Integral Pre-emption of EU Democracy in Economic Crisis under Transnational Law

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Abstract
This article examines the challenges of transnational law for democracy in the European Union in times of economic crisis. The concept of democracy is fleshed out first. This is followed by a two-pronged study of the internal and external democracy-affecting processes, taken separately as well as jointly, and of their impact on democracy in the European Union. Finally, some normative proposals, embedded in the theory of legal pluralism, to improve the state of European Union democracy in the present unfavourable internal and transnational environment are offered in the conclusion.

Keywords
European Union, Democracy, Economic Crisis, Transnational Law, Legal Pluralism

1 Introduction
This article examines the challenges of transnational law for democracy in the European Union (EU) in times of economic crisis. Much has already been written about the ills and virtues of EU democracy. The so-called democratic deficit has been treated, if not exhaustively, then to the exhaustion of its audience. Making little progress, one should add, the debate has boiled down to entrenched opinions on the very existence or non-existence of an actual democratic deficit. To avoid this limbo, my focus on EU democracy here will be much more specific. I will concentrate exclusively on democratic developments in the EU in the context of the ongoing financial and economic crisis. In so doing, two distinct and yet related democracy-affecting processes will be investigated. The first process is internal to the EU. It results from the EU’s own response to the

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economic crisis in the context of the Union’s specific constitutional structure. The second process is external to the EU, and essentially concerns its Member States’ access to credits offered by global financial markets. As the accessibility of funds in global financial markets depends heavily on the sovereign bond ratings provided by credit rating agencies (CRAs), the external impact of these transnational actors on national and supranational democracy in the EU will also be studied.

Both democracy-affecting processes under investigation here are underpinned by an assumption that democracy is about self-determination. A democratic polity is one in which its members decide together on the resolution of collective problems, issues and challenges in procedurally pre-determined ways. However, a real and meaningful democracy only exists in a polity in which self-determination is actual and not merely hypothetical. This means that the decision-makers in such a polity possess actual means for deciding on major issues of genuine and concrete relevance to the polity. The former stands for economic, and the latter for political sovereignty. In other words, a democratic polity must possess sufficient economic resources (economic sovereignty) to be able to exercise competencies over the key aspects of its socio-political existence (political sovereignty). Of course, both terms—sufficient economic resources and key competencies—are relative, context-dependent and a question of degree, making it hard, if not impossible, to argue in abstracto when a polity runs out of its economic and political sovereignty.

However, irrespective of the exact point of the drying out of economic and political sovereignty, I argue that a meaningful democracy is in close correlation with them. If a polity is bankrupt or at least heavily indebted, then it is obvious that the democratic process of self-determination in such a polity has no way available to influence the socio-political world to any tangible extent. A polity without economic resources is practically dysfunctional, a failed polity, but also democratically emptied. Its democracy might still exist formally, on paper, but not in practice. The outcome is similar if a polity, even if it has economic funds available, has refrained from exercising its key competencies. Also in such a polity, democracy as self-determination might exist as a formal, yet practically empty, shell.

The argument of this article is therefore structured as follows. The concept of democracy will be fleshed out first. This will be followed by a two-pronged study of the internal and external democracy-affecting processes described above, taken separately as well as jointly, and of their impact on democracy in the EU. Finally, some normative proposals, embedded in the theory of legal pluralism, to improve the state of EU democracy in the present unfavourable internal and transnational environment will be offered in the conclusion.

2 The idea goes back to Kant and Rousseau who have insisted that the addressees of the laws must also understand themselves as their authors—which is the expression and a proof of their political autonomy. See, eg, Jürgen Habermas, ‘Constitutional Democracy: A Paradoxical Union of Contradictory Principles?’ (2001) 29 Pol Theory 767.
2 On the concept of democracy

There are many conceptions of democracy out there. Eleftheriadis broadly distinguishes three competing theories of democracy: the collective theory, the procedural theory and the substantive theory. The collective theory conceives of democracy as the self-government of a sovereign people. The procedural theory defines democracy as a fair procedure for participation in deliberation and decision-making, while the substantive theory postulates the equal treatment of every individual as a paramount substantive value of democracy. Rather than seeing these theories in competition, this article opts for an integral approach so that the concept of democracy defended here is the sum of all these theories. Accordingly, inspired by the work of Fritz Scharpf, I have argued that democracy can best be described as consisting of three elements: input legitimacy, democratic political process, and output legitimacy, whereby all of its elements are conducted within the framework of the rule of law.

The starting point of input legitimacy is a free individual whose equal human dignity awards them with an unalienable right of self-realisation within the limits set by the equal rights of others. The purpose of democracy is to ensure the flourishing of individuals pursuant to their own chosen conception of a good life. Since there are many different individuals, there are many conceptions of a good life, which means that a free society is inherently pluralist. The essence of democracy is to cherish this plurality and make it work. A prerequisite for democracy is thus a pluralist polity, a polity in which all encompassing pluralism—political, value, religious, cultural, interest-based and economic pluralism—exists, is ensured and fostered. To limit or even to deny pluralism means curtailing an individual’s right to self-fulfilment. The suppression of pluralism always leads to an incursion into an individual’s freedom and their autonomy, and ultimately afflicts their human dignity.

The input legitimacy in a democracy must therefore enable the most faithful translation of this societal pluralism possible, composed of individuals’ and collective interests, in the formation of a government. To do so, democracy must be inclusive. This is best ensured by fair elections which comply with the highest constitutional standards, including a free and pluralist media, a vibrant civil society and robust

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4 ibid 5.
5 ibid 7. This theory is most closely associated with the works of Habermas including Jürgen Habermas, Between Facts and Norms (MIT Press 1996), but perhaps also with Jeremy Waldron, Law and Disagreement (OUP 1999).
6 Eleftheriadis (n 3) 7. The substantive theory of democracy has been defended in, for example, Ronald Dworkin, Law’s Empire (Harvard UP 1986).
7 See Matej Avbelj, ‘Cries and Perspectives of Building a European Nation—The Case of Slovenia’ in Peter Jambrek (ed), Nation’s Transitions: Social and Legal Issues of Slovenia’s Transitions: 1945–2015 (Graduate School of Government and European Studies, European Faculty of Law 2014).
8 The elections must be general, equal, direct, secret and, of course, free.
political parties. The latter represent the backbone of democracy as they stand for an institutional link between individuals, civil society and the political process conducted in the parliament.

Directly elected by the people, the parliament enjoys the highest democratic legitimacy, and is therefore endowed with the power to select the executive branch. The latter manages the state by proposing new laws and executing the existing ones. The judiciary, as the third independent branch, ensures that the law is observed and that individuals’ rights are not violated. From a democratic perspective, it is crucial that the parliament’s composition reflects the plurality residing inside the polity, and that those elements of the polity who failed to prevail in the elections enjoy all the rights and privileges of the opposition. The latter controls those in power and suggests alternative solutions with an ambition to win the next elections. At the heart of the parliamentary proceedings thus lies a political conflict which must be conducted in dialogical way by striking compromises in view of achieving the polity’s common good. The media plays a decisive role here, monitoring the work of both the government coalition and the opposition, enabling the voters to form their political preferences for the next election. This system of checks and balances between different branches of government is sometimes also complemented by popular referenda, which serve as an additional check on the decisions of elected officials, as well as by the constitutional courts.

Finally, any government, including a democratic one, is there to achieve certain outcomes. It is on this basis that its outcome legitimacy is measured. In a democracy the outcomes ideally have to benefit as many as possible, but they must simultaneously come into being in accordance with the law. This is important so that democracy remains faithful to its essential commitment to respect the freedom and equal human dignity of every individual, rather than turning into a utilitarian system in which individuals are instrumentalised in the hands of the arbitrary power.

