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Avoiding monocultures in the European Union: the case for the mutual recognition of difference in conditions of uncertainty

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Avoiding monocultures in the European Union: the case for the mutual recognition of difference in conditions of uncertainty

Richard Bronk* & Wade Jacoby**

Abstract

The European Union is a unique blend of harmonised practice and mutual recognition of different regimes. In this paper, we conclude that arguments for continued diversity are more significant than the existing literature recognises. We build on the Varieties of Capitalism argument for trading on (rather than effacing) comparative institutional advantages, as well as Sabel and Zeitlin's for the learning potential of 'directly deliberative polyarchy'. We link these to the emphasis in non-EU focused literature on the lack of robustness implied by one-size fits all. Diversification of gene pool, model or policy regime is essential insurance against unforeseen threats. We also focus on dangers of epistemic closure implied by analytical monocultures in conditions of uncertainty, and on epistemological justifications for disciplined eclecticism in regulation and analysis. The relevance to banking and fiscal union and other policy areas is briefly considered, as are the dangers posed by an emerging German Consensus.

Keywords: mutual recognition, policy diversity, analytical monocultures, German Consensus, uncertainty

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Avoiding monocultures in the European Union: the case for the mutual recognition of difference in conditions of uncertainty

1. Introduction

The history of the European Union has been marked by a fiercely contested trade-off between two fundamental approaches: the search for the best common framework on which countries can converge and the search for the best *modus vivendi* between different regimes. The EU has evolved as a delicate balance between supra-nationalism and intergovernmentalism and between harmonisation of regulations or policies and the mutual recognition of different regimes. Many of the arguments for being on one-side of this trade-off or another are well rehearsed. The need to avoid negative externalities of individual country behaviour, resolve coordination problems, achieve economies of scale and reduce transaction costs points in the direction of supra-nationalism and harmonisation. By contrast, the need to respect the different goals, values, comparative *institutional* advantages and functional requirements of member states – as well as the superior democratic legitimacy of their polities – points in the direction of intergovernmentalism and the mutual recognition of difference.

This paper examines whether the preferred balance between these two broad approaches to EU policy making should also be a function of two further factors that are much less often considered: first, we apply to the case of the EU general arguments advanced by Evans (2004) against 'institutional monocropping' and Rodrik (2009) against 'one size fits all' policies, and show that diversification of policy response in conditions of uncertainty is often essential if the EU as a whole is to be robust in the face of shocks. In a nutshell, we argue that in a world of uncertainty we cannot know what the best model or best practice is or will be, and that this raises the insurance value of diversity of theoretical framework and practical regulation. For this reason alone, we argue that there is more merit in diversification of policy and market response to shocks across the Union, and in low correlations in behaviour, than the normal focus on the costs of poor policy coordination would suggest.

Secondly, we build on the work of Sabel and Zeitlin (2010) and specifically their claim that at present many aspects of EU governance exhibit qualities of 'directly deliberative polyarchy' – qualities that provide the Union with unrivalled potential for learning from diversity and for innovative policy adaptation in the face of strategic uncertainty. Such uncertainty is indeed ubiquitous – thanks in particular to policy innovations. But, while we agree with Sabel and Zeitlin (2010, p.9) that this makes the deliberative polyarchy enabled by a multipolar distribution of power attractive, we are less sanguine than they are about its continued persistence in many areas of EU and Eurozone policy making. For this reason, we examine the very real dangers of epistemic closure leading to myopia about emerging risks whenever we instead get harmonised practice and univocal deliberation and this hardens into an analytical monoculture.

To this end, the paper applies the insights of Romantic and postmodern philosophy into the framing (and distorting) role of theory and language in order to construct a new argument for disciplined eclecticism (or deliberative polyarchy) in EU policy and analysis. We argue that the EU should not see its current patchwork of partial harmonisation, subsidiarity and mutual recognition of difference as (at best) a politically necessary weakness but rather trumpet it as an epistemic source of strength. In particular, we argue that the Eurozone should not even be aiming for a full banking and fiscal union if this is taken to imply (which it need not) a full harmonisation of regulation, policy approach and analysis rather than a carefully coordinated *modus vivendi* between still different regimes. We also argue that the recent upsetting of the balance of power and influence in the EU and the emergence of a 'German Consensus'[1] backed by the strong conditionality of crisis bailout funds risks entrenching a univocal policy and regulatory response. As a result, we argue that the EU and Eurozone should strive to preserve multipolar decision-making, and to find third-way responses that can answer legitimate German concerns about free riding, reform fatigue and coordination problems while avoiding the epistemic and practical risks of a fully harmonised or monoculture approach.

In its present form, this working paper consists principally of a high level abstract argument, whose general implications are considered in relation to three facets of the modern EU – the Single Market, Economic and Monetary Union, and the Open Method of Coordination. We do also consider in outline the likely practical relevance of our thesis to two topical issues – fiscal union and banking union within the Eurozone. The paper should nevertheless be seen as work in progress. Much work remains to be done to consider its merits at the level of detailed EU policy generation and implementation.

[1] 'The term 'German Consensus' is used here by analogy with the 'Washington Consensus' associated with the World Bank and IMF in the 1990s. The intention is not to suggest a complete consensus on fiscal and regulatory matters *within* Germany any more than there was such a consensus within the World Bank and Washington establishment. Rather, the intention is to suggest an analogous imposition on weak recipient states of a hegemonic 'world view' backed by the use of strong conditionality'.

