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Another view of the cathedral: What does the rule of law crisis tell us about democratizing the EU?

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The rule of law in the EU is in crisis. The independence of national judiciaries in Hungary and Poland is under attack by governments that call themselves 'illiberal' democracies.[1] Not surprisingly, scholars pointing to the cracks in the EU architecture have offered some solutions to avoid its collapse. These solutions range from the Commission enforcing a rule of law framework by bringing systemic infringement actions based on democratic values enshrined in Article 2 of the Treaty on European Union (TEU) or by cutting EU cohesion funds to the autocrats.[2] Both solutions seem to have been taken seriously in Luxembourg by the Court of Justice of the European Union (CJEU)[3] and in Brussels by the Commission in shifting European funding from Central and Eastern to Southern Europe.[4] Yet the EU seems to be drawing the wrong lesson from the rule of law crisis. After imposing new rule of law conditionalities and economic sanctions on autocrats, it is necessary to ask why judicial independence slid away so quickly in Poland and Hungary and why cohesion funds did not create a more egalitarian society in the EU.[5]

1. See K.L. Scheppele, 'Understanding Hungary's Constitutional Revolution', in A. von Bogdandy and P. Sonnevend (eds.), *Constitutional Crisis in the European Constitutional Area* (Oxford University Press, 2015), p. 111–112 and M. Bánkuti, G. Halmai and K.L. Scheppele, 'Hungary's Illiberal Turn: Disabling the Constitution', 23 *Journal of Democracy* (2012).
2. See K.L. Scheppele and D. Keleman, 'Defending Democracy in the EU Member States: Beyond Article 7 TEU', (2018), paper on file with the author.
3. See Case C-64/16 *Associação Sindical dos Juízes Portugueses*, EU:C:2018:117, emphasizing how EU law relies on the independence of the national judiciaries for its enforcement.
4. A. Barker, 'EU Plans to cut finding to nations where rule of law is at risk', *Financial Times* (2018), https://www.ft.com/content/fa422d26-4bb2-11e8-97e4-13afc22d86d4.
5. See P. Lindseth, 'Viking's "Semantic Gaps": Law and the Political Economy of Convergence in the EU', in B. Davies and F. Nicola (eds.), *EU Law Stories: Critical and Contextual Histories of European Jurisprudence* (Cambridge University Press, 2018).

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The rule of law crisis begs the following question: what has been the impact of the EU on the democratization in Central and Eastern European (CEE) countries transitioning from communist to liberal democracy regimes and transforming planned into market economies.[6] The EU has prioritized judicial independence because national judiciaries hold a unique place in the model of European integration by tying together domestic and European regimes and ensuring their compatibility. In addition, the judiciary ensured the protection of property and human rights that was central to market liberalization, even though such reforms increased inequalities and allowed the creation of powerful oligarchies.[7] The current crisis shows how, by over relying on the rule of law to consolidate the European integration project, the EU has failed in the creation of more democratic and egalitarian societies in its member states.

1. The rule of law history in CEE as a vehicle for liberalization and Western colonization

In 1992, the EU served as a stabilizer to the rupture with Communism that allowed the CEE countries, which lagged behind, to transition to the modernist development.[8] This process of colonization under the EU carried the flag of 'market democracy' and integration through law that entrenched deep hierarchies and an inferiority complex of Eastern vis-à-vis Western elites. After the fall of the Berlin Wall, a 'renaissance' in legal and political reform spread throughout the CEE countries.[9] Legal experts from the USA and western European governments and non-governmental organizations (NGOs) 'swarmed formerly socialist economies with constitutions, codes, statutes, and regulations'.[10] Under the guise of spreading the 'rule of law', judicial reforms and, in particular, development agencies were careful to point out they were not pushing an agenda.[11]

The predominant attitude of Western elites at the time was that democratic reforms needed to be pushed quickly in post-communist countries in order to fend off reversions to socialist regimes[12] and to implement capitalism through 'shock therapy'.[13] Speedy reforms did not lend themselves to an evaluation of the legal regimes existing in former communist countries,[14] as the economic orthodoxy of the Washington consensus called for catching up with the globalized financial and trade regimes.[15] In this context, the rule of law became an objective for development policy 'in its