Having said that, what remains to be emphasised is the inherent, intimate link and mutual dependence between democracy and the rule of law. In a democracy, all three of its elements—input and output legitimacy, and the political process through which they are connected—have to take place within the framework of the rule of law. Simultaneously, there can be no rule of law if the laws that govern people do not come into being in a democratic manner. Democracy and the rule of law thus presuppose each other, but at the same time their relationship is not entirely symbiotic. There is a dormant democratic threat that a democratic majority trumps the rights of the outvoted minorities. This is what the rule of law is there to prevent. This counter-majoritarian problem, as it has come to be known, is, however, only a purported one. If democracy is not understood as a simple rule by the majority, but as a system for the organisation of political power whose central value is the protection of equal human dignity, then

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9 The term was first introduced by Alexander Bickel, *The Least Dangerous Branch* (Bobbs-Merrill 1962) 16.
the constitutional self-limitation of a democratic majority does not entail the denial of democracy, but is its vindication.10

3 Democracy in the EU

Having outlined the concept of democracy to be used here, it cannot be overlooked that this concept derives from the statist tradition and is expected to do its work inside a state. Like many, if not even all constitutional concepts, democracy also carries a strong statist imprint.11 Democracy simply is a statist concept and, when juxtaposing it with the EU, which is not a state, what one finds is not a democratic deficit but a conceptual misfit. As it makes very little sense to argue that pears suffer from an apple deficit, because they are not apples but pears, it is equally unproductive to draw up a laundry list of democracy within states, compare it line by line with democracy in the EU, and then because of its missing statist democratic elements declare the EU democratically deficient. This comparative exercise, so typical of EU scholarship, will therefore be eschewed here by simply assuming that the EU as a union is not a state, thereby making any mechanical comparison between intra-state democracy and democracy in the EU inappropriate.

As I have argued elsewhere, the supranational level of the EU has developed its own, particular supranational political community.12 The EU polity is composed of the citizens of the Member States who have been recognised with the complementary status of EU citizens. Through the rights attached to their status, whose essence is equal treatment within the material scope (ratione materiae) of EU law, they have been legally acknowledged and constructed as a supranational constituency which can directly inspire the EU political authority via a bottom-up influence. On the one hand, this legally mandated de-alienation effect has paved the way for the gradual sociological emergence of the Community-wide ‘we feeling’;13 whereas on the other hand the EU institutional decision-making structure has been set up in a way to mimic as far as possible the elements of a statist democracy: input legitimacy, a democratic political process, and output legitimacy.

The success of this latter strategy has been mixed, presumably because of the very conceptual inappropriateness of translating statist democratic mechanisms to a non-statist entity. For example, since the 1970s the EU has worked hard to improve its input

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10 This would be again in line with Dworkin's conception of substantive democracy. See Dworkin (n 6). For further discussion, see Frank Michelman, Brennan and Democracy (Princeton UP 1999) ch 1.
12 ibid.
democratic legitimacy by strengthening the role and powers of the European Parliament. However, with the growing role of the Parliament, which has eventually become an equal co-legislator, we have also paradoxically witnessed growing abstention from elections. The formal attempts to improve input legitimacy have not been internalised by EU citizens. This is notwithstanding the attempts to make EU elections even more attractive by translating the latter’s result directly, in the form of Spitzenkandidaten, into the composition of the European Commission whose by now (at least allegedly) independent, bureaucratic supranational character will inevitably, but also more unpredictably, become politicised. This might also impact on the dynamics of the EU democratic political process which continues to take place in the more or less vacuous EU public sphere. It is also here in the institutional triangle between the Commission, the Parliament and the Council that the legislative process, characterised by its peculiar absence of ideological divisions between the coalition and the opposition, is conducted. However, the EU has been able benignly to neglect all of these democratic peculiarities as long as it could rely on its traditionally dominant way of democratically legitimising itself through the output legitimacy. The process of EU integration has been about uploading competencies from the national to the supranational level motivated and legitimated by the greater output on both levels. As is well known, the outbreak of the acute financial and economic crisis has decisively put an end to this possibility.

A friend in need is a friend indeed; and it has been only with the emergence of the economic crisis that the true extent of the crisis of democracy in the EU has become apparent. Fritz Scharpf has aptly dubbed this state of affairs the pre-emption of democracy. The pre-emption of democracy in the EU has occurred on both the national and supranational levels across three dimensions: substantive, institutional and economic. The pre-emption of national democracy has mainly occurred under the internal constraints of the EU’s specific constitutional structure, whereas the pre-emption of supranational democracy has been caused by external constraints resulting from the actions of transnational actors. We turn next to a more detailed description of this phenomenon, starting with the pre-emption of national democracy first.

14 See, eg, Mattias Kumm, ‘What Kind of a Constitutional Crisis is Europe in and What should be Done about it?’ (2013) 801 WZB Discussion Paper 1, 18 <http://econstor.eu/bitstream/10419/86147/1/770693296.pdf> accessed 5 August 2015. Kumm writes, ‘It is high time to be serious about proposals, endorsed among others by current President of the European Parliament Martin Schulz and by Wolfgang Schäuble, to make the elections for the European Parliament genuine European elections for the choice of the President of the European executive.’

15 For a more in depth discussion of this particular problem, see Francisco Perez, Political Communication in Europe: The Cultural and Structural Limits of the European Public Sphere (Palgrave MacMillan 2013).

16 See, eg, Jürgen Habermas, ‘Democracy, Solidarity and the European Crisis’ (lecture delivered at KU Leuven, 26 April 2013) <http://www.socialeurope.eu/2013/05/democracy-solidarity-and-the-european-crisis-2/> accessed 31 August 2015, who stated that ‘[t]he Union legitimized itself in the eyes of the citizens primarily through its outcomes and not so much from the fact that it fulfilled the citizens’ political will.’

4 The pre-emption of national democracy in the EU

The pre-emption of national democracy in the EU has occurred across three dimensions: substantive, institutional and economic. The substantive pre-emption of democracy describes the process of reducing the number of competencies preserved by the Member States. The institutional pre-emption of democracy denotes the declining role of national parliaments as a core representative institution of the people, which is simultaneously at the heart of the national democratic political process. Finally, the economic pre-emption of democracy indicates the factual incapacity to exercise competencies due to a lack of economic resources. The three processes are both independent of each other as well as closely intertwined, and together contribute to the hollowing out of the national democratic process. The substantive pre-emption feeds directly into the declining role of the national parliaments as they are formally left with fewer substantive policy fields in which they can legislate. However, the role of national parliaments can be decreasing even if the scope of the national competencies is left intact, so that other branches, in particular the executive one, take up tasks, sometimes even informally, traditionally belonging to the legislative branch. However, the latter phenomenon is not exclusive to the EU. Most modern democracies have seen the trend of a rising executive, but the EU has added its own special twist to this. Finally, the economic pre-emption of democracy can again happen in the circumstances of the full preservation of both substantive and institutional democracy when the two cannot be practised simply because the state has run out of money to fund its apparatus and core functions. Several EU Member States, as we shall see below, have found themselves in a similar situation in the economic crisis context due to the transfer of monetary competencies to the EU. The substantive pre-emption of democracy has therefore importantly contributed to the economic pre-emption of democracy. We now turn to a more detailed description of these processes.

