Abstract

Liberal intergovernmentalism explains the politics to cope with the euro zone crisis by the constellation of national preferences and bargaining power and by institutional choices designed to commit euro area countries credibly to the currency union. National preferences resulted from high negative interdependence in the euro area and the fiscal position of its member states: a common preference for the preservation of the euro was accompanied by divergent preferences regarding the distribution of adjustment costs. These mixed motives constituted a ‘chicken game’ situation characterized by hard intergovernmental bargaining and brinkmanship. Whereas negotiations produced a cooperative solution averting the breakdown of the euro zone and strengthening the credibility of member state commitments, asymmetrical interdependence resulted in a burden-sharing and institutional design that reflected German preferences predominantly.

Keywords

Euro zone crisis, European Union, Institutional reform, Integration theory, Liberal intergovernmentalism
1. Introduction

The euro zone crisis has been the deepest in European integration. In many member states, it featured a major economic downturn and fiscal squeeze, a sharp decrease in citizen support for European integration, and mass protest against EU-imposed austerity policies. It also put in question the euro zone membership of some countries – and potentially the survival of the common currency, the EU’s flagship integration project. At the same time, the crisis produced a major leap in financial and fiscal integration designed to stabilize the euro and the euro area. The EU strengthened its regime of fiscal and economic surveillance; it created a permanent bailout mechanism for insolvent countries (the European Stability Mechanism ESM) and a ‘banking union’.

Both deep crises and major progress in European integration have regularly triggered and reshaped debate between theories of integration. From the mid-1960s, the ‘empty chair crisis’ and the subsequent period of stagnation in supranational integration did much to boost ‘intergovernmentalism’ as an alternative to the dominant neofunctionalist paradigm (e.g. Hoffmann 1966). The new dynamism in European integration from the Internal Market Program to Monetary Union was accompanied by a revival of neofunctionalism (e.g. Stone Sweet and Sandholtz 1997) and a reformulation of intergovernmentalism (Moravcsik 1993). In turn, the politicization of European integration spurred by this dynamism was reflected in a ‘postfunctionalist’ approach (Hooghe and Marks 2009) focusing on the mass-level politics of European integration.

Liberal intergovernmentalism (LI) is a major contender in this debate. Developed by Andrew Moravcsik in the 1990s by fitting a liberal theory of state preferences and a neoliberal theory of international interdependence and institutions to earlier – predominantly ‘realist’ – approaches, LI has quickly established itself as the most elaborate version of intergovernmentalism (Moravcsik 1993; 1998). In a one-sentence summary of his theory, Moravcsik argues ‘that a tripartite explanation of integration – economic interests, relative power, credible commitments – accounts for the form, substance, and timing of major steps toward European integration’ (1998: 4). LI conceives of ‘European integration ... as a series of rational choices made by national leaders’ (Moravcsik 1998: 18) in response to international interdependence. Integration results from three steps that translate the incentives created by international interdependence into collective institutional outcomes: the domestic formation of national preferences, intergovernmental bargaining to substantive agreements and the creation of institutions to secure these agreements. In a nutshell, LI argues that national preferences are shaped by the economic interests of powerful domestic interest groups in a situation of international interdependence; substantive agreements reflect the constellation of national preferences and bargaining power; and the design of international institutions is a function of the kind and size of cooperation problems they are supposed to manage.

LI has arguably acquired the status of a reference or baseline theory: ‘an essential first cut against which other theories are often compared’ (Moravcsik and Schimmelfennig 2009: 67). On the other hand, LI has been criticized for providing mere ‘snapshot’ views of individual intergovernmental bargaining episodes and for failing to account for the endogeneity of the integration process, i.e. for how integration decisions at one point in time are shaped and constrained by the effects of earlier integration decisions (e.g. Pierson 1996: 127; Wallace et al. 1999). I argue in this paper that LI does, indeed, provide an ‘essential first cut’ in explaining the ‘major steps toward European integration’ taken in euro zone crisis. Because LI is a theory of integration, it offers no specific propositions to
account for the crisis as such. The euro area’s responses to the crisis, however, can be explained plausibly as a result of intergovernmental bargaining based on partly converging and partly diverging member state interests and designed to strengthen the credibility of member state commitments to the common currency. National preferences resulted from strong interdependence in the euro area and the fiscal position of its member states: a common preference for the preservation of the euro was accompanied by divergent preferences regarding the distribution of adjustment costs. These mixed motives constituted a ‘chicken game’ situation characterized by dynamics of hard bargaining and brinkmanship. Whereas negotiations produced a cooperative solution averting the breakdown of the euro zone and strengthening the credibility of member state commitments, asymmetrical interdependence resulted in a burden-sharing and institutional design that reflected the preferences of Germany and its allies predominantly. In a broader historical perspective, however, crisis bargaining was very much constrained by the unintended spillovers and path-dependencies of the original decision for and design of monetary union. These spillovers resulted both in the endogenous interdependence of the euro zone and in the converging preferences for the preservation of the euro zone, which shaped the bargaining dynamics and outcomes.

