István Benczes – Gergely Rezessy

Governance in Europe, Trends and Fault Lines

SUMMARY: The deepening of European integration has been expected to trigger constant adjustments in Member States since the start, especially with regard to the harmonisation of development of their national institutions. Our empirical analysis of Member State-level governance found, however, that such an expectation proved to be an illusion in most of the cases. One of the most typical lessons of the past decade or so is precisely that the quality of governance has deteriorated in quite a few countries despite the fact that it was during this period that the euro was introduced, allowing a level of integration deeper than ever before. This in turn signals that establishing successful European-level uniform governance is a hopeless endeavour – at least with the current Member States. The deep-rooted differences impact the ability of countries to move together with the rest and also their capacities to achieve macro-economic convergence. The absence of such convergence does not simply make individual Member States vulnerable, but endangers the whole of the euro area.*

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The debate on the future of European economic governance is focused on the rethinking of the institutional system as well as the system of rules of the European Union, or more precisely the Economic and Monetary Union. The most recent reform of the Stability and Growth Pact, the creation of the European Stability Mechanism is the result of this process, as is the signing of the inter-governmental treaty on "GMU Stability, Coordination and Governance". The establishment of the single European bank supervisory system and the expansion of the tasks of the European Central Bank are also part of this process.

These forward-thinking measures, that are reshaping the whole of European economic governance, operate under the assumption that there is sufficient capacity, expertise and most importantly political commitment available at the EU institutions representing the supra-national level and at the Member State level alike. Our study, however, points out that while a group of Member States indeed has high quality and constantly improving national governance; another group, typically narrowed down to periphery countries, is forced to face the erosion of governance quality. The question arises: under the current conditions, can an EU and GMU economic governance reform be implemented; a reform that covers all Member States and assumes a precise norm-following behaviour from all parties.

E-mail address: istvan.benczes@uni-corvinus.hu

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From the very beginning, there has been a keeping of distance within the EU's practice with respect to national-level governance. The Community – in line with the principle of subsidiarity – focuses(ed) specifically on EU-level reforms, in the hope that large-scale and system-level reforms will make their impact felt at the Member State-level sooner or later. The EU also expected the deepening of European integration to trigger constant adjustments in Member States. Based on experiences, however, such an expectation proved to be an illusion in most of the cases. One of the most typical lessons of the past decade or so is precisely that the quality of governance has deteriorated in quite a few countries despite the fact that it was during this period that the euro was introduced, allowing a level of integration deeper than ever before. This in turn signals that establishing successful European-level uniform governance – with the current Member States and in the current EU system of governance – is a hopeless endeavour in a community where the national governance of participating Member States is so significantly different from those of the others. The deep-rooted differences impact the ability of countries to move together with the rest and also their capacities to achieve macroeconomic convergence. The absence of such convergence does not simply make individual Member States vulnerable, but also endangers the whole of the euro area.

The objective of the study is to point out the real or perceived fault lines that stretch between the countries of Europe in terms of governance quality and which seem increasingly rigid and impenetrable. Our cluster analysis research unequivocally refutes the popular notion that on the one hand the Member States of the euro area, and on the other, those left outside form two separate levels of a multi-speed Europe. We were also unable to clearly confirm whether GMU membership automatically strengthens convergence between members – either with regard to the quality of governance systems or the progression of the levels of development. All this, however, does not mean that the introduction of the single currency should be considered a failure or that the adoption of the euro lowers the quality of a given country's governance.

Following the introduction, the second half of the study presents the varying, though not necessarily contradictory concepts of governance. Part three illustrates the databases and indicators used to measure the quality of governance. The fourth section presents the lessons learnt from the ranking we performed with principal component analysis. Part five uses cluster analysis to indicate – on the basis of the varying quality of governance – the fault lines, along which the various countries can be classified into groups that are more or less homogeneous. The sixth, closing section deals with the partial failure of endogenous OCA theories, the institutional crisis threatening the unity of the euro area and the reform of the GMU that we consider conceivable.

DEFINITION AND MEASUREMENT

The definition of national-level governance is not standard, and there is no definition that is accepted by all. The content of this concept changes depending on context (ECOSOC, 2006).[1] The UN's specialised institution, the UNDP for example interprets governance covering the whole of society as well as all levels of interactions (UNDP, 1997). It considers all values, policies and institutions by which a society manages its economic, political and social affairs part of governance. Governance, therefore, is the way a society (not just the state) organises itself (UNDP, 2007).