6. See H-W. Micklitz, 'Prologue: The Westernization of the East and the Easternization of the West', in M. Bobek (ed.), *Central European Judges under the European Influence* (Bloomsbury, 2015), p. 6.
7. See S. Moyn, *Not Enough. Human Rights in an Unequal World* (Harvard University Press, 2018).
8. See D.W. Kennedy, 'Turning to Market Democracy: A Tale of Two Architectures', 32 *Harvard International Law Journal* (1991), p. 373.
9. J. Rasmussen, 'A Short History of the American Bar Association Rule of Law Initiative's Technical Assistance Approach', 31 *Wisconsin International Law Review* (2014), p. 776.
10. D. Berkowitz et al., 'The Transplant Effect', 51 *American Journal of Comparative Law* (2003), p. 164.
11. M.M. McKeown, 'The ABA Rule of Law Initiative Celebrating 25 Years of Global Initiatives', 39 *Michigan Journal of International Law* (2018).
12. T. Carothers, *Aiding Democracy Abroad: The Learning Curve* (Brookings Institution Press, 2011), p. 261.
13. See J. Sachs, 'Shock Therapy in Poland: Perspectives of Five Years', *The Tanner Lectures on Human Values* (1994), https://tannerlectures.utah.edu/_documents/a-to-z/s/sachs95.pdf.
14. See G. Ajani, 'By Chance and Prestige: Legal Transplants in Russia and Eastern Europe', 43 *American Journal of Comparative Law* (1995), p. 93.
15. See J. Sachs, *The Tanner Lectures on Human Values* (1994), p. 4, explaining that such fast reforms were driven by globalization showing the path to 'borrow technology, capital and management techniques to help catch up economically after decades of falling behind'.

own right'.[16] Under the leadership of Ibrahim Shiata, the World Bank in the early 1990s openly tied governance and rule-of-law reforms to loan disbursement conditions.[17] The bank was able to condition loan disbursements in the borrowing countries fostering neoliberal policies upon the transplant of unquestionable legal reforms that entailed greater efficiency for the legal system.[18] Western legal elites entrenched rule of law reforms through the notion of 'legal failure'[19] in communist regimes and the implementation of the shock therapy approach: a mix of neoliberal policies and human rights reforms under the flag of the Washington Consensus.

The spread of liberal democracy required judicial training to transform the dangerous practices of formalist interpretation that were, at the same time, a source of socialist 'national pride'.[20] Western reforms transplanting rule of law and liberal democratic values in CEE countries aimed to create institutions as well as civil society organizations, such as NGOs. The creation of these 'middle of society' institutions, however, was left in the hands of statutory agencies which continued the communist tradition rather than breaking with it.[21] The omnipresence of the Commission, aiming to impose the massive legal transplant of the *acquis communautaire,* left no room for negotiation between the Easterners and the virtuous Westerners.[22]

The rule of law constituted by judicial independence, transparency and accountability worked as vague and adaptable terminology that legitimized broad economic reforms, as it was taken for granted that it was nonexistent in post-communist states.[23] Implemented under the guise of rule of law reforms, liberalization policies were based on the protection of individual rights, privatization of property rights and greater contractual freedoms.[24] When the EU became more involved under the accession scenario in promoting rule of law reforms, it created new adjudication regimes that were designed by judges from the West assuming a legal vacuum on the other side of the Iron Curtain. After the accession, Brussels focused mostly on macro-level reforms mimicking Western standards while ignoring micro-level internal reforms.[25] At the same time, the ability of EU institutions to monitor and assess compliance with basic EU values virtually disappeared.[26]

After the accession in 2004, many judges in CEE countries remained at odds in enforcing European private and regulatory law regimes, even when these offered a social-market alternative to free market fundamentalism. European environmental and consumer protection regulations tackling economic inequalities were not successfully transplanted but instead resisted as bourgeois