The substantive dimension of democracy denotes the material competencies that remain within the domain of the national democratic process. The state has traditionally been considered to have comprehensive control over all social affairs in the public domain. As a sovereign state it has exercised the entire bundle of competencies in full and to the exclusion of any other non-statist authority in its territory. All political issues lato sensu, which encompass everything that is not of an exclusively private concern, have been subject to democratic decision-making. The people of the state have thus self-legislated in toto. The national democratic process was thereby fully substantiated. Nothing would be beyond its control. Of course, while such a total democratic state

18 See Deirdre Curtin, ‘Challenging Executive Dominance in European Democracy’ in Christian Joerges and Carola Glinski (eds), The European Crisis and the Transformation of Transnational Governance (Hart Publishing 2014) 205. Curtin refers to Peter Mair who has argued that the EU has been ‘deliberately constructed as “a protected sphere” in which policy-making can evade the constraints imposed by representative democracy at national level’: see Peter Mair, Ruling the Void: The Hollowing of Western Democracy (Verso 2013) 99.

has always been just an ideal, perhaps even a fiction, with the co-operation of states under international law and furthermore under the impact of processes of supranational integration, such as the EU, and globalisation the gap between the national democratic ideal and reality has been growing steadily.

In the process of EU supranational integration, the Member States have thus transferred an ever bigger share of the national bundle of their competencies to the supranational level. The uploading of national competencies to the EU has taken place gradually, through different stages. In the first stage, economic competencies were transferred to the EU, closely following the well known Balassa model of economic integration.20 In 1968, the Member States formed a customs union, and in 1993 the single market was completed, with this leading to the creation of the monetary union with the issuance of a single currency in 2001, whose crisis several years later prompted the laying down of the keystone of a nascent fiscal union.21 In the second, more political stage of integration, competencies beyond economic ones have been transferred: such as justice, security and foreign affairs.22 The sheer number of competencies transferred to or even taken over by the EU through the proverbial competence creep23 has been detracting from the substance of the national democratic processes to the extent that theory has started to talk about Entstaatlichung (emptying of the state)24 and the national constitutional courts—in particular the Federal Constitutional Court of Germany (BVerfG)—were prompted to draw a line in the sand of what is still acceptable so that a Member State and its democracy can still be meaningfully described as such.25

However, the full extent of the substantive pre-emption of national democracy can be understood best if our focus is complemented with the pre-emption of democracy in its institutional dimension. The two have been occurring side by side and simultaneously. In national institutional terms, the process of European integration has meant the persistent rise of the executive branch at the expense of the legislative branch. For several decades, the representatives of the national governments were exclusive EU legislators in the Council whose legal acts held, according to the principle of primacy, precedence in application before national laws, as well as the incipient capacity of pre-empting national legislative fields in the domains unified or fully harmonised by the EU legislature.26 The national parliaments have thus not only become substantively undernourished, but also increasingly institutionally side-lined. They have tried to fight back on the national level

21 See, eg, Derek W Urwin, The Community of Europe: A History of European Integration since 1945 (2nd edn, Routledge 2014); Chris J Bickerton, European Integration: From Nation-States to Member States (OUP 2012).
22 ibid.
by increasing control over national governments’ actions in the EU legislative process, as well as on the supranational level by involving themselves in scrutiny of the European Commission’s respect of the subsidiarity principle. The new approach to harmonisation and other models of the so-called new EU governance designed to leave more room to the national legislature for the autonomous exercise of national regulatory choices have also been attempted.

4.1 The substantive and institutional pre-emption of national democracy in an economic crisis

The outcome has been modest, but even as such it has been almost entirely offset by substantive and institutional developments in the wake of the EU economic crisis. As is well known, in 2009 the Eurozone countries found themselves in a vicious circle of a sovereign debt crisis which threatened not only their individual economies, but by way of a domino effect the survival of the single currency as such. Almost entirely unprepared for such a scenario and under great pressure, the EU sought the assistance of the International Monetary Fund (IMF) and hastily drew together rescue funds for the most vulnerable economies in need of financial assistance. These so-called bail-out funds have enabled the struggling Member States to meet their financial obligations to external and internal creditors and thus escape almost imminent bankruptcy. However, this financial assistance came with strict conditions, mandating comprehensive and not infrequently painful structural reforms, the purpose of which was twofold; namely, to ensure that the credits would be repaid as the reforms take shape and the economy picks up, and to prevent the moral hazard lurking in the possibility of using the money while continuing on the same old economically devastating course.

However, while well motivated, the effect of these conditions has been a de facto substantive and institutional emptying of national democracies in the economically pre-empted Member States. The national parliaments have been turned into rubber-stamping institutions. The Member States, which have already transferred a significant share of their national competencies to the EU, now find themselves in a dire economic situation leaving them, in political terms, with a take-it-or-leave-it scenario. This is an example of a ‘zero-choice democracy’. They either signed up to the troika conditions or faced a

29 In particular, Portugal, Ireland, Greece and Spain.
30 See, eg, Ari Hirvonen, ‘Reinventing European Democracy: Democratization and the Existential Crisis of the EU’ in Massimo Fichera, Kaarlo Tuori and Sakari Hänninen (eds), Polity and Crisis (Ashgate 2014) 154.
31 Christian Joerges, ‘The Transformations of Europe and the Search for a Way out of its Crisis’ in Christian Joerges and Carola Glinski (eds), The European Crisis and the Transformation of Transnational Governance (Hart Publishing 2014) 35 n 30 referring to Nikos Hlepas, Supranational Technocracy and Zero Choice
default on their debts, with potentially disastrous and therefore practically unthinkable national and supranational economic and political consequences. As a result, even those limited material competencies that have at least formally remained with the Member States can no longer be de facto self-legislated upon by these countries’ peoples in the context of their indebtedness. This confirms a simple truth: while in liberal democratic countries the economy is to enjoy as much autonomy from the political as possible, on the other hand politics cannot be meaningfully exercised in the absence of sufficient economic funds. In other words, political self-determination is only possible in the conditions of economic independence, which as a rule applies to any entity, national or supranational.

The depth of the crisis, however, suggested that a one-off response to it was insufficient and that a more systemic approach to reforming the EU’s economic governance is called for. As we shall see, its implementation has put additional strains on national democratic processes. A systemic shift in EU economic governance was introduced by the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (Fiscal Compact) together with the so-called ‘six-pack’ and ‘two-pack’ legislation. They intended to achieve several objectives. First, they reinforced the Stability and Growth Pact as the substantive framework of European economic governance and placed it within a well defined timeframe known as the European Semester. The substantive framework centres on fiscal and economic policies, such as budgetary control and


33 Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (Fiscal Compact) (adopted 1 February 2012, entered into force 2 March 2012) D/12/2 <http://europa.eu/rapid/press-release_DOC-12-2_en.htm> accessed 17 December 2015. The Fiscal Compact is not an instrument of EU law; rather it was concluded as an international treaty among all the EU Member States, other than the UK and the Czech Republic.


control of macroeconomic imbalances in the Member States, and consists of so-called preventive and corrective arms. The former's purpose is to ensure that Member States do not deviate from the agreed fiscal and economic criteria, while the latter provides for the measures, including sanctions, necessary to ensure compliance in cases of deviation.

The cycle of a European semester starts in November each year, when the Commission presents its annual growth survey along with the alert mechanism report in which it singles out for an in-depth review those Member States that exhibit macroeconomic imbalances. Simultaneously, the Member States have to report on their fiscal policy. Their budgetary duty is two-fold. First, they are to present a draft annual budget for assessment to the European Commission and the Council, as well as the preparation of the Stability Programme laying down the national mid-term budgetary objectives (MTBO) for the next three years. The latter is, again, evaluated by the European Commission, both \textit{ex ante} and \textit{ex post} (that is, confirming past and likely future compliance with commitments). Besides the Stability Programme, the Member States also have to present the National Reform Programme in accordance with the Europe 2020 Strategy and the Euro Plus Pact to demonstrate how they intend to meet the latter's economic objectives.