2. Theoretical frames

2.1. The current state of debate on the balance of advantage between harmonisation and diversity

There is no need to rehearse at any length the standard arguments for top-down coordination (the Community Method) and harmonisation of policy and regulation across the shared trading, economic, social, and currency space of the EU or Eurozone. Supranational coordination and regulatory or policy harmonisation are usually seen as superior to intergovernmentalism and the mutual recognition or toleration of difference in at least six respects: (i) in solving basic coordination and collective action problems; (ii) in limiting the negative spill-overs of individual country initiatives; (iii) in preventing some countries free-riding on the stability or growth enhancing efforts of others; (iv) in avoiding a race to the bottom in regulations; (v) in lowering the transaction costs implicit in doing business in multiple regulatory regimes; and (vi) in boosting economies of scale across the Union. Useful reviews of this literature can be found in Levi-Faur (2011) and Dehouse (1997).

Many of the contrary arguments in favour of safeguarding both national diversity in regulation and the primacy of nation states in collective decision-making (intergovernmentalism) are equally well-rehearsed: the need to respect different stages of development and different preferences among member states; and the greater democratic legitimacy and efficacy of nationally based decision-making and regulation (Nicoläidis and Shaffer, 2005). Perhaps the most sophisticated economic argument for diversity comes from the Varieties-of-Capitalism thesis that different countries evolve specialisations in line with their own distinct comparative *institutional* advantages (Hall and Soskice, 2000). By extending Ricardo's argument to cover institutions, the clear implication is that a trading bloc is stronger for having members with different institutional strengths and different specialisations. Indeed, this thesis implies that there is no single efficient regulatory and institutional model on which all countries can converge without loss (Hodson and Simoni, 2009). It is central to the Varieties of Capitalism approach that there are different ways of being efficient given different institutional legacies and specialisations (just as surely as there are different equally rational value trade-offs between efficiency and equity). It is also central that a country's institutional mix is often a delicate bundle of self-reinforcing, mutually complementary and interdependent institutions (Hall & Soskice, 2000). This means that any attempt (e.g., at EU level) to harmonise around some new hybrid compromise or 'common' set of regulations may fatally weaken the existing strengths of each *ex ante* national model by introducing institutional inconsistency that may cause the respective model to unravel (Bronk, 2000). The institutional differences and corresponding specialisations on which each country's competitiveness depends can all too easily be effaced by clumsy harmonisation and by attempts to cherry-pick the 'best' features of all the various models.

2.2. Diversity for robustness: avoiding the dangers of monocropping in conditions of uncertainty

The argument in this paper, however, partly centres on a different problem: that even if all countries could agree on a 'one-size fits all approach' in any particular policy area, without any country suffering obvious immediate damage or institutional inconsistency or loss of competitiveness, they might still 'end up converging on the wrong set of regulations', the wrong solutions (Rodrik, 2009). Indeed, the discourse of best practice and of creating a level playing field is always in danger of leading to 'institutional monocropping' that – exactly like a monoculture in agriculture where every farmer uses the apparently 'best' or most productive strain – is highly susceptible to unforeseen diseases (Evans, 2004; Haldane, 2009; Bronk, 2011a). This is an argument that centres on the limits of rational planning and law-making in conditions of uncertainty, and on the benefits – well articulated in investment theory – of diversification and low correlations in the face of unforeseen shocks. As Rodrik (2011, p.224) puts it in a discussion of global capital adequacy standards: 'In the light of the great uncertainty about the merits of different regulatory approaches, it may be better to let a variety of regulatory models flourish side by side'.

To understand the importance of this argument, it is necessary to examine, first, the prevalence of intractable or radical uncertainty especially in innovative regimes; and, secondly, why relying on any one regulatory model or conceptual framework may be fatal to our ability to make open-minded assessments of our evolving predicament. Only then can we understand why revision of what is considered best practice is unlikely to be sufficiently radical to inoculate policymakers against the dangers of analytical and regulatory monocultures.

It is well understood in economics (since Knight, 1921) that there is a fundamental difference between measurable risks that can be assigned probabilities (or otherwise controlled for) and immeasurable uncertainty. Less well acknowledged is how prevalent the latter type of uncertainty is, and how unavoidable in complex and innovative regimes. Uncertainty comes in two main forms. The first is 'epistemological uncertainty', where firm prediction or definitive analysis is precluded by the multi-faceted nature of our predicament, the presence of increasing returns and non-linear reactions to small events, and by the sheer volume of relevant information (Bronk, 2011b). Even more intractable is the 'ontological uncertainty' or indeterminacy implied by innovation and the freedom to choose between newly imagined and constantly surprising options. Furthermore, first-order uncertainty caused by constant innovation and the imagining of new possibilities is normally 'compounded by uncertainty about the second-order creative reactions of others' (Bronk, 2011a).

Where it is present, the implications of uncertainty for policy-makers are very significant: it implies that we can never know what best practice is, especially as it relates to the future yet to be created by constant innovation. As a result, uncertainty further implies that, all things being equal, it is better to have a diversified set of practices or regulations in play, since they will not all suffer from the same errors at once. Of course, there are strict limits to the extent to which any one polity can keep its regulatory options open without suffering from hopeless confusion and inconsistency; but at the level of a Union of polities like the EU, the argument from uncertainty suggests the possible benefits of having different constituent polities operating under different regulatory regimes side by side. That is, the common good of the Union as a whole may be better protected by diversification at a national level amongst what are *ex ante* (given uncertainty) equally error-prone regulatory models, and by efforts to establish a *modus vivendi* between such models, rather than by efforts to harmonise to one apparently 'best' standard.

This epistemic argument for the value of diversity in the face of uncertainty is distinct from the democratic legitimacy and institutional reasons also discussed by Rodrik (2009) and Evans (2004). In other words, it is distinct from (if complementary to) the argument that pluralism allows for greater sensitivity to national preferences, while homogeneity of practice enforced by supranational actors risks causing political and institutional infantilism at national or regional level.

