court, as shown, does not share the normative arm of Weiler's reasonning. It considers in fact that the Europeans may become a people, and that the institutional design may play a central role in the process. However, the Court shares the positive analysis of the supporters of the *no demos thesis* concerning democracy, including the basic arguments for which democracy (and thus majority voting) is possible only within one Demos. Although (unlike Weiler) the Court does not rule out the emergence of a European Demos, especially through institutional reforms, it recognises that such a Demos is still yet to emerge; and thus only inter-governmental politics are possible provided the existing institutional balance. In particular the approach suggested by the Court reverses the Weiler's inference: is *democracy,* defined by *political equality* and its *essential functions* (like fiscal and economic policy) that defines the *demos.* Where individuals enjoy political equality and their decisional power concerns essential democratic functions, then we have democracy and thus the *demos* is established. Thus, differently from Weiler's approach (under which the People pre-exists at the state and thus the People creates the Constitution) in the Court understanding a proper constitutional agreement on competences, institution and representation *may* create a European *demos*, but such an agreement is not in place yet.

If we accept at least part of the *no demos assumption,* we face a major problem: either we decide to proceed in securing the EMU with fiscal integration giving up any claim of democratic control over it, creating a purely inter-governmental (output legitimized) fiscal union; or we decide to maintain democracy at national level, avoiding fiscal integration, and therefore receding from the monetary integration. In other words, the EU is facing a true *governance trilemma*, which may be resumed by figure 2. We can preserve democratic decision making, the monetary union, and the no-demos assumption, but only two of these features at a time; pursuing all three simultaneously would prevent any resolution to the crisis.

The trilemma could be studied in its properties under a *static functional perspective,* and from a *dynamic functional perspective.* The dynamic functional analysis will focus on the theoretical consequences of each of the three pairs of choices, while the static functional perspective requires an analysis of relevant actors' preferences. The next section will explore the dynamic functional analysis of the trilemma.

Figure 2 The legitimacy Trilemma of EU governance



3) Democratic legitimacy after the crisis: the governance trilemma.

The first part demonstrated that the EU was not in need of direct democratic legitimacy before the crisis, so the question whether the EU suffered a democratic deficit seems redundant. However, it also showed that the wave of functional integration triggered by the crisis has substantially changed this result. Today, the range of policies undertaken at EU level does need democratic legitimacy; if the EU is not able to provide it, then it does suffer of a democratic deficit. However, if we share Weiler's logics of democracy, we end-up being trapped in a trilemma without apparent way out.

The implications for the European Union and its quest of legitimacy differ under each of the different options. From this point onwards, we enter a rather uncharted territory. An apparently similar trilemma has been proposed by Dani Rodrik (2011). In his trilemma he relates, on a global level, *nation state, democracy and globalisation.* However, Rodrik's trilemma cannot be simply transposed into the European situation: several alterations are needed, leading to the development of the new trilemma presented above.

Firstly, as shown in the previous section, not *any* level of globalisation (or centralisation of competences) threatens democracy: only integration rounds requiring sharing of essential democratic functions with clear redistributive implications, like fiscal and economic policy.[4] Secondly, the concept of *nation state* in the trilemma is misleading. Rodrik stresses the loss of statehood aspect, but in fact is the nationhood which constitutes a problem for fiscal integration. If, purely hypothetically, the EU were to be forged in a State, the Rodrik's trilemma wouldn't hold anymore; the inherent problem of redistribution and democracy outside the demos however would still be there (and in fact it is in many existing nation-states). Nation-states are under threat only in the measure they represent the *milieu* of the democratic process: in this particular function they enter in the trilemma. As a consequence of this reasoning, even if Rodrik's work may provide some insights concerning the long term outcomes of the trilemma's pairs, it is insufficient to provide a correct understanding of the European Union crisis.