The European Commission integrates its findings on both the fiscal discipline and the national macroeconomic situation into country-specific recommendations, which are finally adopted by the European Council. If a Member State falls short of the prescribed fiscal benchmarks or exhibits an excessive macroeconomic imbalance, the corrective arm of the EU's economic governance is launched, resulting in an excessive deficit procedure (EDP) and/or an excessive imbalance procedure (EIP). The EDP is triggered if a Member State violates the deficit or the debt rule. According to the former, the annual budgetary deficit cannot exceed 3 per cent of GDP; according to the latter the national debt must be less than 60 per cent of GDP or, if higher, it must be shrinking at a satisfactory pace. Following adoption of the Fiscal Compact, the national budgetary positions, such as the Member States' MTBO, have to be balanced or in surplus. This is achieved if the MTBO deficit does not exceed 0.5 per cent or 1 per cent for those


\footnote{European Commission, ‘Making it Happen: The European Semester’ (European Commission, 7 July 2015) \url{http://ec.europa.eu/europe2020/making-it-happen/index_en.htm} accessed 4 August 2015.}

\footnote{ibid.}

\footnote{ibid.}


\footnote{The gap between the national debt and the 60 per cent requirement must be diminishing at 1/20 annual rate.}

\footnote{Art 3(b) Fiscal Compact.}
Member States whose national debt is significantly less than 60 per cent.\textsuperscript{45} If this benchmark is not achieved, other than in cases of exceptionally permitted deviations,\textsuperscript{46} an automatic correction mechanism is initiated.\textsuperscript{47}

The EDP results in enhanced surveillance of a Member State by the European Commission, the strictness of which varies depending on the gravity of the economic situation in a Member State. Three types of EDP can thus be effectively distinguished: (1) regular enhanced surveillance; (2) enhanced surveillance with precautionary financial assistance; and (3) enhanced surveillance under the macroeconomic adjustment programmes. Once subject to a regular EDP, a Member State must adopt a budgetary and economic partnership programme consisting of a detailed description of the structural reforms required to correct the excessive deficit.\textsuperscript{48} In addition, the Commission can request a number of specific measures to implement the enhanced surveillance.\textsuperscript{49} The Commission carries out regular review missions together with the European Central Bank (ECB), the European Supervisory Authorities and the IMF.\textsuperscript{50} These are reinforced in case of enhanced surveillance with precautionary financial assistance from the European Stability Mechanism (ESM)\textsuperscript{51} and/or European Financial Stability Facility (EFSF)\textsuperscript{52} under an Enhanced Conditions Credit Line or a Precautionary Conditioned Credit Line, for which a Member State has to meet specific criteria and policy conditions.\textsuperscript{53} Finally, countries in the Macroeconomic Adjustment Programmes\textsuperscript{54} are subject to the strictest

\textsuperscript{45} Art 3(d) Fiscal Compact.
\textsuperscript{46} Art 3(c) Fiscal Compact.
\textsuperscript{47} Art 3(e) Fiscal Compact.
\textsuperscript{48} Art 5 Fiscal Compact.

1) A stress test on banks to be implemented by the ECB/EBA;
2) An assessment of the domestic financial supervisory capacity to be implemented by the ECB/EBA;
3) Any information needed for the monitoring of macro-economic imbalances;
4) A comprehensive independent audit of the public accounts of all sub sectors of the general government;
5) Any information available for the monitoring of the fiscal deficit;
6) Access to disaggregated data on the developments of the financial sector.

In addition, Member States must also meet new reporting requirements foreseen for countries under the excessive deficit procedure (EDP) irrespective of the existence of the latter [internal citations omitted].

\textsuperscript{50} ibid 11.
\textsuperscript{51} For a general overview of this mechanism, see ‘European Stability Mechanism’ (2015) <http://www.esm.europa.eu/index.htm> accessed 15 September.
\textsuperscript{52} For a general overview of this facility, see ‘European Financial Stability Facility’ (2015) <http://www.efsf.europa.eu/about/index.htm> accessed 15 September.
\textsuperscript{54} Greece, Ireland, Portugal and Cyprus were subjected to a macroeconomic adjustment programme. Portugal and Ireland have already exited it, and are now in the post-programme surveillance phase. Spain was not part of the macroeconomic adjustment programme as it requested financial assistance for the recapitalisation of its financial institutions only: Communication from the Commission of 28 November 2014 to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, ‘Economic Governance Review: Report on the
surveillance and must ensure full cooperation with the Commission, the ECB and the IMF to prevent the Council interrupting their access to the financial assistance.55

On the other hand, the EIP imposes on the affected Member State a duty to prepare a corrective action plan, which must be endorsed by the Council and the Commission, the latter also being responsible for closely monitoring the plan’s implementation.56 All of these surveillance measures, in both the preventive and corrective arms of fiscal and macroeconomic control, are supported by the threat of sanctions. These sanctions, depending on the infringement, can be gradually increased from an interest-bearing deposit of up to 0.2 per cent of GDP to a non-interest-bearing deposit of the same size and, finally, a fine of 0.2 per cent of GDP or a maximum 0.5 per cent of GDP.57

The thus reformed EU economic governance model has importantly impinged on national democracy in both substantive and institutional ways. In substantive terms, national fiscal powers have been constrained the most, to the extent that two important democracy pre-emptying effects can be spoken of. First, by constitutionalising the golden fiscal rule requirement on the national level, a whole set of important economic questions will be removed from the national ordinary democratic process and political contestation.58 Secondly, by increasing EU control even over the exercise of national budgetary competencies the Member States might be giving up the last material brick of national democracy. If anything constitutes the heart of national self-legislation or self-determination, then this is collectively making or at least influencing the decisions on how to spend the money the state collects from its taxpayers. As there should be no taxation without democratic representation, this very representation becomes meaningless if it can no longer decide how and what the collected taxes are to be spent on. If decisions regarding the fiscal burden imposed on citizens and the social conditions in which they will live are effectively taken away from the national electorate,59 then the national democracy has undergone a systemic substantive pre-emption, not only a temporary one, resulting out of a transient troika conditionality.


55 Art 7 Council Regulation 472/2013 integrates the previous intergovernmental macroeconomic adjustment programmes with the new supranational regulation.


57 ibid.

58 Pursuant to art 3 Fiscal Compact, the national budgets must be balanced or in surplus (art 3(1)), which means that other than in explicitly prescribed exceptional cases (art 3(3)), a lower level of structural deficit cannot exceed 0.5 per cent in GDP at market prices (art 3(1)(b)) or 1 per cent in case of countries whose general government debt in GDP is significantly lower than 60 per cent (art 3(1)(d)). These rules must be inscribed in the national law of a binding and permanent character, preferably constitutional (art 3(2)), a lower level of a structural deficit.

59 See Mark Dawson and Floris de Witte, ‘Constitutional Balance in the EU after the Euro-Crisis’ (2013) 76 MLR 817, 823. In this piece, the authors are alluding to the Lisbon decision of Germany’s Federal Constitutional Court (n 25) paras 256, 259.
This is not to argue that such a point in national democratic development has already been reached, but important steps have indeed been taken in that direction, depending on the economic stature of a given Member State. As we have seen above, the EU economic governance regulation draws an important distinction between Member States with balanced economic figures and those which exhibit either fiscal or even broader macroeconomic imbalances. In the economically balanced states, the EU’s material inroads into national democratic processes will be more limited than in the economically imbalanced states. While both groups of Member States face EU legal restrictions on growth in domestic expenditure, which in principle cannot exceed potential growth in GDP, the imbalanced states must also cut their domestic expenditure to compensate for the identified budgetary imbalance. In addition, they must ‘ensure rapid convergence’ towards a balanced budget. This adjustment path is then subject to the annual assessment of the stability programme of each Member State which is, as reported by Chalmers, wide-ranging and onerous: ‘it assesses not simply their targets, the robustness of their planning, the direction of any reforms and crucially but the socio-economic context and the demands placed on them by this.’ It goes without saying that these rules translate directly into how taxes are being decreased or increased; they determine the scope of the governmental investment as well as the depth and breadth of the national welfare state. All of these are issues that national parliamentary elections should be decided on and decide about.