Our version of the monocropping argument is also distinct from the Varieties of Capitalism thesis that there is a necessary plurality of ways of being efficient given different path-dependent institutional and specialisation configurations. We argue that taking uncertainty seriously casts doubt on the importance of any static definition of economic efficiency. In conditions of ontological uncertainty, where the Union will inevitably face unexpected common shocks, it may be beneficial for the long run democratic and economic stability of the Union as a whole to have the insurance policy of some member countries operating at any particular moment inside the short-term efficient frontier, if they are doing so as a result of an institutional configuration with very different properties to those of other member states.

Of course, it is possible to overstate the prevalence of uncertainty in some fields and to ignore the possibility of learning from experience which regulatory regime stands up best to unexpected shocks. But especially in those areas where innovation (not least in regulatory and policy regimes themselves) constantly changes the parameters of life, uncertainty should not be underestimated. For example, little that even five years ago passed for received wisdom in the area of monetary or fiscal policy or banking regulation in the EU has stood the test of time given the enormity of the unfolding regime change implied by the novel experiment of Economic and Monetary Union. Moreover, we should not underestimate how far our ability to spot problems as they emerge, and then revise the regulatory frameworks we use, is compromised by the tendency for our analysis to be framed by the cognitive internalisation of those same frameworks. This brings us to the problem of epistemic closure if harmonised practice hardens, as we suggest it often does, into an analytical monoculture.

2.3. From monocropping to monoculture: analytical frames and the epistemological argument for diversity

The 'monocropping' analogy used by Evans (2004, p.34) brings out the important argument for the greater robustness and adaptive value of diverse ecologies in the face of change. In this paper, though, we switch from using this monocropping analogy to its close cousin, the 'monoculture' analogy. We do so, in part, because the latter has epistemic and cultural framing connotations missing from the former. Our contention is that the tendency for any single or homogenous policy approach to constrain the way we *think* about issues, construct data and analyse problems is every bit as important as its direct constraint on action.

Here a reminder of some basic Romantic (post-Kantian) or postmodern epistemological arguments is in order.[2] In particular, naïve empiricism that sees data and facts as simply 'out there', able objectively to inform, constrain and constantly update our choice of theoretical frameworks, fails to take account of the extent to which our analysis and beliefs – indeed the data themselves – are necessarily partial products of the conceptual and theoretical structures that our minds supply (Bronk, 2009; Bronk, 2011b). We cannot make sense of the chaos around us without the light shone by theory, model or conceptual structure; but since any one theory, model or conceptual framework has its weaknesses as well as strengths, it necessarily distorts as well as focuses our vision (Bronk, 2011a). This means that if we rely at any one time exclusively on one (apparently 'best') theoretical or conceptual framework, we are liable (at least initially) to miss aspects of reality outside the area illuminated by that framework – only registering them (if at all) when they have already unexpectedly tripped us up (Bronk, 2010). The

[2] This paper builds on a philosophical tradition that is described in some detail in chapters five and ten of Bronk (2009)

epistemic and practical costs of such theoretical dogmatism or conceptual monoculture are likely to be highest when the reality we are dealing with is not merely multi-faceted but also constantly changing as a result of product and policy innovation.

This then is why regulatory and policy monocultures in the EU or elsewhere are potentially so dangerous: they tend to be informed by, or to harden into, a monoculture in the theoretical and conceptual framework with which we interpret the world. Such an analytical monoculture makes us less prone to spot anomalies that challenge us to revise our conceptual or regulatory framework before it is too late. Moreover, the theoretical and conceptual frameworks we use structure our behaviour as well as our analysis and help construct social reality in their own image (Bronk, 2009). As a result, a theoretical (as well as regulatory) monoculture may lead to frighteningly high correlations in our responses to unexpected common shocks, increasing the risk of social and economic destabilisation if the theoretical framework is misleading in some significant way.

Fortunately, the dangers of conceptual and regulatory monocultures can be greatly reduced by modelling pluralism, disciplined eclecticism and constant experimentation with new conceptual frameworks and perspectives (Bronk, 2009, p.282f; Bronk, 2011a, p.16f). And here the EU has an enormous potential inbuilt advantage: as an epistemic and policymaking community, it comprises a huge plurality of different conceptual frameworks and regulatory models. Nicolaidis (2012, p.252) reminds us that the EU is 'not constituted by separate demoi nor demoi-made-into-one but by distinct demoi progressively opening to each other and to each other's democratic systems' – a 'third way' that involves 'sharing, pooling, enmeshing, but not unifying'. Moreover, at the institutional and regulatory level, Sabel and Zeitlin (2010) argue that – through mechanisms such as 'councils of regulators', the open method of coordination and the tendency to devolve implementation down to local level – the EU has stumbled upon a novel form of experimental governance, which they dub 'directly deliberative polyarchy' (See also Cohen and Sabel, 1997). In their view, 'deliberative polyarchy is a machine for learning from diversity', and one that transforms an apparent 'obstacle to closer integration into an asset for achieving it' (Sabel and Zeitlin 2010, p.6). To the extent that this is true, it should render the EU almost uniquely well suited to the task of remaining open-minded and innovative in how it analyses and interprets the challenges it faces in an uncertain and constantly changing world. But we argue that it can only be true to the extent that the EU continues to balance its tendency to harmonise with a mutual recognition and toleration of difference, and to the extent it continues to balance the Community Method with an inclusive involvement of nation states and sub-national actors in its deliberations and decision-making. As Sabel and Zeitlin acknowledge, deliberative polyarchy also rests in an EU context on the persistence of a multipolar distribution of power across the Union.