The main sections of this paper follow LI’s tripartite analysis of preferences, bargaining, and institution-building. In each section, I develop case-specific expectations on the euro zone crisis and put them to a series of simple congruence tests with the empirical record. I do not provide a chronological narrative of negotiations and integration in the euro crisis but need to limit myself to a few crucial episodes at the height of the euro zone crisis between 2010 and 2012. In addition to the scholarly literature, I rely mainly on newspaper reports and official documents on the integration outcomes. Moreover, I cannot systematically test alternative explanations to check whether LI offers the only or best explanation of integration in the euro zone crisis. I hope to show, however, that the LI expectations fit the broad pattern of preferences, negotiating behavior, and outcomes reasonably well. The concluding section summarizes the results and discusses the merits and limitations of LI.

2. National preferences in the euro crisis

According to LI, the preferences of governments on European integration are national and issue-specific. They result from a domestic process of preference formation and are oriented towards increasing (and possibly maximizing) national welfare in the issue-area at hand. This assumption distinguishes LI from other integration theories. In contrast with both supranationalist and constructivist assumptions, preferences are conceived as exogenous to integration. They are neither the result of institutionally induced international learning or socialization processes nor primarily shaped by domestic ideas. Finally, states do not pursue strategic geopolitical interests as assumed by realist intergovernmentalism.

Most fundamentally, preferences for integration result from critical positive or negative interdependence. Actors seek policy integration if they are convinced to reap higher net benefits than from unilateral, autonomous or only loosely coordinated national policies. LI thus expects steps of integration taken in the euro crisis to be driven by common perceptions of interdependence and the desire to avoid losses and reap benefits. Among the various forms of integration and substantive rules that produce such net benefits, actors strive to realize those that maximize their gains.
The nature of the preferences and the relevant domestic actors and interests vary by issue area. Domestic economic interests most clearly shape state preferences on issues of commercial or economic policy, the ‘more intense, certain, and institutionally represented and organized’ they are (Moravcsik 1998: 36) and the less ‘uncertainty there is about cause-effect relations’ between EU rules and individual welfare. Conversely, ‘the weaker and more diffuse the domestic constituency behind a policy’ (Wallace et al. 1999: 171) and the more uncertain and modest ‘the substantive implications of a choice’, the less predictable are national interests and the more likely ideological preferences will prevail (Moravcsik 1998: 486-9; Moravcsik and Nicolaïdis 1999: 61). In Moravcsik’s original formulation, macro-economic policies such as monetary policy and fiscal policy are generally less likely to have strong or clear substantive implications for specific interest groups than market-making or market-regulating rules. Therefore, he expects integration preferences in this area to reflect ‘the macro-economic preferences of ruling governmental coalitions’ (Moravcsik 1998: 3).

Because the euro zone crisis started out as a financial and banking sector crisis before it turned into a sovereign debt crisis, and because the reforms included supranational regulations of the financial market, however, business interests need to be taken into account as well. In the sovereign-bank nexus that developed during the crisis, financial market and state interests became strongly intertwined. Finally, the short-term welfare implications of many crisis policy alternatives, especially the austerity policies, were clear and strong. For this reason, LI would assume material interests to prevail over ideological preferences.

Monetary union brought together countries pursuing different growth strategies: a supply-side or export-led growth strategy based on wage restraint, productivity and competitiveness in Germany and the ‘north’ of the euro zone and a demand-led growth strategy based on fiscal expansion and wage inflation in the ‘south’ (Hall 2012: 358-9). Monetary union increased the divergence of these strategies, forcing Germany into even stronger supply-side reform in the early 2000s and allowing the southern countries to borrow at low cost (Scharpf 2011: 13-16). As a result, the financial market shifted large balance-of-payment surpluses generated in the north to the south, fuelling real-estate bubbles (mainly in Ireland and Spain) and public sector debt (above all in Greece, Italy, and Portugal) and leaving southern countries highly vulnerable to the financial market turbulence and credit squeeze that followed the US subprime mortgage crisis of 2008 (Hall 2012: 360; Scharpf 2011: 17-22). Because EMU left the responsibility for rescuing national banks and banking systems with the member states, a dynamic sovereign-bank nexus developed: governments undertook financial sector bailouts that increased sovereign credit risk, which in turn increased the vulnerability of banks invested in sovereign bonds (Acharya et al. 2011). In Ireland and Spain, the bursting of the real-estate bubble forced states with balanced budgets to go into debt and risk their creditworthiness; in Greece, a government facing sovereign default was about to drag down its national financial system; and both banking and sovereign debt crises in the south left French, German and other northern banks heavily exposed, threatening northern governments with the prospect of having to bail them out.