When combining this substantive pre-emption of national democracy in economic governance by the institutional regime, we can see that the position of national parliaments has been further weakened. Their fiscal competencies have, as described above, been substantively limited, and also put under a great time constraint due to the timing of EU semesters. After the EU institutions have spoken about the soundness of a proposed national budget, a national parliament is left with very little time and even less room for democratic political manoeuvre. The national parliament is thus again being turned into a rubber-stamping institution. Things get even worse for the national parliaments of those Member States under enhanced surveillance. The present EU legislation provides only for a limited information flow to them from the EU institutions involved in the surveillance and for so-called economic dialogue whereby representatives of the Commission may be invited by a national parliament to justify the specific measures to be adopted by that Member State.

Further, at the peak of the economic crisis in 2011, the Member States decided to coordinate on the EU level even those economic policies that had formally remained

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61 ibid.
62 ibid.
63 Dawson and de Witte (n 59) 834. The authors write, ‘The time constraints imposed by the European Semester make it all but impossible for national parliaments to control their own executives.’
64 See, eg, European Commission, 'The Two-Pack on Economic Governance' (n 49) 17.
outside of the scope of EU competencies. The Europe 2020 Strategy and the Euro Plus Pact\(^6\) have been decisive in that regard. They provide for so-called integrated guidelines, combining the broad economic policy guidelines and employment guidelines, covering the macroeconomic, microeconomic and employment policies, which are proposed by the Commission and adopted by the Council. They serve as the common objectives which ought to be achieved in a country-specific way by each Member State through the National Reform Programme. The national parliaments, social partners and civil society are specifically invited to participate in preparation of the Programme. However, this is more to create the impression of the ongoing national ownership of the structural reforms, while the latter are essentially being driven by the Commission, the Council and the European Council.\(^6\) What we are witnessing here is the significant inroads of EU institutions into the formally exclusive national economic competencies through the allegedly nationally ‘owned’ and controlled open method of coordination.\(^6\) This is an example of a further substantive pre-emption of national democracy without any formal transfer of competencies.

Finally, during the economic crisis, formal and informal institutional shifts, to be described in more depth below, have taken place in the EU and affected not only supranational but also national democracy. An important formal shift was the introduction of so-called reversed qualified majority voting in the Council,\(^6\) which means that an economic measure proposed by the Commission against a Member State in the EDP and/or EIP is deemed adopted unless blocked by a qualified majority of the Member States. This system, again, tips the balance in favour of the supranational institutions, which is all the more apparent, as pointed out by Dawson and de Witte, in smaller Member States which now face a much harder task of blocking legislation they oppose.\(^6\) This effect is exacerbated by the informal institutional shift taking place on the level of the Council whose steering and controlling role over the EU decision-making process has expanded substantially,\(^7\) even to the extent that the Council has increasingly assumed the role of a de facto legislative initiator.\(^7\) The combined effect of these institutional shifts is an appreciable strengthening of the executive branch in


\(^6\) ibid 3.

\(^6\) However, Joerges (n 31) 41 provides a more optimistic view arguing that the powers of national parliaments remain considerable as long as they retain their so-called ‘ownership’ of the national contributions to the Semester process. On the other hand, see Davor Jancic, ‘Countering the Debt Crisis: National Parliaments and EU Economic Governance’ (2014) LSE Law: Policy Briefing Papers 1/2014 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2482309> accessed 4 August 2015. Jancic argues that national parliaments are actually the beneficiaries of the euro crisis.

\(^6\) Art 238(3) TFEU.

\(^6\) Dawson and de Witte (n 59) 839.

\(^7\) ibid 832.

\(^7\) ibid 830; Curtin (n 18) 210.
the EU and, in particular, of the most powerful EU Member States with the greatest influence in the Council, at the expense of the national legislative branches as well as of the smaller and economically weaker Member States in general.\footnote{Dawson and de Witte (n 59) therefore speak about the dismantling of the substantive, institutional and spatial balance so crucial for the EU’s legitimate functioning and its overall viability.}

**4.2 The economic pre-emption of national democracy in an economic crisis**

In the course of the development of the European integration, but especially in the years following the outbreak of the economic crisis, national democracy has thus come under considerable strain in its substantive and institutional dimensions. The situation has been exacerbated when we add the economic dimension. To repeat the simple truth: in practice there can be no democracy conceived of as self-legislation by the people in the absence of the economic funds required for its exercise. The state can typically rely on three sources of revenue to fund its activities: fiscal resources, monetary resources and foreign loans. The process of European integration has affected all three of them. With the establishment of the single market a whole range of protectionist measures, including fiscal ones, was eliminated which initially led to a decline in national fiscal resources that was latter compensated for through the positive effects of economies of scale.\footnote{Frank Mattern and others, ‘The Future of the Euro: An Economic Perspective on the Eurozone Crisis’ (McKinsey Germany, January 2012) <http://www.mckinsey.de/sites/mck_files/files/The%20future%20of%20the%20euro_McKinsey%20report.pdf> accessed 4 August 2015.} The greater yield of the single market thus offset the loss or the capping of many national fiscal measures. This positive economic effect was further increased, although unevenly among the Member States,\footnote{Art 3(1)(c) TFEU.} by establishment of the single currency, although this move meant that the euro Member States relinquished their monetary competencies and turned them into an exclusive EU competence under the control of the ECB.\footnote{It has been estimated that the single market has contributed 2–3 per cent to the growth of the EU GDP: see, eg, Bas Straathof and others, ‘The Internal Market and the Dutch Economy’ (2008) 168 CPB Netherlands Bureau for Economic Policy Analysis 1, 9 <http://www.cpb.nl/sites/default/files/publicaties/download/internal-market-and-dutch-economy-implications-trade-and-economic-growth.pdf> accessed 17 September 2015.} These positive economic effects lasted as long as the economic trend also remained positive. As this suffered from a downward turn, the Member States found themselves in an uneasy fiscal situation which could no longer be rescued by the traditional resort to the national monetary instruments of currency devaluation intended to pump the necessary money into the domestic economic system and simultaneously improve, albeit artificially, its level of competitiveness in the world economy. The only way out was to raise loans in the global financial markets. However, this option was foreclosed immediately when the markets, also under the impression of the global economic crisis, sensed the high risk associated with the troubled countries’ national bonds and claimed yields on them that were economically unsustainable.
At the peak of the crisis, the Member States thus found themselves in a triple economic deadlock. Their budgets were deeply in the red, of course in violation of EU law; the monetary competencies to alleviate the situation had gone; and access to the global financial markets was effectively closed. The only way out of the economic collapse was to turn to the EU—but the EU, too, as explained above, was completely unprepared. Unlike in a federal state, the EU was legally and practically prevented from assisting its Member States in need in either monetary or fiscal terms. With regard to the former, the EU founding treaties contain a no-bail-out clause and the ECB’s power to print money is limited, whereas in fiscal terms the EU budget, as noted by Scharpf, ‘is miniscule in comparison to the budget of federal states’, largely because ‘there are no European taxes and there is no European social policy to alleviate interregional imbalances’. As a result, the economic crisis has threatened to create a domino effect, spilling over from one country to another, to eventually engulf the EU as a whole. Ultimately this would lead to the complete economic pre-emption of democracy not only on the national, but also on the supranational level. To prevent this, the Member States and the EU have struggled to regain access to the global financial markets. But, in so doing, they have run into external constraints posed by a specific set of transnational actors: CRAs.