In our brief review in section 3 of several areas of recent EU policy making, and in particular aspects of policy reaction to the Eurozone crisis, we explore two complementary dangers that threaten to undermine the rosy picture painted by Sabel and Zeitlin. First, there is a danger that, as the networked and polyarchic agencies that currently exist within the EU succeed in establishing best practice and fine-tuning a more harmonised approach for the future, the cognitive diversity that has up to now been their greatest source of strength in coming up with innovative solutions and spotting new problems may become a wasting asset. Our disquieting suggestion is that the EU has benefited from a long phase transition during which it enjoyed the undoubted benefits of greater harmonisation and coordination together with the cognitive benefits that were the legacy of past diversity. In the brave new world of policy best practice, level playing fields in regulation, and (within the Eurozone) banking and fiscal union, there may be insufficient mechanisms for ensuring the continued replenishment of cognitive diversity – the wellspring of policy experimentation and nuance.

Secondly, the combined effect of German reunification, Germany's relative economic outperformance within the Eurozone, Germany's imposition (as the principal creditor) of strict conditionality for bailout funds, and the United Kingdom's progressive disengagement from EU deliberations, has served to entrench German financial and intellectual dominance within the EU. This brings with it the danger that cognitive as well as policy diversity at EU level may be damaged by an increasing power imbalance and by the progressive emergence or imposition of a German Consensus.[3] As we argue below, this threatens not only the capacity of the EU as a whole to adapt to unexpected shocks but also represents an unacknowledged potential source of huge burdens for Germany as *de facto* the chief financial shock absorber of the Eurozone. We argue that cognitive and policy diversity remains an insurance premium worth paying even for the German paymasters themselves.

3. Safeguarding diversity in EU practice and analysis

This section applies our basic intuitions about regulatory monocultures discussed above to important areas of EU policymaking. It also follows these areas into the on-going economic and financial crisis in the EU, which has generated important impulses towards further policy harmonization The areas we investigate are the Single Market, European Monetary Union and

[3] Beck (2012) argues similarly that we are seeing the emergence of a 'German Europe'. He also argues (p.28) that 'compulsion to act speedily' in the face of crises short-circuits the normal process of democratic and pluralistic deliberation.

resulting moves towards fiscal and banking union, and the Open Method of Coordination.

3.1. Mutual recognition of difference in the Single Market

The Single Market in goods, labour and, to a lesser extent, services has been the most significant EU achievement of the last thirty years. Initially, it spurred an enormous effort to replace a multitude of national regulations with common harmonised standards that would reduce transaction costs for cross-border trade and remove the scope for tacit protectionism. But the Commission's '1992' internal market initiatives quickly moved in many areas from the attempt to harmonise regulations to securing mutual recognition of different standards (Nicoläidis, 1997). An early example of this in the area of free movement of labour was the 1984 decision to introduce the 'principle of a general system of mutual recognition for all higher education qualifications' (Owen & Dynes, 1989). Another, in the area of financial services, was the decision to allow banks to open branches and operate in member states other than the one in which they are regulated on the basis of a 'passport' authorisation provided by their home regulator (Tilford & Whyte, 2010).

In legal terms, mutual recognition means that if a product or service can be sold in one jurisdiction, it can be sold lawfully in any other participating jurisdiction without being subject to additional checks, tests, and regulations (Nicolaidis and Shaffer, 2005). More specifically, mutual recognition involves a contractual norm among governments (or standard-setting bodies to whom governance has been delegated) to transfer regulatory authority from the state where a transaction occurs (host country) to the home country of an individual product, person, service or firm (Nicolaidis, 1997). In this sense, mutual recognition is more than an instrument to protect national diversity. It can also be thought of as an instrument of extraterritoriality in that it allows states not only to keep their regulatory standards but also to project them into the legal systems of other contracting partners. In practice, mutual recognition is generally conditional or 'managed.' One implication is that mutual recognition itself constitutes a 'third way' between national and regional (or global) regulations insofar as it accepts 'foreign regulatory determinations implicit in the import of goods and services' (Nicolaidis and Shaffer, 2005) or 'consensual extraterritoriality'.

Does mutual recognition then succeed in providing the EU with the benefits of greater cross-border trade while also affording it prudential protection against the perils of institutional monocropping and analytical monocultures? In principle, the answer is 'yes'. First, such regimes obviously do allow different standards to co-exist, and avoid the wholesale harmonisation of institutional and regulatory frameworks. As we have seen, such diversity helps each country protect its specific comparative *institutional* advantages (thereby boosting the economic vibrancy of the bloc as a whole). It also helps the EU avoid putting all its regulatory and associated analytical eggs in one basket, reducing the chances of highly correlated economic failures or shared spells of cognitive myopia associated with analytical monocultures. Secondly, mutual recognition regimes are (or can be) sensitive to unexpected shifts in the political environment. For example, many mutual recognition regimes were unwound after the 9/11 attacks, including ones for container shipping inspections and airline passenger data (Nicoläidis and Shaffer, 2005). Finally, mutual recognition regimes often explicitly include braking mechanisms, such as exceptions for national security, financial stability, and social peace. While such instruments can be abused, they also provide, at least in principle, scope to prevent unwarranted or premature closure on one regulatory system.

Looking back over thirty years of Single Market policy practice, however, the position is more complex than this argument from principle suggests. While many of the theoretical benefits of mutual recognition have materialised, and it has often proven quicker and easier to negotiate such a regime than a full harmonisation directive, disadvantages (real or imagined) have also become apparent. In particular, there has been considerable anxiety in some countries that mutual recognition would lead to a race to the bottom in regulations if countries gained advantage from more lax regulation. This fear proved largely fatal to the Bolkestein directive on general services in 2004, which had sought to allow firms to operate throughout the Union on the basis of the regulations in their country of origin (Tilford &Whyte, 2010). In the area of banking, too, 'passporting' suffered a reputational hit when Iceland's banks ran into difficulties in 2008 and Irish banks reached a size that threatened the solvency of that country (Tilford &Whyte, 2010). Not surprisingly, such problems have again boosted the willingness of member states to consider harmonising financial regulatory standards under a single European Banking Authority; and they have distracted attention from some of the good effects of diversity of regulation. Spain's lone use of some countercyclical capital requirements even before the crisis may stand out as a rarely acknowledged benefit of allowing countries to experiment with and pursue initially unfashionable regulatory paths.