16. D.M. Trubek and A. Santos, *The New Law and Economic Development* (Cambridge University Press, 2006), p. 1, 9.
17. A. Santos, 'The World Bank's Uses of the "Rule of Law" Promise in Economic Development', *Georgetown University Law Center* (2006), p. 271-278.
18. See M. Graziadei, 'Comparative Law and the Study of Transplants and Receptions', in M. Reinmann and R. Zimmerman (eds.), *The Oxford Handbook of Comparative Law* (Oxford University Press, 2006), p. 459.
19. See J.L. Esquirol, 'The Failed Law of Latin America', 56 *American Journal of Comparative Law* (2008).
20. See P. Cserne, 'Formalism in Judicial Reasoning: Is Central and Eastern Europe a Special Case?', in M. Bobek (ed.). *Central European Judges under the European Influence*, p. 41.
21. See H-W. Micklitz, in M. Bobek (ed.), *Central European Judges under the European Infuence*, p. 4, 7.
22. Ibid., p. 5.
23. See V. Ernst, 'The Law and Development Learning Curve: 5 BIG Assumptions of Law and Development Organizations in Post-Communist Europe', (2018), paper on file with author.
24. See D. Kennedy, 'Three Globalizations of Law and Legal Thought: 1850–2000', in D.M. Trubek and A. Santos (ed.), *The New Law and Economic Development*, p. 19.
25. M. Bobek and D. Kosar, '"Euro-Products" and Institutional Reform in Central and Eastern Europe: A Critical Study in Judicial Councils', in M. Bobek (ed.), *Central European Judges Under the European Influence*, p. 180–88.
26. D. Kochenov, *The Acquis and its Principles: The Enforcement of the 'Law' Versus the Enforcement of 'Values' in the European Union* (Oxford University Press, 2017), p. 10–11.

laws that undermined governments' autonomy and promoted liberalization.[27] The EU ordoliberal orthodoxy was built on the relationship between liberalization and free movement without specifically addressing spiking inequalities between East and West or between the cosmopolitan elites who collected the benefits of free movement and those who were stuck at home with stagnant wages and high levels of unemployment. The promises of a redistributive EU consumer law, a social market economy and of EU cohesion funds in support of democratic and social structures in Europe's peripheries were shattered.[28]

2. Private law ideology in trade and investment regimes in the EU

Scholars preoccupied with the rule of law crisis have mostly shown the constitutional pitfalls of the European public law order without showing how private law influences transnational law making, often with the effect of entrenching social and economic inequalities. Private law and its theoretical apparatus is a power resource in transnational lawmaking; private law being a set of ideological tools and discursive strategies that can be neutrally employed by actors seeking to advance discrete political and economic agendas.[29] Influenced by mainstream law and economics, the transformation of domestic private law regimes into a transnational European private law had important redistributive consequences that have not been grappled with.[30]

The transformation of affluent and technologically savvy European societies over the last generation led to the stunning growth of economic inequality due to, among other factors, accelerated returns to capital[31] together with the erosion of historic tools to ensure social inclusion.[32] Elite actors – including judges, lawmakers, lawyers and bankers – have pushed for transnational legal regimes in which private law is disembedded from its local and social practice.[33] Private law rules are often deployed as a neutral and overdetermined means of reforming transnational markets. Yet, the particular rule sets proposed often advance market fundamentalism ideologies and disembed legal regimes from their social context, for example, by embracing concepts such as Kaldor–Hicks efficiency,[34] cost benefit analysis[35] and the primacy of consumer welfare.[36]