5 The pre-emption of supranational democracy

Having described the pre-emption of democracy on the national level, which has occurred in the process of European integration and in particular under the impact of the economic crisis, it is important to note that these democracy pre-emption effects have not been limited to the Member States, but extend to the EU at a supranational level, too. Here, one cannot speak of a substantive pre-emption of democracy, as the material scope of EU competencies has been increasing rather than decreasing. Similarly, in institutional terms on the supranational level the trend has been one of democracy-enabling, rather than one of pre-emption. In order to escape the charge of a democratic deficit, the EU has been doing its best to mimic as far as possible the institutional structure of national democracies. This has translated directly into constant improvement of the European Parliament’s position in the EU institutional constellation, so that it has eventually become an equal co-legislator. The chain of democratic legitimation from EU citizens to the European Parliament has thus been formally established and made operational, even though it is widely believed that this link has not been appropriately internalised.

76 Art 125 TFEU.
77 The ECB has, however, been losing these bounds, especially recently with the so-called quantitative easing programme.
78 Scharpf (n 17) 34.
by the EU constituency. In this respect, at least formally, the institutional dimension of EU democracy serves well the requirements of input and representative democracy as described at the beginning of this chapter. Nevertheless, as already intimated above, the EU response to the economic crisis has brought about certain institutional changes that are reversing this established trend.

First of all, several of the crisis mechanisms had to be concluded under international law so they are intergovernmental rather than supranational in nature. This per se brings them beyond the scope of competencies of the European Parliament, which is thus excluded from their shaping and control. Moreover, even those legislative mechanisms in six-pack and two-pack forms that have been adopted by the European Parliament only provide for a duty of notification and economic dialogue of the European Commission and the Council with the European Parliament. As observed by Dawson and de Witte, with the escape to international law, the core legislative institutional triangle between the Commission, the Council and the European Parliament has been seriously weakened, and the institutional balance has been shifting to the most influential capitals of Europe, as represented in the European Council. In institutional terms, the most important decisions regarding the crisis and post-crisis management are therefore not adopted by democratically representative institutions, but by an intergovernmental forum that many argue leans in favour of the biggest and economically more powerful Member States. These institutional changes clearly detract from the ideal of a supranational democracy: they lend support to the claims of the existence of a democratic deficit and, if nothing else, fuel the impression of the pre-emption of supranational democracy.

However, the most significant impact of the democratic crisis in the EU has been in the latter’s economic dimension. For the first time, the EU, or at least the Eurozone, has found itself in an economic situation beyond its control, whereby the availability of funds needed for the functioning of both the EU and national democracies hinges on the global financial markets’ willingness to make loans available under still acceptable or at least economically sustainable financing conditions. What is also new, perhaps even unprecedented, is the fact that in determining the lending conditions the global financial markets have, rather than relying on the actions or assurances of the Member States or even the EU as a whole, followed the sovereign bond ratings of the CRAs. In this way, these agencies have started to act as gatekeepers of the global financial markets, determining the economic and therefore, at least indirectly, also the democratic fate of the EU as a whole. This confronts us with an interesting case study of the influence of transnational actors such as CRAs on democracy in the EU.

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80 This is also confirmed by a declining interest in the EU citizens’ initiative: while 49 such initiatives have been launched, only two have been completed. Even these two have lacked meaningful follow-up by the European Commission. See Honor Mahoney, ‘EU Democracy Tool Hanging in the Balance’ EUObserver (26 February 2015) <https://euobserver.com/political/127808> accessed 15 September 2015.

81 Dawson and de Witte (n 59) 828 ff.
6 CRAs and the economic pre-emption of democracy in the EU

CRAs form part of the international financial architecture and profoundly influence the ordering of global financial markets. CRAs are typical actors of transnational law. They belong to the field of private administrative transnational law, and consist of: (1) administrative rules adopted by (2) private transnational actors, which (3) bind or regulate through acceptance (4) the collective practices of numerous entities in designated sectors without their prior assent to these rules.

The designated sector at hand is a global market in sovereign bonds, such as debt securities issued by states to raise money in global financial markets. The three biggest world CRAs—Moody’s, Standard & Poor’s and Fitch—jointly control around 70 per cent of the overall market, and as much as 90 per cent of the sovereign bond market, and are all private companies established in New York with many branches worldwide. Despite national legal anchoring, they are transnational actors because their activities stretch far beyond the USA; they perform services for a majority of states, and make their products available to the global financial markets. The latter adapt their actions subject to the ratings issued by CRAs. They do so voluntarily, in pursuit of the greater efficiency generated by CRAs, which arguably help reduce the asymmetry of information traditionally existing in the markets.

The products of CRAs in the sovereign bonds market are ratings which assess the credit capacity of a state. These ratings do not have a legal character, and are therefore not binding with the force of positive law. Their formal authority stems from the CRAs’ expertise, while their practical authority derives from the fact that the produced ratings are followed in practice by the relevant markets. The states which order and pay for their ratings cannot influence the criteria under which they are developed. They are therefore set unilaterally by the CRAs and are not based on a contract or any other instrument requiring the consent between the CRA and the country ranked. This endows the CRAs’ ratings with elements of vertical hierarchy and authority and hence makes them administrative in their character.

The ratings are thus private administrative norms which, following the criteria chosen by the CRAs, establish the state’s credit capacity which is then followed by the

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82 Aline Darbellay, Regulating Credit Rating Agencies (Edward Elgar 2013) 5.
83 ibid 6.
84 This ranking is determined according to the percentage of customers served by the CRA with respect to the overall market, in which the leaders have the following market shares: Moody’s: 35.8 per cent; Standard & Poor’s: 20.25 per cent; and Fitch: 16.05 per cent (figures 2012). See Gianluca Mattarocci, The Independence of Credit Rating Agencies (Elsevier 2014) 40.
86 The main contemporary uses of CRAs have been described as: financial information, regulatory tools, contracting tools and monitoring tools. See Darbellay (n 82) 37–41.
87 ibid 38.
global markets in determining the interest rates to be paid on the national bonds. The CRAs’ rating has important direct public and private economic consequences. If the required interest rates are low, loans are more readily available and the state does not find it hard to finance its needs even in the absence of its own funds. In contrast, if the interest rates are (too) high, the state’s access to the global markets becomes limited or even closed, which can (potentially) place huge constraints on the provision of public services. However, the worsening of a sovereign bond rating also negatively affects the private sector due to the so-called sovereign ceiling effect. Private entities normally cannot be ranked higher than the state in which they are established.89 If a state is downgraded, the ratings of private companies incorporated within them also decrease. Money then also becomes more expensive for those companies, which all translates into a worse overall business environment. In short, the CRAs’ ratings directly affect the economic conditions of the public and private sector in a given state and as such—since modern democracies are fund-dependent—have an important impact on democratic life in that state.

For example, in the above described situation of an internal economic pre-emption of national democracies in the conditions of exclusive EU monetary competencies with the concurrent absence of EU fiscal competencies, several EU Member States found themselves on the brink of bankruptcy due to the prohibitive bond yields resulting from the CRAs’ ratings. For the first time, the CRAs’ systemic importance in global financial markets had become apparent and the systemic risk for sovereign states and the global economy as a whole that CRAs’ ratings can (potentially) bring about had also become obvious. This spurred several critical reactions.