It is clear then that the consensual extraterritoriality associated with mutual recognition sometimes goes too far to allow countries to be confident that they can protect vital areas of national difference in norms, interests and *institutional* advantage. It is equally clear, though, that mutual recognition sometimes threatens to externalise risks associated with individual regimes through contagion effects. When this happens, there are frequently calls for a return to a policy of full regulatory harmonisation and unified policy practice

– a move that would often, we have argued, imply very real economic, social and democratic legitimacy risks. For this reason, the EU has developed in many areas of single market policy a host of third-way alternatives to a rigid dichotomy between total harmonisation and mutual recognition of difference. These include (i) 'comply or explain' clauses in harmonisation directives; (ii) common standards coexisting and competing with home country regulation (e.g., the European Company Statute); (iii) common testing and safety modules agreed at practical level for use within still divergent national regulatory regimes; and (iv), finally, a pragmatic mix in any particular area of harmonised regulation for core issues and mutual recognition of difference for less salient aspects of regulation. Such a pragmatic approach often allows the EU in practice to find a compromise that ensures harmonisation where the potential gains are greatest and considerable residual variation in national practice within this broadly harmonized framework. Such a balancing act is key to achieving economies of scale at EU level while protecting cognitive diversity and preserving policy and economic diversification in the face of uncertainty.

3.2. Economic and Monetary Union and the dangers of a 'German Consensus'

EMU may at first sight seem to be a paradoxical case of harmonisation (in this case of monetary policy) leading not to dangerously *high* correlations in economic performance (as mooted above) but rather to damaging *divergence* and dislocation. This is because the shocks felt in the Eurozone over the last decade have been the asymmetric impacts of the regime change represented by the launch of EMU itself. Given immensely different starting points in background inflation, institutional and industrial capacity and the political will to reform, the apparently common shock of EMU became a source of asymmetric competitiveness and real interest rate shocks. In this environment, the loss of nominal exchange rate shock absorbers has caused dislocation and divergence. This underscores that policy innovations and a piecemeal harmonisation of policy may have unintended consequences; and it also suggests that harmonisation only increases the correlations of response to common shocks when all the relevant parameters are harmonised or shared in common.

The current crisis in the Eurozone now looks set to increase the pressure for harmonisation of policy among member states across the board – and particularly in the areas of fiscal policy and banking regulation. The initial rationale for EMU (lowering transaction costs and furthering economic and political integration) remains in place, but is now dwarfed by fear of the costs of a Eurozone breakup. In this environment, and when creditor countries are exercised by the negative externalities and contagion effects of fiscal and banking failures in weaker member states, there is a clear impetus for more centralised control of fiscal policy and a 'banking union' with harmonised standards and rules. Equally, it is politically unacceptable for some large European banks to be 'international in life but national in death.' As the argument in section 2 above suggests, however, great care needs to be taken not to harmonise fiscal policy and banking regulations more than is strictly necessary to limit contagion, free-riding and unwarranted concentration of fiscal risk. In particular, Germany and other creditor nations need to take care not to focus exclusively on the externality costs of failure of an individual country to reform in line with dominant thinking. If dominant thinking (at present in favour of fiscal austerity) were to be at fault, harmonisation of approach across the Eurozone would imply larger rather than smaller risks of generalised default for creditors and debtors alike.

The essence of the current 'German Consensus' imposed by bail-out conditionality is a combination of supply-side reform and fiscal austerity. To be clear, this is not an anti-statist paradigm since the state is envisaged as having a key role in promoting competition (Silvia, 2010; Dullien and Guerot, 2012). In principle, the German paradigm also remains open to a substantial social state to help citizens cope with high adjustment costs. In practice, though, the German focus on limiting fiscal deficits in crisis-hit Eurozone members has mitigated against social measures in the recent context. As with the Washington Consensus before it, the German Consensus has many detractors. Merkel's policies have been roundly criticized by officials in Southern Europe and by many academics; but Germany's relative economic power and pivotal role in funding bailout mechanisms has given its current government's vision a disproportionate role in fashioning associated conditionality mechanisms. Within Germany, some opposition parties have misgivings about the policies of harmonized fiscal retrenchment across the Eurozone, but the domestic popularity of this policy mix – what the Germans often refer to as a 'stability culture' – means little open displeasure is voiced by the opposition. In this way, a virtual economic monoculture in the Eurozone has been born, with likely long-term consequences in terms of high correlations in weak economic performance and a reduction in cognitive diversity and analytical openness.

3.2.1. The perils of a misconceived fiscal union

A major element of German policymaking throughout the crisis has been the push for renewed efforts for enforceable fiscal limits in individual states. These fiscal harmonization efforts have resulted in a kind of 'Groundhog Day effect' in which many of the now-30 EU crisis summits seems to produce a new variant of the same basic idea. These steps include the Fiscal Compact, the Six-Pack, the Two-Pack, and various other measures (Mabbett and Schelkle, 2013). In essence, all these measures seek to spread the idea of 'debt brakes' constitutionalized in Germany at both federal and state (*Land*) levels by a 2009 reform.

How wise is this stampede towards national fiscal uniformity across the EU? Belke and Gros (2009) have argued convincingly that, since fiscal policy and reform is often a source of unanticipated shocks (given uncertainty about the impact of any particular measure), there are considerable diversification benefits in allowing countries to pursue independent national fiscal policies rather than a common fiscal policy. As they put it, 'the variance of a sum of shocks is lower the lower the covariance among the individual components' (p.46). This argument rests on the frequent self-evident failure of policymakers and economists to predict the impact of their fiscal interventions in uncertain and highly dynamic situations.