27. B. Kas, '*Hybrid' Collective Remedies in the EU Social Legal Order* (PhD thesis, European University Institute, 2016), describing the non-implementation of EU consumer policy in Hungary.
28. See F.G. Nicola, 'The False Promise of Decentralization in EU Cohesion Policy', 20 *Tulane Journal of International and Comparative Law* (2011), p. 65.
29. See K. Klare, 'The Public/Private Distinction in Labor Law', 130 *University of Pennsylvania Law Review* (1981), p. 1359.
30. See F.G. Nicola, 'Transatlanticism: Constitutional Asymmetry and Selective Reception of U.S. Law and Economics in the Formation of European Private Law', 16 *Cardozo Journal of International and Comparative Law* (2008), p. 87.
31. See T. Picketty, *Capital in the Twenty-First Century* (Belknap Press, 2014); F. Block and M. Somers, *The Power of Market Fundamentalism* (Harvard University Press, 2014).
32. See T. Perisin and S. Rodin, *The Transformation or Reconstitution of Europe. The Critical Legal Studies Perspective on the Role of Courts in the European Union* (Bloomsbury, 2018).
33. See K. Polanyi, *The Great Transformation* (Farrar & Rinehart, 1944).
34. See Z.D. Liscow, 'Is Efficiency Biased?', 85 *University of Chicago Law Review* (2018), forthcoming.
35. See S. Rose-Ackerman, 'Precaution, proportionality, and cost/benefit analysis: False analogies', 4 *European Journal of Risk Regulation* (2013), p. 281–286; F.G. Nicola 'Genealogies of Cost Benefit Analysis in Transatlantic Regulatory Cooperation', 15 *Comparative European Politics* (2017).
36. See A. Leff, 'Economic Analysis of Law: Some Realism About Nominalism', 60 *Virginia Law Review* (1973), p. 451.

Thus, private law and private law theory play a dual role in this story: on the one hand, they are terrains of struggle with profound distributive consequences; on the other hand, they provide a set of discursive resources to legitimate particular regulatory structures and undetermined socio-economic outcomes. The evolution of private law and private law theory[37] – in particular the market fundamentalism ideology perpetrated by European private lawyers – is therefore central to the broad retreat from social welfare policies and governance strategies that ensured a more egalitarian political economy in the *trente glorieuses*.

This story also helps illuminate the legitimation crisis that is now facing many transnational governance regimes, including the EU. In response to rising inequality and the shrinking of national middle classes, politicians in many member states have implemented protectionist, autocratic and isolationist policies that undermine the very nature of transnational legal regimes that are deemed managerialist and undemocratic.[38] As a response, constitutional legal scholars have rightly denounced autocratic legalism and its illiberal premises. They have suggested reversing such trends by relying on fundamental rights.[39] By the same token, administrative law scholars have suggested moving away from managerialism and towards a more democratic approach to regulatory processes.[40] Yet, no systematic account has shown the role of private law and private law theory in this process.[41]

For instance, contract law theory prominently re-emerges in international trade where lawyers have set aside multilateralism, and even mega-regionals (the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership), by re-negotiating smaller bilateral trade agreements which negatively impact on third-parties.[42] Through contract law theory, trade lawyers legitimize unfair and unequal agreements between nations based on economic assumptions that trade deals encourage more transactions, and these are just better for everyone. In parallel, private lawyers focusing on non-parties to market agreements have elaborated sophisticated distributive justice analyses to show how third parties, excluded by trade deals, suffer economic hardship.[43] However, contract law theory, when uplifted in the transnational sphere, ends up being part of the problem because the privatizing ideology assumes equality among parties and lacks ways to address structural inequalities.[44]

In a similar way, international arbitrators have revamped property law to modify primary entitlements though bilateral or plurilateral investment treaties, which protect foreign investors from uncompensated expropriation and discrimination through out-of-court dispute settlement mechanisms called investor-state dispute mechanisms. Today, this system of investor-state

37. See D. Kennedy, 'The Stages and the Decline of the Public/Private Distinction', 130 *University of Pennsylvania Law Review* (1982), p. 1349.
38. See K.L. Scheppele, 'Autocratic Legalism', 85 *University of Chicago Law Review* (2018), p. 545.
39. See K.L. Scheppele and L. Pech, 'Rule of Law Backsliding in the EU', 19 *Cambridge Yearbook of European Legal Studies* (2017); D. Kochenov, 'The Acquis and Its Principles', in D. Kochenov (ed.), *The Enforcement of EU Law and Values.*
40. See K. Sabeel Rahman, *Democracy against Domination* (Oxford University Press, 2017).
41. A. Somek, 'The Social Question in a Transnational Context', *LEQS Paper* No. 39/2011 (2011), http://www.lse.ac.uk/europeanInstitute/LEQS%20Discussion%20Paper%20Series/LEQSPaper39.pdf.
42. See J. Klabbers, 'Megaregionals: Protecting Third Parties?', *New York University Institute for International Law and Justice* (2016), https://www.iilj.org/publications/megaregionals-protecting-third-parties/.
43. See A. Bagchi, 'Other People's Contracts', 32 *Yale Journal of Regulation* (2015).
44. See D. Caruso, 'Non-Parties: The Negative Externalities of Regional Trade Agreements in a Private Law Perspective', 52 *Harvard International Law Journal* (2018), forthcoming.