In contrast with the above approach, one of the earlier definitions of the World Bank limited governance to the role played by the state in the management of economic and social resources (World Bank, 1992). A decade later the World Bank significantly expanded (and slightly reinterpreted) its concept of governance. According to the new definition, governance is the state's ability to establish and support institutions that serve the operation of the market (World Bank, 2002). In a report released directly before the outbreak of the global financial and economic crisis, however, the World Bank narrowed down the above definition, and shifted emphasis from the establishment of the conditions of market operation to the relationship of the individuals that make up the state (players of the public sector) and power (World Bank, 2007). In the World bank's reading, therefore, governance today stands for the manner in which public institutions, and public officials themselves, acquire and exercise power over the distribution of scarce resources.

The European Union defines governance as the rules, institutions and behavioural norms that affect the way in which powers are exercised at a European (read: community) level, particularly with respect to openness, participation, accountability, effectiveness and coherence (European Commission, 2001).

One of the most well-known definitions was formulated by *Kaufmann and associates*, who defined governance as *"the traditions and institutions by which authority in a country is exercised"* (Kaufmann, Kraay and Mastruzzi, 2010, p. 5). The objective of the collaboration was to make governance measurable, and to make the results of these measurements comparable.

Our study, which focuses on the governance quality of 30 European states, greatly relies on the database compiled by Kaufmann et al., the so-called *World Governance Indicators* (WGI).[2] Focused on the national state level, the WGI provides comparable values in six dimensions of governance, which are:

❶ voice and accountability;
❷ political stability and absence of violence;
❸ government effectiveness;
❹ rule of law;
❺ regulatory quality;
❻ control of corruption.

Besides other things, the usefulness of the World Bank database stems from the fact that it provides very broad country coverage, greater than that provided by any other data source, and can be considered a sort of summation that averages information from many different data sources. By averaging information, it is able to conveniently grasp the substantial elements of governance, and is more able to ensure its measurability than any individual data source. By providing the margins of error for the estimates, it admits to a certain degree of uncertainty, but at the same time allows the grasping of the significance of the difference between the given values when comparing the indicators in time and space (Kaufmann et al., 2007. p. 1).[3] Also among the unique features of these indicators is that they grasp the opinions (perceptions) of economic players and households on governance, instead of attempting to adequately measure specific regulatory systems, particularly criteria considered to be objective and actually observable, such as legislative, organisational and institutional conditions. The data do not provide the input values of governance, but are interpreted as output values, the summation of opinions on governance and its quality.[4]

Besides the six dimensions of the WGI, four other sources were also used during the research:

❼ the Transparency International corruption perceptions index;

❽ the political rights and civil liberties index of Freedom House;

❾ the index of economic freedom of the Heritage Foundation; and

⑩ the World Economic Forum competitiveness index.

With the exception of the tenth indicator, these also measure subjective perceptions, in other words, the output side of governance.[5]

The index of economic freedom and the competitiveness index provide information specifically on the quality of economic governance. With respect to the current crisis of the European Union, it is of particular importance that this dimension is emphatically represented. The inclusion of competitiveness is important also because one of the decisive directions of public discussion established in connection with the crisis explains divergent economic performances with this (or more precisely its absence), and primarily sees the improvement of competitiveness as the chance to recover from the crisis (see for instance Rácz, 2012; Török, 2012).

As, among other things, the objective of the study was to track the changes of governance quality, it deals with data from 2002 (the first year after the introduction of the euro) as well as 2010 and 2011 (when the countries of the euro area had been using the currency for close to a decade and the impact of the financial and economic crisis was already evident).[6]

Of course, the indicators selected to measure the quality of governance are not independent of each other – this is also true for the WGI published by the same workshop. If for example, the efficiency of government operation improves substantially in a given country, then we can rightly assume that the quality of regulation also improves and that corruption declines.[7] It would also come as no surprise if, as a result of the above, the country's competitiveness were also to improve. In general, we can say that if a given country improves its governance position in a certain area, this change could have significant impact on the whole of governance, and not just a given dimension (the results of the correlation analysis performed using the data of countries included in the sample are contained in the Appendix). The very strong and significant link between the various indicators also shows that the dimensions meant to test the quality of governance (and the variables illustrating these dimensions) are consistent with the definition of governance as well as each other.