- *3.1 democratic principles, no demos thesis*

Concerning the pair of nodes preserving *no demos assumption* and democratic decision making, theory and historical experience seem to suggests at this regard that the dissolution of the Euro Area would not move the European system into a stable equilibrium, and therefore further institutional adjustment would be needed, endangering the European Union and the Single Market**.**

This option on the trilemma would require the disbanding of the monetary union. Besides the short

[4] Note that what is considered "essential democratic function with redistributive implications" may change across time and societies; as noted by Moravcsik (2002: 614) although monetary policy might have redistributive implications, it was possible to create the ECB because the redistributive function of monetary policy was widely rejected at the moment of its creation.

term effects of a similar decision (which according to several studies, including from UBS (Deo, Donovan and Hathaway 2011) and from the Bertelsmann Stiftung (Belke 2012) might acquire a global magnitude several times higher than the collapse of Lehman Brothers) especially long term stability is under threat. The monetary union, in fact, was introduced for specific reasons. If, from one side, there was a sincere political willingness to push forward the European integration process, there was also a clear macroeconomic concern behind its introduction: the famous "Impossibility Trilemma" of Robert Mundell (Mundell 1961). Following Mundell's argument, a group of countries cannot simultaneously pursue free movement of capitals, independent monetary policy and fixed exchange rates. The EMU is an institutional solution to this trilemma, in favour of free movement of capitals and fixed exchange rates (thus repelling independent monetary policy). The collapse of the EMU would raise the same questions again: how to create monetary stability in Europe? If the EMU collapses, it would be because a fixed exchange rate system is not sustainable. Therefore, the choice will be for free movement of capitals, independent monetary policy and flexible exchange rates.

From the Collapse of the Single Currency to the Collapse of the Single Market?- A similar combination of factors, however, represents the first step towards the collapse of the residual economic integration, the Single Market. As suggested by James Meade (1957)[5] and more recently by Eichengreen (2008) and Kawai and Akivama (2003) if the short term preferences over the trade-off inflation/unemployment are different (and indeed, they are different among European countries) and monetary policy is independent, it is unrealistic to think that free trade agreements (and as a consequence, the Single Market) would survive in the long term.