This negative financial and fiscal interdependence provides the background for the development of state preferences at the outset of the euro zone crisis. LI expects that such interdependence creates a strong incentive for more integration under the condition that euro zone governments perceive that integration would produce lower losses than stagnation or even disintegration. According to the mainstream scenarios, this was the case. For the highly indebted countries, abandoning the euro would have meant sovereign default, a likely breakdown of the monetary and financial system,
hyperinflation, and being cut off from external capital. Moreover, contagion effects were widely expected. Whereas the other euro countries may probably have been able to cope with a default and exit of Greece alone, there was reason to fear that financial markets would lose trust in the euro more generally, withdraw from further debt countries, and force the euro zone to back countries (such as Spain and Italy) that were too big to rescue. For Germany and the north, a breakdown of the euro would have resulted in a steep appreciation of its currency, a concurrent slump in exports, and deep and long-lasting recession.

Any common interest in avoiding the costs of non-integration, however, would be accompanied by distributional conflict about the terms of integration. Simply put, the costs of adjustment in the crisis could either be mutualized, e.g. in the form of Euro bonds or fiscal equalization schemes, in which case the solvent member states of the North would pay for the heavily indebted member states and their banking systems; or adjustment could be nationalized in the form of fiscal austerity, wage and price depression, thus putting the burden of adjustment on the debt-ridden southern countries, forcing them to create the means to service their credits, and sparing the northern countries from bailing out their banks. These considerations lead to two propositions on national preferences in the euro crisis:

(1) States prefer (more) integration to disintegration or the status quo in order to avoid welfare losses in a situation of negative international interdependence.

(2) National preferences on the terms of integration depend on the fiscal position of the state.
   a. Solvent northern countries prefer national adjustment.
   b. Heavily indebted southern countries prefer mutualized adjustment.

LI thus expects mixed state motives in the euro crisis: a common interest in the survival of the euro (area) based on perceptions of interdependence and potential net losses and conflicting preferences on the distribution of the burdens of adjustment depending on their fiscal position.

From the beginning of the acute crisis, governments have, indeed, been united in their commitment to the survival and defense of the euro (zone), and this position was underpinned by a strong sense of negative interdependence and prohibitive costs. No government of a highly indebted country intended to give up the euro. Greek Prime Minister Papandreou asserted there was ‘no chance’ this was going to happen. The same is true for the solvent countries. Early on in the crisis, the German government vowed to ‘act decisively’ if the ‘stability of the euro’ was in danger. Accordingly, German Chancellor Merkel and Finance Minister Schäuble publicly defended the rescue of Greece as necessary to ensure the ‘stability of the euro’ and the ‘entire euro area’. Schäuble considered the damage of a default of a euro country to be incalculable and more costly than the rescue. In fact, he likened a potential default of Greece to the bankruptcy of Lehman Brothers that accelerated the global financial crisis in 2008. In this vein, Merkel and Schäuble repeatedly declared the rescue to be ‘alternativlos’ (without any alternative). Merkel furthermore strictly refused to push for the exit of Greece from the Eurozone. Similarly, French President Sarkozy stated: ‘if we created the euro, we cannot let a country fall that is in the euro zone.’ He declared France to be ‘fully determined to support the euro and to support Greece’. Later in the crisis, EU heads of state and government have continued to stress their public commitment. Merkel vowed to do everything to defend the euro; French President Hollande and Italian Prime Minister Monti expressed ‘their will to do everything ... to defend, preserve, and consolidate the euro zone’.
According to a *Financial Times* background series on the crisis, there was indeed no questioning of defending and consolidating the euro but support for Greek membership did not remain rock solid behind the scenes (Spiegel 2014). Reportedly, at the height of the crisis, Schäuble headed the “infected leg camp” of policymakers and advisers arguing that the exit of Greece from the euro zone was necessary to save and strengthen the euro. By contrast, the “domino camp” feared that “Grexit” would result in market panic and contagion including Spain and Italy and lead to the unraveling of the euro zone. In a situation rife with uncertainty, Merkel ultimately decided against taking the risk of Grexit. This debate shows that the preferences of Germany, a core actor, on Grexit, a core policy question during the crisis, were not unitary, fix or internalized but resulted from calculations of negative interdependence and risk in a situation of high uncertainty.