In our opinion, the strong correlation that is evident between the dimensions of governance we have determined can be traced back to a sort of general level of institutional development. In the end, by combining the ten dimensions (with the help of the principal component analysis employed in the study), this level of general institutional development becomes indirectly measurable.

EMPIRICAL RESULTS I: THE CHANGE OF GOVERNANCE QUALITY

The creators of the monetary union saw the guarantee of the stability of the single currency in, among other things, the convergence of the performance (such as inflation, long-term interest rate, budgetary deficit or public debt) of acceding countries measured with nominal macro-economic indicators. At the same time, they failed to take into account the fact that convergence realised in nominal indicators by no means stands for the actual harmonisation of Member State governance. The ranking created with the help of the ten dimensions and using principal component analysis informs us of the development of Member State-level governance quality and is shown in *Table 1*.[8]

The governance quality ranking shown in Table 1 presents no particular surprises. The leaders include developed Western European countries (regardless of whether they are GMU or EU members). In the middle, we find the states that acceded in 2004, while those lagging behind include the countries of the Balkans

Table 1

THE RANKING OF GOVERNANCE QUALITY IN EUROPE

Rankings 2010–2011	Rankings 2002	Change	Country	Principal component value, 2002	Principal component value, 2010–2011
1	3	+2	Switzerland	1.19	1.34
2	2	0	Denmark	1.20	1.34
3	1	–2	Finland	1.33	1.34
4	4	0	Sweden	1.11	1.26
5	5	0	Netherlands	1.10	1.11
6	7	+1	Norway	0.92	1.05
7	8	+1	Austria	0.86	0.88
8	9	+1	Germany	0.83	0.83
9	6	–3	United Kingdom	0.95	0.81
10	10	0	Ireland	0.83	0.79
11	11	0	Belgium	0.63	0.64
12	14	+2	France	0.27	0.45
13	15	+2	Estonia	0.09	0.29
14	12	–2	Spain	0.40	0.00
15	19	+4	Czech Republic	–0.16	–0.02
16	13	–3	Portugal	0.33	–0.06
17	16	–1	Slovenia	–0.03	–0.13
18	22	+4	Poland	–0.44	–0.17
19	20	+3	Lithuania	–0.35	–0.21
20	24	+4	Slovakia	–0.50	–0.29
21	17	–4	Hungary	–0.04	–0.38
22	23	+1	Latvia	–0.49	–0.56
23	18	–5	Italy	–0.16	–0.61
24	26	+2	Croatia	–1.14	–0.91
25	21	–4	Greece	–0.38	–1.05
26	25	–1	Bulgaria	–0.93	–1.08
27	27	0	Romania	–1.45	–1.11
28	28	0	Turkey	–1.71	–1.46
29	29	0	Albania	–2.01	–1.59
30	30	0	Ukraine	–2.26	–2.50

Note: Based on the principal component analysis, only a single component could be identified in both periods under review. The component explained 87.1 per cent of variable variance in 2002, and 83.7 per cent of variable variance of data recording in 2010–2011. As the indices – depending on their sources – all give the values of governance quality on different scales, comparability was ensured by so-called Z-values. The expected value of the data recalculated on the basis of certain indicators is 0, and dispersal is 1. The change in rank of course only indicates how the given country performs(ed) compared to the others. It is possible for a country to climb/drop in the rankings even though there is no actual change in the quality of governance (in fact, it may drop/climb even if the aggregate governance indicator improves/deteriorates in the period under review).

Source: Authors' own calculations based on World Bank (2011), TI (2012), Freedom House (2012), Heritage Foundation (2012) and WEF (2012).

and the Ukraine, as well as Romania and Bulgaria. In light of our results, what might be novel is the direction and rate of changes. Two new trends are emerging in the new millennium. On the one hand, the quartet comprising Spain, Portugal, Italy and Greece (increasingly frequently referred to as periphery countries) are beginning to fall behind developed Western (or core) countries. On the other, the majority of countries from the ex-Socialist block are showing significant improvement.

The Southern (or periphery) countries that are considered old Member States clearly showed worse results than in 2002. Deeper data analysis proves that this is most apparent in the efficiency of government work. The quality of public services, not of an outstanding level to begin with, deteriorated as did the efficiency of the shaping and implementation of public policy as well as the credibility of governance. Corruption in the public sector increased. The abuse of power reached such a dramatic rate in Italy and Greece that it undermined political stability. Political stability was also shaken in Spain; by the time the crisis arrived, the level of stability approximated that of Albania and Greece. Along with Portugal, the quality of regulation also plummeted in Greece, in other words, the ability of the government and the public sector to support the development of the private sector through public policy weakened significantly. Unsurprisingly, the Southern states also showed a decline in economic freedom.