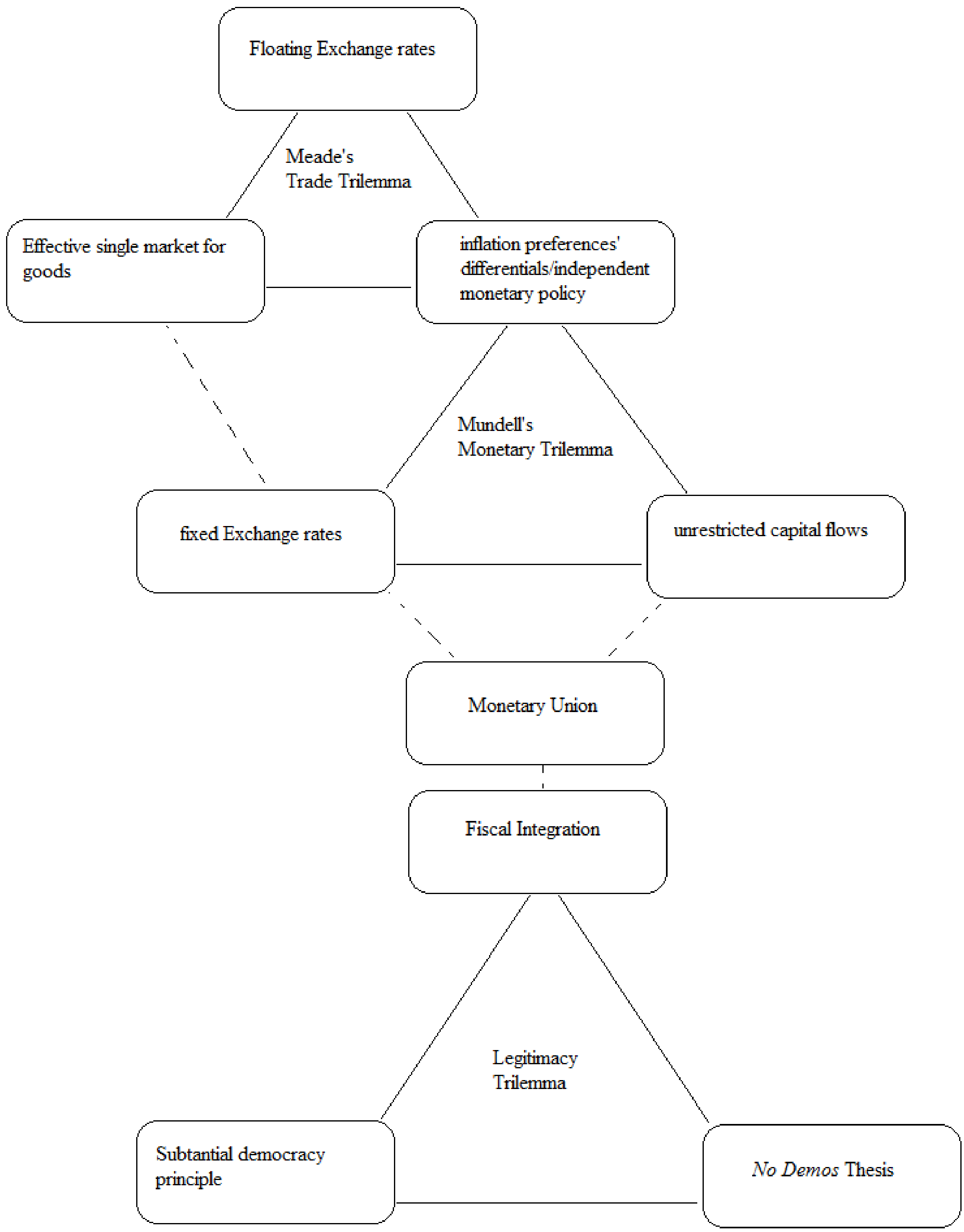
The Single Currency surely was a political project but was also justified as a rational solution to the well-known Mundell's trilemma of international economics- which states that fixed exchange rates, independent monetary policies and unrestricted capital flows are not compatible. The European solution to the Mundell's trilemma has been to permanently remove the possibility of diverging monetary policies in order to preserve free movement of capitals and fixed exchange rates. But why fixed exchange rates are so important? The rationale for fixed exchange rates is to ensure the correct functioning of a level-playing field single market for goods. Meade (1957) suggests that an effective level-playing-field single market for goods cannot endure in a floating exchange rate system if countries hold different inflation preferences. If there are no trade barriers, countries with higher inflation preferences have an incentive to expand continuously their monetary base, thus depreciating their currencies, in order to boost short term price competitiveness, adopting a beggar-thy-neighbour policy. Partner countries with lower inflation preferences have little options against this behaviour: they can either (a) do nothing accept a higher level of unemployment, or (b) change their own inflation preference and accept a higher level of inflation, or again (c) change their preference concerning free

[5] *"Governments are nowadays so wedded (and, in my opinion, rightly so wedded) to the idea that it is one of their duties to preserve full employment that the probable outcome of this solution would in fact be the breakdown of the free-trade-area arrangements".* Meade, J. (1957:385)

trade and recede from the single market agreement.

In other words, a third trilemma is implied by Meade's economic reasoning – requiring the choice of a pairs between *differentials in inflation preferences*, *flexible exchange rates*, and a *level-playing field Single Market*. From this perspective, it is straightforward to understand the pressure that the European

Figure 3: Sequence of integration trilemmas



Source: author's own elaboration

single market for goods would suffer in case of dismantling of the Euro Area.

A reverse reading of the previous reasoning is helpful to reconstruct the *economic rationale* behind the progressive process of European Integration: a first political goal (single market for goods) requires a choice of monetary stability in the forms of fixed exchange rates; a second political choice (single market for capitals) requires the evolution of the fixed exchange rate system into a proper monetary union; and the preservation o the monetary union requires some degree of fiscal integration, which in turn moves the Union into the legitimacy trilemma. Of course, being the whole European construction somehow dismantled in the process, the issue of democratic legitimisation disappears: not only fiscal integration, but also monetary policy and potentially trade policy (at a later stage in the dis-integration chain) are kept at domestic level. The need of a democratically-legitimised EU fades away alongside the deconstruction of the EU itself (figure 3).

The remaining two patters, even if they can be easily labelled as “federal” and “executive-federal” integration, require more in-depth analysis.