The argument does, of course, need to be set against the manifest problems of fiscal externalities and of some countries free-riding on the fiscal prudence (or reflation) of their neighbours. Furthermore, many would argue against Belke and Gros that the point of the fiscal coordination championed by Germany is not to enforce homogeneity of behaviour, but to incentivise behaviour appropriate to the particular circumstances that each country finds itself, with sanctions against time-inconsistent or free-riding behaviour. But the Belke and Gros thesis could be extended to cover even this sort of nuanced approach if it is assumed that the coordination is based on a shared monoculture theoretical perspective on how fiscal policy works. For example, it is not self-evident that the dominant German view of the value of fiscal austerity is without blind spots as to the merits of demand management in times of crisis. If everyone had internalised this German view in 2008 (perhaps as a result of being initially forced institutionally to follow its dictates), there might have been fewer champions of coordinated fiscal easing in the first months of the post-Lehman crisis and perhaps even some catastrophic fiscal tightening at the height of the crisis. Fiscal dogma or theory can be a source of cognitive myopia, an epistemic source of shocks in its own right. A theoretical monoculture across the EU may increase rather than decrease the risk of highly correlated negative shocks.

Looking forward there are many who might point to the German Consensus that is currently being imposed across the EU by the conditionality attached to bailout mechanisms but also more broadly by the Fiscal Compact — which all EU members except the UK and the Czech Republic have signed — and see exactly the risks elaborated above with a monoculture approach. With German policy makers constitutionalizing austerity at home, they appear blind to the fallacy of composition and to the danger that the externalities of fiscal austerity may be as damaging as the externalities of other countries' high debt levels.

In addition to the Belke and Gros argument that preserving *national* diversity in fiscal management can have a systemically prudential justification, one might add that the EU's own fiscal impacts could and should be made less uniform and more responsive to national conditions. Indeed, as wide divergences among states become more apparent — as seen in large current account imbalances and divergent wage trends — EU instruments might be redesigned away from one-size-fits-all frameworks. Paradoxically, more centralized policies can be made attentive to difference. Proposals here include EU-wide unemployment insurance that takes account of very different growth rates across the EU (Pisani-Ferry et al., 1993; Dullien, 2008) or moves to peg infrastructure spending through the Structural Funds much more carefully to underlying conditions (Dullien and Schwarzer, 2009).

If respect for diversity need not discredit centralized policy, neither can formally decentralized policy guarantee respect for epistemic diversity. In principle, Merkel's emerging preference for binding agreements between member states and the EU could accommodate substantial diversity in fiscal policy approach simply because they will be bilateral. In substance, however, the agreements seem likely to be highly uniform in their focus and their targets, essentially entrenching a variant of the German Consensus in each member state irrespective of whether they are export economies that can reap the full benefit of wage restraint inside the Single Market.

3.2.2. The need to preserve diversity within a banking union

When it comes to a banking union, the pressures in favour of harmonisation are clear. A monetary union without an integrated banking system is fundamentally flawed; and there are clear fiscal externalities and contagion effects when the banking system of one Eurozone member comes under pressure. Creditor member states in particular have an interest in ensuring that banking regulation and capital adequacy rules are robust in debtor countries. In this context, it is little surprise that we have seen pressure not only for a single regulator, but also a single rulebook, common deposit regulation and a common resolution mechanism.

And yet, as the Varieties of Capitalism thesis makes clear, the idiosyncrasies of national banking systems (e.g., *Hausbanken* and *Sparkassen* in Germany) are often central to the comparative *institutional* advantage of each country, militating against enforced harmonisation of key aspects of financial structure. Moreover, the harmonised banking standards at the global Basel II committee level proved to be deficient in the financial crisis since 2007 – championing risk models that in retrospect confused uncertainty with measurable risk, while encouraging a fatal confluence of perspective among regulators and regulated (Bronk, 2011a, p.15; Power, 2007, p.74). This underscores that regulators can never expect to be able to design a regulatory system able to cope perfectly with the unknown crises of tomorrow, and that they must remain open-minded about different modelling approaches.

Given this, there may be strong diversification benefits for the EU as a whole (and Eurozone creditors in particular) in allowing considerable national diversity in banking regulation, under the aegis of loose coordination by the European Banking Authority and ECB. Despite this, there is ample evidence that the EU has in recent years consistently aimed to reduce the diversity of national banking regulation, even if the speed and the scope with which it has been able to do so has been constrained. In particular, the Committee on European Banking Supervisors (CEBS) – a network of national authorities – gave way in 2011 to the European Banking Authority (EBA). While the EBA remains a network of national authorities and has no direct supervisory power, it has a more hierarchical structure than the CEBS. For example, the EBA is clearly prioritizing technical convergence and a single European rulebook[4] for banking. When its proposed technical standards are endorsed by the Commission, they have the same legal status as directives and regulations and do not require transposition into national law (Penders, 2013, p.30). The EBA also has the power to monitor member state compliance with these rules, although initial evidence is that the EBA has been quite deferential to national regulators (Giegold, 2013). In addition to binding regulations, the EBA can issue guidelines to banks with a 'comply or explain' obligation (Busuioc, 2013). Peer review panels are also deployed as mechanisms for testing and promoting further convergence. The EBA even did its own 2011 round of stress tests on 90 banks. These tests were widely

[4] Not to be confused with the Single Supervisory Handbook being developed by the ECB in close coordination with the EBA.

seen as a failure. Nevertheless, in principle, the EBA remains able to trump national authorities in three contexts: emergency situations, binding mediation, or the breach of EU law (De Haan et al, 2012, p.386; Penders, 2013, p.41).