Nevertheless, dispersion is considerable within the group of periphery countries as well. Though Spain and Portugal moved further away from the core and are today ranked among well-performing CEE countries (the two countries achieved results practically equal to that of the Czech Republic), they are still far ahead of Italy and Greece. Moreover in 2002, in the government effectiveness dimension Spain still performed at the level of Germany or Belgium, and on aggregate was ranked ahead of France for example. At the same time, Greece and Italy are very far behind the EU's "Western-block" and has clearly sunk down to the lower strata of the CEE region. The governance of Greece is on level with that of Bulgaria and Romania, practically tied in positions 24–27 of the governance ranking. Whereas, in 2002, when the country introduced the euro, it was on level with countries today looked upon as success stories, such as Poland for example.

Ireland, which moved into focus in connection with the crisis, deserves special mention. While the other four euro area countries hit by the crisis were forced to suffer significant losses of position, Ireland is stable in maintaining its position and continues to perform at the level of core countries, in other words there is nothing to justify classifying Ireland as a periphery state. The quality of governance not only did not deteriorate in the period under review, but the country proved to be decidedly successful in the fight against corruption. It is no coincidence that the signs of recovery from the crisis were most apparent here. The greatest challenge for Ireland is restoring competitiveness, which task cannot be separated from reinforcing the financial intermediary system.

At the same time, the majority of new Member States acceding to the EU in 2004 achieved positive repositioning, often advancing three or four positions compared to previous results. These countries started off relatively from the back of the line (from very low) and underwent considerable institutional transformations both before and after the EU accession. These profound changes, which impacted formal and informal institutions alike, covered all dimensions of governance. Typically for example, those in the region that performed well all improved in the field of political rights and today boast values virtually equal to those of Western core countries. Moreover, they also improved in terms of rule of law and – though to varying degrees – significantly reduced corruption as well.

As a result of this considerable improvement, the Czech Republic and Estonia has today caught up to the group of developed Western countries and has every chance of rapidly integrating into this group. Both states showed improvement in all the dimensions we have examined. The Czech Republic achieved significant results in reducing corruption and promoting economic freedom, while Estonia showed outstanding improvement in rule of law and government effectiveness. Estonia, in fact is close behind the governance performance of France.

Slovakia has proven to be one of the most dynamically improving countries of the last ten years. Beside the fact that in just under a decade the country improved its aggregate economic performance by a good 50 per cent (per capita GDP was USD 20,760 in 2011), our neighbour to the north also produced a strong turnaround in most dimensions of governance. This is particularly true in the case of the efficiency of government work, the rule of law and the reduction of corruption. Of course this improvement is also due to the fact that Slovakia started the noughties in a relatively bad position; it was only 24th in a list with 30 countries. In other words besides the Albanian-Turkish-Ukrainian triumvirate, it only managed to get ahead of Bulgaria, Croatia and Romania and was considered the weakest performing EU country at the time of the 2004 expansion.[9]

The case of Poland is unique in that in contrast with other countries in the region, it showed the greatest improvement in the field of political stability, which primarily manifested itself in the cycles becoming longer and more predictable, and the fragmented party system becoming more concentrated (Kozenkow, 2012). The Czech-Polish-Slovak improvement gains particular significance through the fact that as countries of the Visegrád block, they are now ahead of Hungary which in 2002 was considered the forerunner of the V4.

At the same time, a trend different from that in CEE countries emerged in Hungary. Ranked 17th in 2002, Hungarian governance was at the level of Estonia, Slovenia, and the Czech Republic and was already ahead of not only Greece, but Italy as well. In under a decade, however, the country fell four positions compared to its previous ranking, which means it is now 7–8 positions behind the Czech Republic or Estonia, which improved greatly compared to themselves. The country today performs at the level of the greatly improved Slovakia or the weakest of the Baltic states, Latvia. In the period under review, Hungary was unable to maintain its governance performance in any of the ten dimensions examined. This led to Hungary becoming almost the only country in the CEE region to worsen in the fields of political stability and civil liberties as well. Of course, on a not entirely unrelated note, the country also suffered a great decline in the dimensions of corruption and government effectiveness.