- *3.2 Monetary Union, No demos thesis*

The combination of monetary union and no *demos thesis*, leading to an inter-governmental type of fiscal integration (or executive-federal in the words of Habermas) produces -in the better of cases- a shift from input (democratic) legitimisation of fiscal policies to an output legitimisation of fiscal policies. The logic is simple. The formal equality of states, including their veto powers on fiscal matters, shall be preserved in order to fulfil the “*no demos assumption”.* However, the credibility of commitments is still essential: credibility must cover not only the willingness of peripheral countries to adopt reforms, but also the willingness of core countries to pay. If each fiscal transfer were to need 28 majorities in 28 national parliaments, the whole system would end-up being a completely unreliable in front of financial markets and of the voters. Moreover, the whole “grand-bargaining” needs to be protected by electoral politics; so fiscal and economic integration (with responsibilities for the two parties) is again “insulated” and protected by unilateral changes by constitutionalisation in a fiscal treaty with redistributive features. Indeed, the “insulation logic” observed by Majone constitutes not only a requirement to achieve effectiveness avoiding decisional traps, but also a strategy to ensure compliance (Wolf 1999: 341). The goal is precisely the *de-democratization* of a given competence; the respect of national sovereignty turns a purely fictional stratagem in an insulation setting. Clearly, the respect of the *No Demos Thesis* is apparent: In order to grant to each *national demos* equal and non-majoritarian rights on fiscal and economic policies, these policies must be excluded by democratic policy-making fields of action. Such an arrangement, albeit eventually effective, would violate both *input* and *output congruence* as defined by Zürn (2000) thus further weakening the democratic stance of the system.

Moreover, additional limitations arise. In particular, output legitimate policies need to face two main issues: (1)*variations* of constituencies' interests and preferences after the constitutional agreement, and (2)time inconsistency problems.

In fact output legitimacy requires, to be achieved, *horizontal* effectiveness of the implemented policies. In other words, if a policy ends up producing losses of welfare in a given constituency, output legitimacy is not achieved. So output legitimisation is *not* an agreement about the *rules of the game*, but about *the winners* of the game. Of course, no constituency would (in theory) agree on a "quasi-constitutional" agreement that is structurally against its interests: during the negotiations the delegates would use their veto powers to block any agreement that does not respect (overall) its own preferences, so the loss *democracy* experienced by the constituency bound by the agreement is matched by the material gains that provide output legitimacy. For a single fiscal decision to be output-legitimised, therefore, a relevant level of ex ante economic convergence is required.

On the long term it could well happen, if we assume that adjustment and convergence process are effective; but to have effective convergence we need (for economic theory assumption, see above) fiscal integration. Can we legitimise fiscal integration with a legitimisation vector requiring, to be effective, actual convergence, thus fiscal integration? The response may be less straightforward than it seems to be: it could depend from the time frame of expectations concerning effectiveness. Some may seek long term effectiveness, while others would opt for a short term one.

So, loss in actual democracy may be supported by relevant agents only if concrete advantages show up timely. The higher the loss in democracy is, the faster results shall be delivered.[6] Naturally, the "timely" definition may vary across regions and individuals: some may accord high values to short terms gains, while others may prefer long term advantages. But, as explained above, these arrangements are credible only if we focus on the long term; if, in other words, their content does not depend from the national political cycle. Thus, as long as multiple constituencies exist, and as long as these constituencies hold different interests, it seems hardly possible to find an agreement that satisfies the long term commitments condition, and the short term effectiveness condition, for any constituency.

- *3.3 Monetary Union, democratic principle*

There is a third possible outcome of the trilemma, a "federal" integration pattern combining supranational democracy and monetary union. Several concerns can be raised, however, despite the clear political appeal of such option. These concerns rely on a simple observation: disbanding the *no demos assumption* might not be as easy as it could appear. There is little doubt concerning the fact that Europeans are *not* (yet) a "people": the *no demos assumption* therefore is extremely relevant, if its

[6] Empirical studies on the European Identity and the legitimacy of the institutions demonstrate that there is an extremely sensitive component of the individual attitude towards EU institutions in relation with short term achievements. See, Bruter (2003:116)

implications are proven true.