arbitration is under serious attack for being an exclusive and secretive arbitrator club that the EU proposes to replace with a multilateral investment court.[45] Yet, the new EU proposal has not challenged some of the questionable assumptions of the international investment regime.[46] A first assumption is that international investment flows will promote economic growth and development, especially in poorer economies. A second assumption is that the protection of property rights will increase the investment flows in a way that will benefit investors and the host states equally. A third assumption is that an investment treaty, often used to lock in liberalization reforms,[47] would also increase rule of law compliance.

While development economists and scholars have strongly challenged the first assumption,[48] the second and the third assumptions have been hardly challenged among transnational and EU lawyers. The privatization of property rights in investment regimes has created a 'global right to investment'[49] that has entrenched socio-economic asymmetries rather than creating new wealth,[50] while limiting the possibility of enhancing public local democratic structures.[51] Finally, in better understanding the local impact of international arbitration, scholars have shown that the side effect of such regimes might favour authoritarian states, ensuring that foreign investment disputes remain out of the domestic judicial realm so that governments can defund independent judiciaries.[52]

To conclude, the current rule of law crisis has created new possibilities to push back and re-imagine fundamental European integration strategies to create deeper democratization and egalitarian societies in the Member States.[53] In opening up the black box, the impact of EU law not only on the constitutional but also administrative and private law regimes of its member states should be under scrutiny so as to rethink how democracy can be entrenched through and beyond independent judiciaries.

45. See F.G. Nicola and D. Gallo, 'The External Dimension of EU Investment Law: Jurisdictional Clashes and Transformative Adjudication', 39 *Fordham International Law Journal* (2016), p. 1081.
46. See J. Bonnitcha, L.N. Skovgaard Poulsen and M. Waibel, *The Political Economy of the Investment Treaty Regimes* (Oxford University Press, 2017).
47. See T. St. John, *The Rise of Investor-State Arbitration* (Oxford University Press, 2018), p. 233 on the US-Polish BIT.
48. See J-J. Laffont, *Regulation and Development* (Cambridge University Press, 2005); R. Howse, 'International Investment Law and Arbitration: A Conceptual Framework', *ILJ Working Paper* 2017/1 (2017), https://www.iilj.org/publications/international-investment-law-arbitration-conceptual-framework/; A. Roberts, 'Triangular Treaties: The Extent and Limits of Investment Treaty Rights', 56 *Harvard International Law Journal* (2015), p. 353, 372.
49. See N.M. Perrone, 'The Emerging Global Right to Investment: Understanding the Reasoning Behind Foreign Investor Rights', 8 *Journal of International Dispute Settlement* (2017), p. 673–694.
50. See D. Kennedy, 'Some Caution about Property Rights as a Recipe for Development', 1 *Accounting, Economics, and Law* (2011), Article 3.
51. See S. Foster and C. Iaione, 'The City as a Commons', 34 *Yale Law and Policy Review* (2016), p. 281.
52. See M.F. Massoud, 'International Arbitration and Judicial Politics of Authoritarian States', 39 *Law and Social Inquiry* (2014); M. Sattorova and O. Vytiaganets, 'Investment Treaty Law and Its Lessons for Developing States', *Social Science Research Network* (2017), https://ssrn.com/abstract=3002067.
53. S. Hennette et al., *Pour un Traité de Démocratisation de L'Europe* (Seuil, 2017).