The recently proposed Single Supervisory Mechanism (SSM) would, of course, go well beyond the EBA in its aspirations for a unified banking union. The SSM currently consists of a Council proposal scheduled for likely approval by the Commission and Parliament sometime after the German elections in September 2013. The intention is that the European Central Bank (ECB) will perform asset quality reviews of systemically important banks and then take over supervisory responsibility of these banks in September 2014. While the EBA will retain a role in standard setting and regulation, supervisory authority will be vested in the ECB, though in conjunction with national supervisors. The ECB was chosen, in part, because TFEU Article 127 already envisioned the possibility of a supervisory role for the Bank and thus obviated the need for a difficult treaty change (Constancio, 2013). The ECB's Board of Supervisors will be composed primarily of national supervisors, including officials from national central banks. Article 1 of the Council draft says, 'When fulfilling its tasks according to this regulation the ECB shall respect the different types and sizes of credit institutions.' Yet while much give and take might be expected — especially early on when prevailing national regulatory differences might be greatest — it is crucially envisaged that national authorities will have no formal authority to resist ECB decisions (even though they would generally have to implement them). In principle, national authorities would remain in charge of those (some 6000) banks that have liabilities under Euro 30 billion, represent less than 20% of a nation's financial sector, or are not among a nation's three largest banks. This would seem to give some real scope for preserving national difference. However, under its formal mandate, the ECB would have the power to regulate any bank it chooses.

Stepping back, if the EU is increasingly going to put all of its banking regulation and supervision eggs in one basket, it is worth asking whether it can really hope to create a 'safe basket' for the future, given uncertainty. As we argue above, diversity acts as a safety valve, helping to ensure that small problems do not become large ones by having highly correlated effects. Several scholars question in any case the EU's ability to create a single working regulatory body. For some, the new policies that have arisen in the wake of financial turmoil are solutions to past problems (Moloney, 2012, p.16). Although learning from past mistakes is a good starting point, there remain serious doubts as to the EMU member states' ability to create good regulatory policy moving forward. Others note that, since these regulators have already failed once, it is unclear why we should trust them now to create a competent system (Black, 2010, pp.13, 16). If regulators harmonize and fail again in appropriate risk assessment (and no system of regulation can be perfect), this increases the chance for negative feedback loops, augmenting the very problem it was meant to fix (Black, 2010, p.14). Moreover, such harmonization carries the risk over time that the relevant regulators will come to share the same cognitive myopia and have fewer resources for diversity of perspective, learning and innovation. Finally, since there was in fact no common institutional design for those economies that weathered the recent storm (each one relying on a different institutional design), there is no clear evidence – even *ex ante* – of a single superior system (Moloney, 2012, p.7)

The financial market, during the time of the crisis, suffered from destructive herd behaviour and homogenization (Moloney, 2012, p.15). This allowed a problem in one corner of the market to spread through the entire market (Haldane, 2009). Harmonization of policy creates endogenous risks, and a unified system spreads problems more quickly when compared to a diversified one (Black, 2010, p.46). In addition to systematic, widespread failures, an SSM suffers from asymmetric information. Although a single governing regulator has a good aerial view of the market, it lacks the 'on the ground' details faced by individual market players (Black, 2010, p. 37).

3.3. The Open Method of Coordination

For any champion of the benefits of multiple perspectives, toleration of diversity and epistemic humility in the face of strategic uncertainty, the Open Method of Coordination (OMC) seems to be the most welcome recent innovation in EU policy practice and one that remains fairly widespread outside trade and Eurozone governance mechanisms. Early versions associated with the Broad Economic Policy Guidelines and the European Employment Strategy were extended and formalised in the Lisbon Agenda launched in 2000 (Zeitlin, 2005). The OMC process operates to some extent under the shadow of monoculture thinking with its aim of fixing common guidelines and goals for the Union and establishing benchmarks of 'best practice'. In its most recent forms, however, the typology of best practice is replaced by that of 'mutual learning' and identifying 'good practices' (e.g., CREST 4th OMC WG final report, 2009). Furthermore, the official OMC rubric makes explicit the paramount importance of translating common broad guidelines and goals into nationally specific plans that take account of 'national and regional differences', and also the importance of allowing for 'periodic monitoring, evaluation and peer review, organised as 'mutual learning processes' (European Council, 2000, quoted in Zeitlin, 2005). The OMC working groups include experts and representatives from a wide range of countries and backgrounds, and the breadth of stakeholder involvement is an important guarantor of the plurality of perspectives and theoretical frames available to those involved.

As Hodson and Simoni (2009, p.120) point out, 'the Lisbon Agenda's rejection of the one-size-fits-all' and its essentially 'intergovernmental approach to economic reform should resonate rather than rankle' with the Varieties of Capitalism approach. Moreover, the Commission's 2008 Joint Report on Social Protection and Social Inclusion quoted in Hassel (2009, p.133) makes clear how far this emphasis on plural solutions to diverse types of problem has permeated the discourse of the EU: 'Everything considered, there is no single combination of policies and institutions to achieve and maintain good socio-economic results, but rather there are different pathways to good performance that are, to a large extent, the result of distinct historical trajectories. Respecting the principles of subsidiarity (and the Open Method of Coordination), this allows scope for tailor-made policy packages to suit national preferences with respect to distributional aspects, risk-taking and other national objectives'.

As we have seen, Sabel and Zeitlin (2010, p.4f) argue that OMC is a major example of a new and promising type of experimentalist governance, which they call 'directly deliberative polyarchy'. In their somewhat idealised version of OMC, they see the EU as having forged a decision-making process that combines the benefits of coordination and peer pressure with those of local experimentation and deliberative pluralism. The system, they argue, has the enormous advantage in conditions of 'strategic uncertainty' of allowing for mutual learning, multipolar input to deliberations, constant peer review and deliberative revision of shared goals and metrics. In this way, OMC can be said to rescue large parts of the EU's governance from the perils of analytical monocultures.