The no demos assumption of Weiler is actually composed of two different assumptions, a normative and a positive part. Under the "federal" integration perspective, we can easily dismiss (as a political choice) the normative claim; however, it is not so easy to dismiss the positive part (that Democracy cannot be deployed outside a single people defined in ethnic and cultural terms). The experience of many democratic fiscal federations like the UK, Spain and Belgium, demonstrates that even consolidated systems may not be in a final functional equilibrium. Even functionalists with rather federal feelings, as Haas (1964) and Schmitter (2002), consider a quick federalisation of the EU unlikely to happen without traumas. The former, in his analysis of international integration patterns, considers that federal integration would succeed only after the instauration of a "liberal nationalism". In other words, after a conflicting phase between original national identities, the supranational authorities may success to build up a true federation overcoming the nationalist oppositions with the creation of a strong shared body of beliefs and values. In addition, Schmitter considers that governments would resist with some forms of "power protectionism" boosting national identities.

This is a core question: the viability of a truly input-legitimised EU depends from the extent the no demos assumption might effectively be ignored. Hypothetically, *democratic fiscal integration might be self-legitimising.*

This hypothesis can be presented as follows: if the power of an elected assembly over fiscal issues is increased, then political parties will increase their efforts to take control of the assembly, investing more in collecting votes, mobilizing consensus and building up organizational structures. As a result of the organizational efforts and of the research of consensus, two effects are likely to arise: A) increased political polarization; and B) increased participation rates in respect of the trend.

This hypothesis has been already proven wrong by Hix (1998) for what concerns the overall powers of the European Parliament, but remains to be tested with particular reference to fiscal powers, which represent the core of the democratic process. At this regard, Hix, Noury and Roland (2007) recognise that a relevant increase of the powers of the parliament in shaping the outcomes of the political process can indeed increase its legitimacy. If this correlation is true, a democratic fiscal integration might indeed be self-legitimising, opening the doors for a fast-track federalisation of the Euro Area. Such evidence however does not exist yet, and further research is needed in the field.

Conclusions

The previous analysis suggest implications for theory and policy-making. In particular, the paper has shown that while talking of a "democratic deficit" before the crisis may have been redundant accordingly both with theoretical reasoning and empirical evidence, the wave of crisis-led integration occurred since 2010 has changed the picture. The EU is not simply facing a need for further democratization: the institutional problem posed by the 2009 Lisbon Judgement of the German Federal Constitutional Court constitutes only a part of the problem: the transformation of the European

Parliament in a truly bicameral system fulfilling the principle of political equality would not be sufficient in granting legitimization for fiscal integration. Instead, the paper shows that the Union is trapped in a policy-and-legitimacy deadlock from which there are no easy ways-out.

None of the possible choices is costless: dismissing the Monetary Union will climb the continent in a financial disaster much worse than the existing, and will deconstruct the single market as well. Proceeding with output-legitimate fiscal integration, avoiding federalism, will have huge costs in terms of democratic legitimacy, a solution that probably will not last long enough to achieve true economic convergence, providing symmetric legitimacy; the risk that short and medium term losers of such process would rebel before accessing long term gains is very high. And finally, a federal integration pattern is extremely risky, as it will require a democratically legitimised sharing of resources among communities which do not have a truly unified public sphere. Experience shows that this is hard to achieve without political conflict and potential break-ups even within long-standing established communities.

The analysis suggests that the EU is caught in a "functional trap": policy makers should be aware of the risks entailed with each of the possible choices over the trilemma, and must identify a clear integration pattern shaped not only by immediate economic needs and political fears, but also by the economic and democratic challenges over the medium term. Failure of doing so may substantially increase the perceived democratic deficit of the EU, effectively expropriating citizens of their democratic decisional power; alternatively, it may create a dysfunctional system hostage of minority blockages in national parliaments and characterised by recurrent instability on financial markets. Ultimately, such sub-optimal solutions may not be sustainable and may end up provoking the collapse of the EMU.