EMPIRICAL RESULTS II: FAULT LINES IN EUROPE

After compiling the database, we were able to carry out a cluster analysis by way of using several types of distances and group formation methods (the results can be interpreted as a summation of these methods). While the cluster analyses performed on the basis of data gathered in 2002 more or less confirmed the three-way division, which divided the 30 countries into (1) leading advanced Western countries, (2) the new CEE countries that have acceded in 2004, and (3) the laggards, countries in the Balkans, this division – typically established on the basis of

Table 2

GOVERNANCE CLUSTERS IN EUROPE (2010–2011)

Developed western countries				Converger group		The 'Balkans'	
Northern block	EU-core	EU-core+	Forerunners	Converger core	Aspirers	West-Balkans	East-Balkans
Denmark	Austria	Great-Britain	Estonia	←Czech Republic	Latvia	Croatia	Albania
Finland	Belgium	....	....	Poland	....	Romania	Turkey
Sweden	Germany	Ireland→	Spain	Slovakia	Italy→	Bulgaria	....
Netherlands	....	....		Lithuania		....	Ukraine
....	←Norway	France→		....		Greece	
Switzerland				Portugal			
				Slovenia			
				Hungary			

Note: The summary table should be viewed as a sort of summation of the various distances and group formation methods. The names do not necessarily represent geographical terms. The arrows indicate the direction of movement of the given country (essentially, they mean that from time to time, the analysis classifies the country examined in the neighbouring cluster).

Source: Authors' own calculations based on World Bank (2011), TI (2012), Freedom House (2012), Heritage Foundation (2012) and WEF (2012).

geographical location and level of development – is now outdated and unsupported by the facts on account of the crisis. The groups have become looser, interoperable, the "new member states" category is no longer justified; it is better to refer to these countries as "convergers". *Table 2* was created on the basis of 2010/2011 data.

There are several fault lines within the ranks of developed Western European countries, which the crisis has made more visible. The separation of Denmark, Finland and Sweden (let's call them the Nordic group) was confirmed by all the methods we have used for our cluster analysis. Netherlands and non-EU member Switzerland also belong to this group. These five countries represent the most stable lot of the 30 countries examined.

Within the comprehensive block of developed Western European countries the group of core countries does exist and can be separated from other units quite well, but with a slightly different composition. The Netherlands for example is closer to the the Nordic group of countries. However, the core group is not uniform either; it is divided into several groups. There is a group of three countries at the very centre: Austria, Belgium and Germany. The wider core group also includes Great Britain, and Ireland also belongs to this group despite the crisis. It is also interesting that while in 2002 Ireland and Great Britain were closely linked together (and Spain was often grouped into the same group as Great Britain and Ireland), as a result of the crisis this close relationship no longer exists and the cluster analysis linked Ireland with Estonia on several occasions. On account of these results, it can be safely concluded that Ireland should by no means be linked to the periphery – regardless of how a periphery is defined.[10]

France, one of the engines of integration, is only part of the wider core group. It is not part of the narrow core group. At the same time the cluster analysis and the ranking generated by principal component analysis show that in the examined period, France edged closer to the core countries, while putting a distance between it, Spain and Portugal, to which it was closer to before the crisis. This change is due to the fact that while the two latter countries have achieved poorer governance quality, France was able to improve. We should mention, however, that according to the lessons of Table 1, even though France is one of the improvers, it is still ranked last among Western developed countries.

The cluster analysis also confirmed that as a consequence of the crisis, the Greek-Italian-Portuguese-Spanish quartet is no longer part of the narrower core, or the broader Western developed block for that matter. This primarily represents a significant change for Spain, which in 2002 was still a member of the broadly interpreted core. Today, it is in the same camp as the successfully acceding new applicants. Portugal on the other hand was already at the level of the Slovenia-Czech pair in 2002, and was rarely in the same block as Spain. Even in 2002, Italy and Greece could not be classified into the same community as the Western developed countries; moreover, they could not be mentioned on the same page (or group) as Spain or Portugal either. The crisis just made the significant differences within the periphery, and the seemingly irreversible break-off of the Italian-Greek pair from Western Europe even more tense. Moreover, based on the governance dimensions we examined, even in 2002, Greece could only make it into the group of 'aspirers', i.e. the countries freshly acceding to the EU. One decade on, and it has no chance of being in the same group as any of the countries which became EU members in 2004. Greece has today become one of the countries of the Balkans.