The CRAs were attacked for their lack of transparency and accountability in the production of ratings.90 The arguments that a degree of secrecy and distance from the rated state are necessary to shield the independence and expertise of the CRAs91 were objected to as falling short of rule-of-law standards. In particular, this is because the rated state (or other entity) basically lacks any means to have its voice heard or to challenge the rating in an appropriate forum. Moreover, the impartiality of the CRAs

para 8, which makes it explicit:

Credit ratings, unlike investment research, are not mere opinions about a value of a price for a financial instrument or a financial obligation. Credit rating agencies are not mere financial analysts or investment advisors. Credit ratings have regulatory value for regulated investors, such as credit institutions, insurance companies and other institutional investors. Although the incentives to rely excessively on credit ratings are being reduced, credit ratings still drive investment choices, in particular because of information asymmetries and for efficiency purposes.


91 ibid.
was contested too.92 Concerns were raised about potential conflicts of interest due to the issuer-pays model93 and preferential treatment of the economies of big and strong states over those of smaller and weaker ones.94

This perception has been reinforced by the fact that the three biggest CRAs are all based in the United States. In addition to their American leaning, the CRAs have also been criticised for keeping an oligopoly in the market,95 which contributes to the homogenisation of information.96 This has further accentuated the systemic risk, in particular when combined with the pro-cyclical effect of the CRAs' actions.97 Especially in times of crisis, the CRAs have often been slow to react.98 They have tended to downgrade a state only when a crisis was already in full swing, but in so doing have intensified the affected state's worsening economic conditions.99 As the EU found itself in this situation, it had to react to the CRA challenge as part of its anti-crisis mechanism. Its strategy has been two-fold: to strengthen the EU regulatory control over CRAs and simultaneously to undermine the latter's importance. In an attempt to increase its regulatory sway over CRAs, in 2009 the EU adopted a new regulation,100 which has since been amended twice.101 It has attempted to address the shortcomings of CRAs identified above: the lack of transparency and accountability, the potential conflicts of interest, the unreliability of ratings, and rule-of-law concerns.102 These objectives were to be achieved through territorialisation. Any CRA that wishes to operate in Europe must register with the European Securities and Market Agency (ESMA). To do so, it must meet a number

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93 See, eg, European Parliament Resolution 2010/2302(INI) on credit rating agencies: future perspectives (23 March 2011).
95 Olaf Cramme, ‘The EU’s War against Credit Rating Agencies is Symptomatic of a New Struggle between Politics and the Market, but it also Lays Bare Growing Tensions in the European Project and Globalisation as a Whole’ (LSE Blogs, 19 July 2011) <http://eprints.lse.ac.uk/37969/1/blogs_lse_ac_uk-The_EUs_war_against_credit_rating_agencies_is_symptomatic_of_a_new_struggle_between_politics_and_the_.pdf> accessed 4 August 2015.
96 Darbellay (n 82) 179 ff.
97 ibid 186.
99 Darbellay (n 82) 188.
of demanding material conditions, which are continuously observed by ESMA. The latter is allowed to impose fines or even to withdraw a registration if a CRA fails to satisfy these conditions. The new legal regulation also provides for a European civil liability regime, enabling the aggrieved parties (investors or issuers) to claim damages from CRAs in case of their malpractice. By tying CRAs back to the EU territory and prescribing detailed material standards for their functioning, the EU is striving to regain regulatory control over their activities at home as well as to spread its normative regulatory influence beyond its confines to the realm of transnational law.

On the other hand, the strategy of undermining the importance of CRAs consists of two main elements: deregulation and pluralisation. De-regulation involves reducing the regulatory reliance, both national and supranational, on the CRAs’ ratings. The EU, as well as the United States, are thus trying to roll back a long present trend in which they have co-opted CRAs for their specific expertise and outsourced certain regulatory functions to them, essentially endowing them with the influence they presently have. The regulatory over-reliance ought to be redressed by removing the references to CRA ratings from EU and national law by 2020 and by encouraging practices via ECB and national central banks that will dissuade market actors from mechanistic reliance on CRA ratings. Further, the CRAs are also explicitly prohibited from equipping their sovereign bond ratings with any direct or explicit policy recommendations on policies of sovereign entities. However, the efforts of diminishing the influence of CRAs have not been very successful so far, especially in the absence of a meaningful alternative source of credit ratings.

With regard to the intended pluralisation, this has combined the objectives of Europeanisation and antitrust measures. The political heads of Europe, as well as the EU legislature, have called for the establishment of a European public CRA. Alternatively, it was also suggested that public credit ratings could be issued by the ECB, which has rejected the idea, or that the Commission’s reports on the Member

103 ibid 7. Here, the quality of credit ratings and rating methodologies, the independence of the credit rating process, the disclosure of credit ratings and methodologies, and the corporate governance and organisational arrangements are crucial.
104 Art 36 CRA III Regulation.
105 European Parliament (n 95) 7.
106 Art 35 CRA III Regulation.
107 The US Dodd-Frank Act of 2010 is reported to have removed all regulatory references to ratings: Darbellay (n 82) 9.
108 Darbellay (n 82) 47: ‘Credit ratings are generally used by regulators for two main purposes: determining risk sensitive capital requirements and defining investment restrictions.’
109 Para 6 CRA III Regulation.
110 Para 45 CRA III Regulation.
111 European Parliament, ‘Credit Rating Agencies’ (n 102) 10.
113 Preamble, para 43 CRA III Regulation.
114 See Nikki Tait, ‘ECB Cool on Plan for Credit Rating Agency’ Financial Times (24 February 2011) <http://www.ft.com/cms/s/0/3fia993a-3f6c-11e0-a1ba-00144feabdc0.html#axzz3TWA3C8rM> accessed 4 August 2015.
States’ economic situation should be complemented by an assessment of their creditworthiness. All of these proposals intend to decrease the influence of American CRAs and, simultaneously, by bringing in new regional CRAs, to gradually contribute to a reduction of the presently existing oligopoly. The same objective is pursued by the requirements to rotate CRAs when rating a specific entity and the involvement of smaller CRAs whose market share does not exceed 10 per cent. Smaller CRAs were even considered by the Commission to be financially supported and integrated in a more formal network. However, the Commission’s recent follow up report casts significant doubts on the feasibility of such a plan, especially since it has failed to win the support of smaller CRAs themselves.

7 Assessment from the perspective of legal pluralism

Having presented the state of national and supranational democracy in the EU and its degree of pre-emption in the substantive, institutional and economic dimensions due to the internal and external constraints under which the EU operates, what can be said about it from the perspective of legal pluralism and what, if any, normative prescription can the latter prescribe for it? In answering this question, account shall be taken of an important difference between the internal and the external constraints on the democracy in the EU. The internal constraints, which derive from the EU’s own constitutional structure, can still be controlled and even removed by the EU and its Member States, whereas the external constraints cannot be. The latter therefore pose a more formidable, practical and theoretical challenge. Most of the discussion that follows will therefore be dedicated to addressing the external constraints on EU democracy under transnational law. Nevertheless, a few words should be said about the internal constraints too.