Whereas the euro area countries (ultimately) agreed on the supreme goal of preserving the euro and the euro zone, they held strongly conflicting reviews on the means to achieve this goal. Germany together with Austria, Finland, and the Netherlands sought to minimize their liabilities and financial assistance. What unites these countries is their high solvency and credit rating, which made them independent of external assistance. In early 2010, Germany was the most reluctant Eurozone country to commit itself to the Greek bailout. The governments of Austria, Finland, and the Netherlands sympathized with the German position, however. The German government favored bringing in IMF assistance, rejected euro bonds and capital-raising by the European Commission, called for a strengthening of the Stability and Growth Pact (SGP) including automatic sanctions, the withdrawal of voting rights, an orderly sovereign default procedure, and a procedure to exclude countries in breach of the rules. Later in the crisis, Germany opposed the expansion of the EFSF, the direct recapitalization of banks through the rescue funds, and a supranational resolution fund for European banks.

By contrast, France urged the EU early on to take active measures against the Greek credit crunch and to rein in financial markets. Together with Belgium, Greece, Italy, Portugal, and Spain, it pushed for the ‘Europeanization’ of sovereign debt and for soft adjustment policies but opposed harsh sanctions for high deficit countries. These countries were in a worse economic and fiscal position than the first group: less wealthy, more highly indebted, and under pressure from the financial market. It was therefore in their self-interest to get access to additional liquidity with minor strings attached. For this reason, the southern euro zone countries led by France demanded, among others, the establishment and expansion of rescue funds, unlimited bond purchases by the ECB, a bank license for the EFSF and ESM, the direct European recapitalization of banks, a European bank resolution fund, and the introduction of Euro bonds – but opposed rigid austerity conditions and automatic sanctions (Schild 2013).

In general, LI offers a plausible explanation of state preferences in the euro crisis. All euro zone countries were in favor of deepening economic integration to manage the high actual and potential negative interdependence created by the debt crisis. They differed starkly regarding the preferred terms of integration, however, and this difference was in line with their fiscal positions. France, however, fits the pattern only partly. At the outset of the crisis, France was certainly the most fiscally and economically stable country of the ‘southern coalition’. It enjoyed AAA credit ratings and bond yields that were only marginally higher than Germany. Yet French bonds already suffered from relative weak fiscal fundamentals and contagion effects of the Greek crisis in the spring of 2010 (De Santis 2012); French preferences might therefore have resulted from incipient and anticipated vulnerability. The stark difference to German preferences, however, is difficult to explain by material
conditions only but points to the relevance of ordo-liberal vs. Keynesian economic ideas (Hall 2012: 367; Olender 2012; Schild 2013).

The intergovernmental preference constellation developed early in the crisis and has remained stable across changes in government and issues. In France, the shift from Sarkozy to Hollande was characterized by a general continuity of crisis policy – in spite of Hollande’s support for euro bonds and criticism of the Fiscal Compact (Schild 2013). Moreover, all issues from the first bailouts via the establishment of the rescue funds and the reforms of budget monitoring policies to the development of banking union were structured by the same coalitions and the same basic conflict between fiscally healthy countries advocating limited financial commitment together with strict fiscal and financial supervision, on the one hand, and fiscally pressurized countries advocating strong European financial commitment in combination with looser fiscal and financial regulation.

3. Intergovernmental bargaining in the euro crisis

Starting from their preference constellation, governments enter into negotiations on integration. New treaties or treaty revisions require unanimous agreement and domestic ratification by each participating state. For this reason, integration needs to be pareto-efficient, i.e. each state must expect to increase its welfare as a result. At least, states must not incur net costs from integration lest they veto the agreement. Potential pareto-efficient outcomes vary with regard to the distribution of costs and benefits across the participating states. In negotiations on integration, states therefore bargain to attain the agreement that maximizes their gains. Negotiations consist in hard bargaining including ‘credible threats to veto proposals, to withhold financial side-payments, and to form alternative alliances excluding recalcitrant governments’ (Moravcsik 1998: 3). The outcomes of negotiations reflect the intergovernmental constellation of bargaining power. Bargaining power results from asymmetrical interdependence: states that are less vulnerable to interdependence gain less from integration. In turn, they can successfully bargain for side payments or terms of integration that work in their favor.