Among the successfully acceding new states, the Czech Republic is stable in maintaining its position in the camp which currently includes Slovenia or Portugal and which used to include Hungary as well. Poland and Slovakia have now solidified their position in the block of 'converging core countries'. Not even ten years ago, Slovakia belonged to the group we call 'aspirers' in the company of Latvia, Lithuania and Hungary. The name 'aspirers' refers to the fact that the objective of the countries in this group continues to be convergence to the EU core (or at least they want to avoid irreversibly falling behind the core countries of the CEE region). At the same time, one of the surprising results of the cluster analysis could be the fact that in none of the cases is the Czech Republic classified in the same group as the other outstanding performer, Estonia. Instead, we see that as a result of the crisis, on the one hand, the Czech-Polish-Slovak trio (which is joined by Lithuania as a fourth country according to the cluster analysis) grew stronger, and on the other, Estonia is in fact more comparable to Ireland than other CEE states.[11]

In the past, Hungary was clearly comparable to the Czech Republic in terms of governance. The composition has now changed, but the country cannot be clearly assigned to the group of the converging core or the converging aspirers, though perhaps it is closer to the latter. Hungary, therefore, which in the past for quite some time was considered the forerunner of the V4, had by 2010 dropped to the back of the group. The question for Hungary is whether it will be able to prevent the further deterioration of its position, as one of the lessons of the cluster analysis is that while falling behind the CEE core countries, Hungary, along with Latvia, is edging closer to the countries of the West-Balkans.[12]

A reorganisation can be observed in the Balkans as well, and in fact, the Balkans, as a type of category of quality, may also invoke a different meaning in the future. The situation was relatively clear in 2002: the Balkans were split into two large units: Croatia, Romania and Bulgaria in the 'West Balkans', and Albania and Turkey in the 'East Balkans' – with the Ukraine joining the latter two, falling slightly behind. By 2011, the two large groups were still there, however, their relationship with one another was terminated. Instead, the West-Balkans in essence became comparable to a set of countries, where Italy pops up from time to time and where Greece has a practically stable position. In fact, at times Greece is comparable to Albania.

GOVERNANCE AND TRANSITION TO THE EURO

Member State-level governance appreciates in connection with the economic and financial crisis if it can be assumed that economic governance can only be transformed successfully at the European level, if the national governance systems show a certain kind of harmony as well. That is because the presence of convergence means that there are certain shared norms, habits, and forms of behaviour beyond the statutory and regulatory provisions (using earlier terminology this would be the input side of governance), meaning that there is a certain common denominator that would make it possible to successfully conclude the institutional reform of the EU's economic pillar.

On the other hand our study proves that in the EU there is no general automatic convergence effect that would affect every member. Certain Member States of the EU and of the euro area, which supposes closer cooperation, are significantly lagging behind in terms of governance, while others are engaged in a clear convergence process. This means that divergence and convergence are simultaneously present in the European Union. This fault line is present both within the euro area as well as outside of it. Therefore, the increasingly popular notion of a multi-speed EU, a categorisation based on who is a member of the euro area and who is not, is unrealistic. Therefore, it would be an obvious error to designate the grades of integration on this basis.

It is now obvious that the nominal macro-economic compliance forced on the countries by the Maastricht convergence criteria directly before accession cannot make up for the long preparation process, which can ensure convergence at the level of the formal and informal institutions (Boltho and Carlin, 2012). Practice shows that the finding of the endogenous optimal currency area theory, according to which convergence is (will be) induced by the act of the adoption of the single currency itself[13] may not be justified, or may not be fully justified. Due to the lack of spontaneous convergence as promoted by the endogenous OCA theories, it was also proven that the euro is not a protective shield for every situation. The fact that a country uses the euro does not mean that it cannot become vulnerable – and not primarily by the actions of the international money and capital markets, rather by its own internal, specifically narrow-minded political actions.

One can even venture that contrary to endogenous theories the introduction of the euro not only did not facilitate the convergence of the peripheral countries to the core countries, but it made it even more difficult. From a somewhat extreme point of view joining the GMU could even be interpreted as an exemption from their obligation to continue to practice disciplined, high-quality, credible governance. In this context, the strained period of convergence of the nineties was more of an exception on the periphery than a typical characteristic of "times of peace" (Benczes, 2012). However, this type of severe judgement is more appropriate for Italy and Greece than for Spain.