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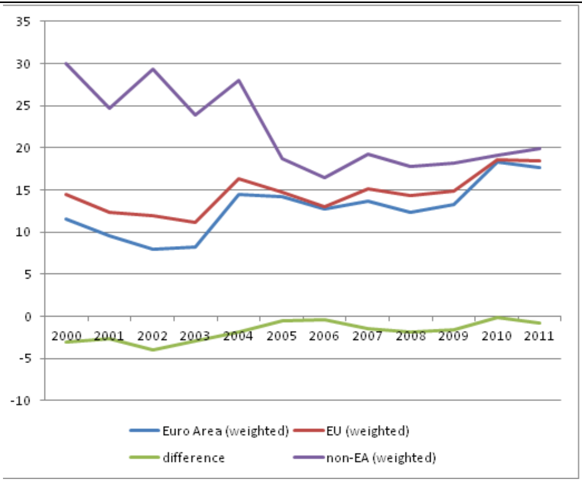
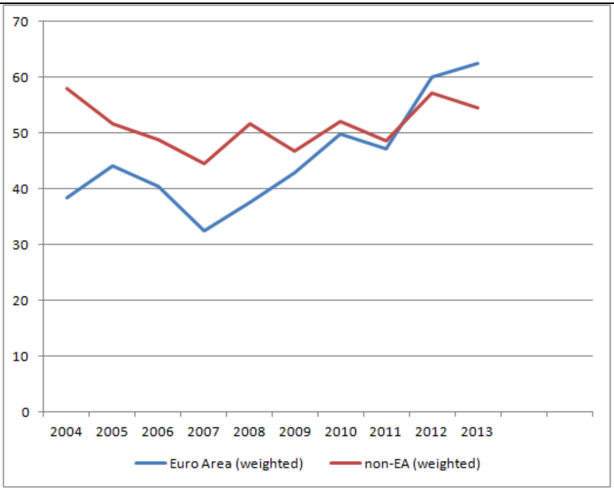
Appendix A: tables

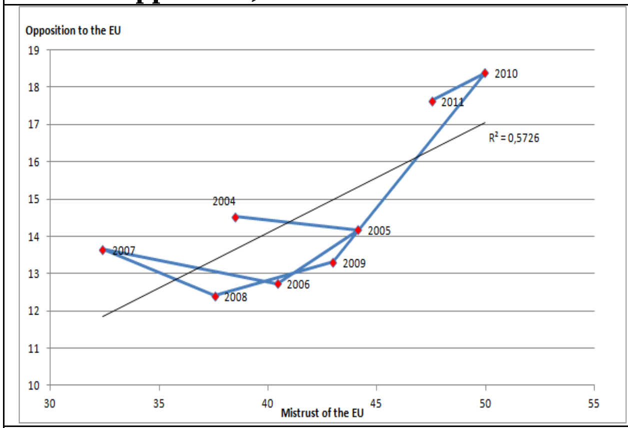
1A: share of citizens against EU membership



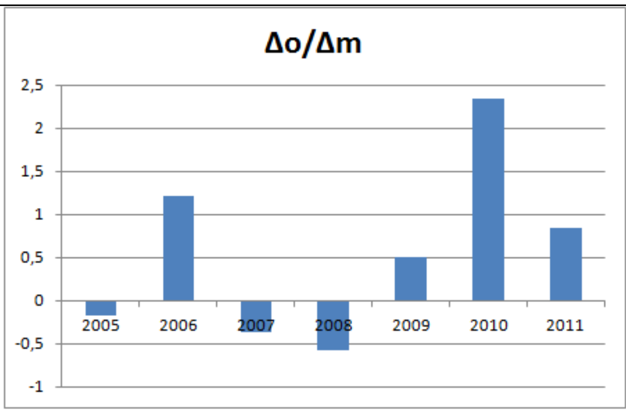
1B: share of citizens reporting mistrust in the EU



1C: correlation between Mistrust and Opposition, Euro Area 2004-2011



1D: elasticity of Opposition to Mistrust in the Euro Area



Notes: Population-weighted averages, dynamic Eurozone & EU composition.
Source: author's calculations based on: European Commission, Standard Eurobarometes Nr.53-78; Eurostat, Demographic statistics