Needless to say, some scepticism is in order. For one thing, there is a tension at the heart of the OMC process between the notion of benchmarking 'best' (or at least 'good') practice and setting common guidelines, on the one hand, and the commitment to policy pluralism and local difference, on the other – a tension which is not entirely resolved by a faith in constant revision of targets and goals. A good example of this is the Lisbon Agenda's target that all member states should invest 3% of GDP in R&D as a central plank in the EU's efforts to become a more innovative and competitive economy. As Tilford and Whyte (2010) argue convincingly, it makes little sense for advanced and heavily industrialised countries such as Sweden to have the same R&D target as catch-up and developing countries (such as Bulgaria) or as predominantly service sector economies (such as the UK). Moreover, R&D is only a small part of the investment (much of it intangible) required to foster innovation especially in the service sector, so that a focus solely on R&D could be profoundly misleading (Tilford and Whyte, 2010). Any benchmarking exercise can begin to imply a normative bias towards conformity to common standards irrespective of local difference, especially if it is oversimplified and overhyped.

A second potential weakness of the OMC approach is suggested by some wording in the CREST 4th OMC Working Group final report (2009, p.9). Arguing that its 'mutual learning exercise' and its mapping of good practices could help develop useful benchmarks, the report argues: 'The benchmarking exercise could also deliver knowledge for a European open inventory of existing and tested policy instruments to improve the research excellence in universities, showing the relations between the instruments and the objectives of research excellence'. However laudable such a mutual learning exercise may be, there are dangers – as the Varieties of Capitalism thesis underscores – in the implicit suggestion that members can learn good practice from each other and cherry-pick the best items from an 'open inventory'. University research is integral to the different national models of capitalism, and this implies limits to the scope for learning and policy transfer across borders. As Hodson and Simoni (2009, p.121) put it: 'Under different sets of institutional complementarities, economic reform must be "incentive compatible" in the sense of being consistent with the functioning of the underlying economy'. This argument, of course, in no way implies that countries cannot learn from each other. It merely underscores the need for intelligent and decentralised learning, with open access to the very different perspectives and experiences of other countries combined with a firm grasp of local particularities.

The final criticism levelled at the OMC and the Lisbon Agenda is that they may have achieved little. Begg (2008, p.434), for example, argues that although 'reform efforts have become more extensive and central to economic governance in all Member States, it is far from obvious that the reforms that have taken place have occurred *because* of the Lisbon strategy'. This might not trouble Sabel and Zeitlin for whom Lisbon and OMC is primarily about mutual learning rather than directly incentivising reform. But here, too, Begg (2008, p.433) has a point: to be justified, the expense and trouble of organising OMC and other Lisbon processes has 'to offer Member States more than they could obtain from informal contacts with their partners or meetings at the OECD'. In a sense, the problem is that the more the process is a soft one of mutual learning from difference, the more it may produce no joint conclusions that are of use to anyone. A satirist would certainly have fun with this passage on research excellence in the CREST report mentioned above (2009, p.14): 'There is no concrete, agreed upon or limited definition of excellence … The diversity of understandings concerning excellence in research across member countries should be supported. However, a number of core aspects relating to the concept frequently emerged among member countries and the WG has indicated the need to provide some basic guidelines in order to come to a clearer understanding of the notion of excellence which can be applied in most contexts. This common understanding does not imply that a single definition for excellence should be agreed upon, but rather, that the differences should be respected while, at the same time, an effort made to identify similar aspects.' Such verbal contortions indicate the fundamental tension in the whole notion of benchmarking in conditions of diversity: how to avoid the Scylla of the lowest common denominator or of motherhood and apple pie and the Charybdis of undigested plurality and diversity.

The jury is out on how effective OMCs and other decentralised and inclusive decision-making structures will prove to be. Suffice it to say, that the more seriously epistemic and ontological uncertainty is taken, the more valuable will be considered 'epistemic communities' (Sabel and Zeitlin, 2010, p.2) like the CREST group that foster an interchange of ideas and perspectives amongst those from very different backgrounds – communities that can help ensure that their members are not locked into monoculture mind-sets that make them blind to unfamiliar challenges.

4. Conclusion

This paper has taken as its starting point the central importance of uncertainty in some areas of policy making within the EU. It has argued that this makes convergence on one 'best' regulatory, policy or theoretical approach more dangerous than conventional analysis suggests. Analytical and regulatory monocultures may be prone to disastrous blindness to emerging problems if hit by unforeseen disasters. Moreover, in any policy area characterised by innovation and uncertainty, there are greater benefits from policy diversification across the Union than the standard analysis of the benefits of coordination around common policies would suggest. These arguments taken together imply a shift in the optimal balance between the principle of harmonisation and that of the mutual recognition of difference, and a shift away from centralised supra-nationalism towards the involvement of a plurality of actors and perspectives in EU decision-making.

In empirical terms, we have argued that the Single Market has succeeded to a significant extent in balancing the need to facilitate cross-border trade with sensitivity to national differences and the survival of a pluralistic regulatory order, not least through the extensive use of mutual recognition. By contrast, neglect of the dangers of monocultures seems at present to be particularly pronounced in fiscal policy — where there is a veritable forced march towards German-inspired debt breaks and a series of other institutional mechanisms to lock in austerity. The neglect is also evident in the proposals for a banking union, which also shows signs of a rush to premature institutional closure in some areas. It is perhaps to be welcomed rather than lamented that a lack of political consensus — not least from Germany itself — has generally slowed more ambitious plans for a banking union in recent months.

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