It is not in the interest of Member States to take a step back and re-introduce their own currencies, nor it is in their interest to keep up the earlier irresponsible economic policies. The rational decision would be for the countries to start transitioning towards elevating certain parts of their national policies to the EU level. This is also supported by the fact that the electorate supports keeping the single currency in the countries that are most heavily affected by the crisis. The decisions made at the supra-national level that take professional considerations into account as well can replace the weaker national institutions with stronger community institutions.[14]

Naturally, from the perspective of the euro area and the future of the economic governance of the EU, one of the most important questions is what is going to happen to Greece and more importantly with two of the larger countries, Italy and Spain. Looking through the lens of our study, bringing up the issue of the voluntary withdrawal (or forced withdrawal) of Greece is no heresy. This option has gained considerable ground in both professional circles (see Feldstein, 2010) and political life (see first Schäuble, 2010). Relying upon the results of our analysis and seeing the processes of the not so distant past, the question now is whether Greece will have a place in the EU at all?

Our analysis clearly proved that Spain cannot be mentioned on the same page with Greece. It is true that the quality of Spanish governance has dropped considerably, but it is still within reaching distance of the governance exercised by the core countries and it is not worse than the Czech Republic's or that of fellow euro-using Estonia. Therefore, with respect to Spain the issue is how much the EU on the hand, and Spanish society on the other hand, is willing to pay to avoid complete economic and political ruin. The establishment of the European Stability Mechanism in a way that allows the non-performing members of the financial intermediary system to receive capital, is a clear indication of the EU's willingness to bail out Spain. The situation, however, is not nearly as clear-cut in the case of Italy. Our analysis shows that Italy does not really fit into the euro area, but is also too big to fail. Therefore, the question once again is whether there is enough political will to bail out Italy both on the part of the internal as well as external actors.

The new Member States also have their share of lessons to teach. Estonia (which is edging closer to the core countries and is barely behind France) and Slovakia (the now stable member of the Visegrád four) are new additions to the euro area. Both have improved their previous governance practices and have come very close to the core countries in terms of economic development. In the case of Slovakia – which introduced the single currency in 2007 – the improvement can at least be partially explained by the introduction of the euro (or the preparation that came with the transition). Estonia's improvement, however, which was only allowed in 2011, was not due to the introduction of the euro or the transition process. The Nordic state has been heavily invested in conscious macroeconomic planning first starting in the nineties, which would have brought success regardless of the euro (or the hope of transitioning to the euro). But other countries in our region were able to practice successful and credible economic policy without the euro (without setting the target of introducing the euro to be more precise). The Czech Republic and Poland are convincing points in case.[15]

Based on our study, there is no clear answer to the question of whether introducing the euro is worth it or not. In our opinion, this can only be ascertained on the basis of the specific circumstances of the given country. Obviously, there are experiments to separate countries that are mature enough and countries that are not mature enough to introduce the euro (a case in point would be the flexibility of the Maastricht criteria, or that of the Mundell factor mobility, or measuring the quality of governance as described in this study) but we have no set of successful criteria that is always applicable under all circumstances.

Appendix

CORRELATION MATRIX (2010–2011)

	Government effectiveness	Regulatory quality	Rule of law	Control of corruption	Voice and accountability	Political stability and absence of violence	Corruption perceptions index	Economic freedom	Political rights	WEF compe-titiveness	Per capita GDP
	2010	2010	2010	2010	2010	2010	2011	2011	2011	2011	2011
Government effectiveness 2010	1.000	0.931	0.971	0.959	0.925	0.708	0.945	0.747	0.787	0.891	0.885
Regulatory quality 2010	0.931	1.000	0.947	0.906	0.919	0.693	0.883	0.863	0.830	0.849	0.826
Rule of law 2010	0.971	0.947	1.000	0.960	0.949	0.684	0.943	0.757	0.796	0.876	0.908
Control of corruption 2010	0.959	0.906	0.960	1.000	0.902	0.665	0.993	0.759	0.715	0.929	0.897
Voice and accountability 2010	0.925	0.919	0.949	0.902	1.000	0.790	0.878	0.710	0.859	0.819	0.889
Political stability and absence of violence 2010	0.708	0.693	0.684	0.665	0.790	1.000	0.644	0.557	0.699	0.600	0.637
Corruption perceptions index 2011	0.945	0.883	0.943	0.993	0.878	0.644	1.000	0.736	0.677	0.944	0.883
Economic freedom 2011	0.747	0.863	0.757	0.759	0.710	0.557	0.736	1.000	0.690	0.718	0.609
Political rights 2011	0.787	0.830	0.796	0.715	0.859	0.699	0.677	0.690	1.000	0.598	0.718
WEF competitiveness 2011	0.891	0.849	0.876	0.929	0.819	0.600	0.944	0.718	0.598	1.000	0.848
Per capita GDP 2011	0.885	0.826	0.908	0.897	0.889	0.637	0.883	0.609	0.718	0.848	1.000