Internal constraints have already been subject to an extensive debate within the EU democratic deficit literature. This has also featured the pluralist attempts of remedying the EU democratic deficit. One such alternative has been the constitutional form of a union that comes along with some normative prescriptions for reducing the national and supranational pre-emption of democracy. It requires the EU to walk a fine line between the two opposites: supranational centralisation and national devolution. With regard to the former, it is necessary to acknowledge that the economic objectives have traditionally entailed a transfer of competencies from the national to the supranational level in the

115 Para 40 CRA III Regulation.
116 Para 50 CRA III Regulation.
118 See, eg, Andreas Follesdal and Simon Hix, ‘Why There is a Democratic Deficit in the EU: A Response to Majone and Moravcsik’ (2006) 44 J Common Market Studies 533.
EU. This effect increases in times of crisis. The ECB quantitative easing programme\(^\text{119}\) is a paradigmatic example, an attempt to quell the crisis by additional centralisation of powers that might not have even been envisaged in the EU founding Treaties. This centralisation, admittedly, eases the economic situation in the most affected countries. By providing a fresh flow of supranational money it decreases the national dependence on the external transnational actors, and in so doing it improves at least the economic state of national and EU democracy. But this improvement is only ostensible.

Quantitative easing is already a form, admittedly a very rudimentary one, of a transfer union: from the rich north to the less prosperous south, which requires not only a democratic back-up, but also strong inter-state solidarity. As neither is present in the EU, the push towards a transfer union automatically generates the opposite reaction of a devolution. Rather than internalising the externalities of the economically poorly performing Member States, those Member States which are faring better economically push for a repatriation of competences from the supranational to the national level.\(^\text{120}\)

In this case, economic centralism is replaced by national isolationism. Both are, obviously, normatively monistic solutions, not concerned with the preservation of the pluralist balance between the national and supranational level. The national isolationism is, moreover, clearly economically unfeasible in the context of the globalised economy. Additionally, neither of them is appealing from a democratic perspective. Centralising solutions result in the further substantive and institutional erosion of national democracy, whereas the national devolutionary demands inevitably detract from the substantive and institutional supranational democracy. A fine-tuned balance between the national and supranational democratic dimension is therefore necessary. By preserving the ethos of a common pluralist whole, some more flexible institutional and even constitutional solutions that would give a better expression to the diversity of the national and supranational expectations, needs and requirements, and which would therefore also better address the internal constraints on EU democracy, could be attempted.\(^\text{121}\)

Having briefly touched upon the internal constraints, let us now look in some more detail at the external ones. Here, we focus on the relationship between the EU and CRAs as transnational actors. Can this relationship be expounded in a legally pluralist way and, if not, what needs to be changed? I want to promote legal pluralism conceived of as a principled legal framework. This requires the presence of several elements: (1) the factual existence of a legal plurality; (2) recognition and continuous commitment to its preservation; (3) a dialectic open-self entailing a reflexive attitude in and among the entities forming up a plurality; and (4) finally a commitment to the common pluralist whole.


\(^\text{120}\) The United Kingdom is the most vocal proponent of this development.

\(^\text{121}\) Matej Avbelj, 'Differentiated Integration—Farewell to the EU-27?' (2013) 14 German LJ 191.
The presence of the first element is established. There is the EU with its own pluralist legal order, and CRAs’ private transnational legal entities as a source of private transnational administrative law. These two legal entities recognise their individual and separate legal existence as a matter of fact. However, it is far more questionable whether they are committed to preserving this plurality. This shadow of doubt pertains, in particular, to the EU. As CRAs have neither a normative ambition nor a practical capacity to subsume the EU legal order under themselves, we have few reasons to assume that they are not committed to preserving the EU legal order’s continuous independent and autonomous existence. As we have seen, the same is not true of the EU. Its legislature has explicitly recognised that ‘for the time being credit rating agencies are [still] important participants in the financial markets,’ but this ought to be changed. As we have seen, it has been part of the EU’s deliberate strategy to undermine the importance of CRAs; to intervene in their sphere by establishing its own public CRA or to bolster the existing smaller private CRAs; to tie CRAs to its territory and render them subject to its own regulatory regime. This is anything but a commitment to the CRAs’ continuous meaningful independent existence. Instead, it exhibits a monist attitude, which however in the absence of a dialectic open-self is detectable on both sides.

Indeed, there are basically no data demonstrating that CRAs in any way take into account the consequences, direct or indirect, of their sovereign bond ratings for the rated entities beyond the immediate increase or decrease of the yields on the bonds under review. Even though, as has been illustratively argued, downgrading a state can be compared with ‘dropping a bomb’ on a country, the CRAs fail to account for the (in)direct implications of their economic ratings on, for example, democracy in a rated entity. The EU, as we have seen, has reacted to this by upgrading and adjusting its economic structure to the challenges posed by the CRAs, but this has undermined its democracy, perhaps unintentionally, even further. The EU’s response has also been less dialectically self-reflexive as anticipated by pluralism. Rather than investing more in reforms of its own constitutional structure, which has provided fertile grounds for an external pre-emption of democracy by CRAs, it has turned its critical edge against the CRAs, attempting to limit them in what they can or cannot do with their ratings. Finally, in the absence of a commitment to plurality, lacking a dialectic open-self, it is also very hard to expect the development of the commitment to the common whole—that is, of the awareness that the actions of CRAs and the EU are mutually interdependent, and that they cannot be treated in isolation as they affect each other as well as cause externalities beyond their own immediate realms.

122 Recital 8 Regulation 462/2013.
123 Frank Partnoy, ‘The Siskel and Ebert of Financial Markets?: Two Thumbs Down for the Credit Rating Agencies’ (1999) 77 Wash UL Quarterly 619, 620, quoted in Darbellay (n 82) 153: ‘[T]here are two superpowers in the world today in my opinion. There’s the United States and there’s Moody’s Bond Rating Service. The United States can destroy you by dropping bombs, and Moody’s can destroy you by downgrading your bonds. And believe me, it is not clear sometimes who’s more powerful.’
This brief review demonstrates that the relationship between the EU and CRAs as transnational legal actors has so far not been carried out in legally pluralist terms and that neither the proposed nor implemented EU reforms point in that direction. Simultaneously, these rather monistic reforms in which the EU strives to undermine CRAs, bring them back under its territorial regulatory regime and stretch its regulatory umbrella over the realm of transnational law, have so far not worked and are unlikely to do so in the future. The CRAs have simply overgrown not just the national regulatory capacity, but also that of the EU. The global financial markets’ habit of obedience to CRAs vindicates their administrative legal character, irrespective of the EU’s attempts to limit or undercut them. The monistic aspirations of EU institutions to bring CRAs under their control are therefore doomed to fail. A different approach is therefore called for—not only on the side of the EU, but also on behalf of the CRAs. They must be reminded that great power comes with great responsibility. As their products are not mere opinions or investment research results, but have a regulatory value, the CRAs need to ensure that they meet the procedural and substantive rule-of-law standards and they, similarly, need to be aware of and mitigate the consequences of their ratings beyond the immediate economic ones. This is essentially what legal pluralism as a principled framework requires.

8 Conclusion

In conclusion, the argument is that had the EU and the CRAs conducted their relationship pursuant to the normative guidance of legal pluralism as a principled legal framework, the circumstances of the economic crisis, its outcome and the consequences for democracy in the EU and its Member States, described above, would have been less grave. For the future, it is thus necessary for the CRAs and the EU to develop an epistemic awareness about the common whole they form, the commitment to which will gradually grow. In their actions, they have to develop a reflexive self-openness that, on the side of CRAs, will require a reform of the key elements of the rating process along the lines of the rule of law and greater accountability, whereas the EU should simultaneously work on its internal democratic constitutional structure and engage externally with the CRAs on cooperative rather than dominating terms. This reflexive self-openness should, however, not remain exclusively on the level of aspiration or normative orientation, but should gradually adopt a more concrete institutional form. The key role in the EU should be played by the ESMA, with which the CRAs could engage either individually or through a common representative.

124 Para 8 CRA III Regulation.