Note: in each case, correlation is significant at the 1% level (one-sided test). There is no substantial difference in the correlation matrices determined on the basis of 2002, 2010 and 2011 data; therefore, we have only indicated the data of the latter. In the table's last column, we used gross domestic product – a generally accepted value that grasps the level of economic development – as a sort of control variable, or more precisely its variant calculated at purchasing power parity with constant market prices. It is clear that the indicator of economic development is also in close relationship with the dimensions of governance.

Source: Authors' own calculations based on World Bank (2011), TI (2012), Freedom House (2012), Heritage Foundation (2012) and WEF (2012).

Notes

[1] The study does not deal with the issues of global or corporate governance, and focuses solely on governance at the national level.

[2] Besides the 24 Member States of the European Union (with Luxembourg, Malta and Cyprus omitted), those with candidate status (Croatia and Turkey), as well as other states (voluntary decliners such as Norway and Switzerland, and non-invitees like Albania, and the Ukraine,) were included in the sample.

[3] For more on the methodology, see Kaufmann et al. (2010)

[4] A summary of the typical criticisms of the methodology has been provided by Kurtz and Shrank (2007). Their refutal has been formulated by Kaufmann et al. (2007) and Kaufmann and Kraay (2008).

[5] We will skip the detailed critical presentation of these databases. An excellent summary is provided in Hungarian literature by Muraközy (2009). Kapás and Czeglédi (2011) (also) write about the measurability of economic and political freedom. The websites of the institutions that published the databases also provide useful information.

[6] The research, therefore, primarily concerns the period between 2001–2002 and 2010, and the conclusions drawn therein are relevant by taking this into account.

[7] The value of the correlation between the efficiency of government operation and regulation is +0.93, while the effectiveness of government and the control of corruption shows an even stronger, +0.96 correlation. Data on the closeness of the relationship of variables are contained in the Appendix.

[8] Similarly to regression analysis, the principal component analysis attaches trends (lines) to the data. The difference is that while regression informs us about the change in the dependent variable caused by the change of the value of the explanatory variable, principal component analysis shows the change caused in the original variables when shifting along the given principal component. As in most cases more than one (in our case all) components may be linked to a given principal component, the method is suitable for reducing the number of dimensions – which explains its widespread use.

[9] On Slovakia's successful convergence see Győrffy (2009) and Sigér (2009)

[10] The situation of Norway is unique in that, depending on the period, it either belongs to the Nordic group (based more on the 2002 data) or the narrow EU core group of Austria–Belgium–Germany (based on the latest data). Therefore, the governance of Norway is closer to the EU core countries as a result of which its accession to the EU could even be justified.

[11] We should mention that with respect to governance quality, our study distinguishes no single CEE block or cluster that could be clearly separable from other, for instance Western European models. At the same time, based on the methodology applied by the school of 'varieties of capitalism', Farkas (2011) found that the countries of the CEE could be classified into an independent (fifth) cluster, alongside the well-known Western Anglo-Saxon, Continental, Northern and Mediterranean blocks.

[12] Based on certain methods (see the Ward method in particular, which produces perhaps the clearest results), the group of 'aspirers' ceases to be an independent block, and the elements of the group

(Latvia, Hungary and Italy) are classified as part of the West-Balkans.

[13] See Frankel and Rose (1998)

[14] Moreover, this process may even result in national institutions becoming stronger, which could reinforce endogenous OCA theories as well. Nonetheless, this requires a critical mass of reforms and EU institutions, the description of which is not covered by the scope of this study.

[15] See Neményi and Oblath (2012) for the chances of the introduction of the euro in the region and specifically in Hungary.

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