As in the case of preferences, the hypothesis of hard intergovernmental bargaining is most likely to hold if stakes are high and the distribution of costs and benefits is clear. The hypothesis of hard intergovernmental bargaining distinguishes LI from other integration theories in two ways. First, in contrast to supranationalism, LI does not attribute a relevant role to supranational organizations and supranational entrepreneur in facilitating integration or in shaping the substantive outcomes of negotiations. Second, in contrast to constructivism, LI does not attribute a relevant role to normative constraints on bargaining or to argumentative behavior and persuasion (Moravcsik 1998: 54-58).

In the euro zone crisis, the mixed-motive preference constellation of the member states corresponds to a ‘chicken game’ situation. Chicken game situations have several characteristic features. First, the actors have a strong joint preference for avoiding an extremely costly common bad – such as the breakdown of the euro – but also seek to avoid the costs of backing down and making the first move to avert catastrophe. In other words, although non-cooperation is everybody’s least preferred outcome, the players receive the highest payoff from not cooperating while the other player does. Whereas all governments perceived a breakdown of the euro to be the worst case, the solvent countries would have benefited most from shifting the burden of adaptation to the highly indebted
countries, and the indebted countries would have benefited most from being bailed out without having to impose austerity on their economies.

Second, chicken games tend to produce 'brinkmanship' in bargaining behavior. The players send each other signals of resolve as they move closer to the brink and make cooperative moves at the latest opportunity to avert disaster. Assuming that the other player is rational and will do everything to avoid the crash in the end, hard bargaining pays off. Because both players count on the other's rational cooperation, it is further useful to send signals of irrationality or incapacity. If actors demonstrate credibly that their hands are tied or that they have lost control over events, they can force the other side to back down. In the euro crisis, solvent countries had an incentive to refer to legal, political and financial constraints and push the highly indebted countries to make fiscal cuts and sell state assets up to the point at which sovereign default was imminent. The indebted countries, in turn, had an incentive to postpone painful adjustment measures and demonstrate their incapacity to counter financial market pressure until the solvent countries came to the conclusion that rescue was inevitable.

If a chicken game is symmetrical, i.e. the costs of disaster and backing down are the same for both players, it is hard to predict who will back down – unless one player is better at demonstrating irrationality or incapacity. In the euro zone crisis, however, interdependence was asymmetrical. Whereas the stakes were prohibitively high for all euro zone countries, the immediate consequences of the crisis were significantly more severe for the highly indebted countries than for the solvent countries. The highly indebted countries were faced with increasingly unsustainable bond rates and, in the case of Greece, imminent bankruptcy. In addition, as the largest economy of the euro zone and the country enjoying the strongest confidence of the markets, Germany was pivotal for the survival of the euro and any rescue scheme. Because they were less immediately and heavily threatened by the crisis and held the key to remedying the situation, the solvent countries, and Germany in particular, were in principle in a better position to realize their preferences on the terms of integration than the southern countries.

However, Germany could not fully exploit its relatively secure and pivotal situation. First, it had to cope with the fact that the highly indebted countries were objectively unable to ‘swerve’ without damaging the euro zone. Unilateral adaptation measures by Greece and other debtor countries alone were unlikely to avoid default, contagion, and potential exit from the euro. Some form of rescue seemed therefore inevitable to avoid disaster. Second, exactly because Germany’s contribution to the rescue was indispensable, and because it did not have a credible option to abandon the euro, the German government was forced to commit itself financially at some point. The observable implications of LI for the euro crisis negotiations are:

(3) **Intergovernmental negotiations are characterized by hard bargaining and brinkmanship.**
(4) **Solvent countries (and Germany in particular) ultimately come to the rescue of the highly indebted countries but shape the terms of the rescue in return.**

There is ample evidence for hard, brinkmanship bargaining behavior on the part of the participants. The characteristic pattern for the highly indebted countries was to evoke imminent disaster and stress their incapacity in order to force reluctant creditor countries to come to their rescue. They further sought to delay or block the stringent conditions attached to the rescue measures in order to limit or deflect adverse domestic political reactions. The characteristic pattern for Germany was to
reject or delay financial commitments at first and point towards the domestic political impediments (the Bundesbank and public opinion) for making such commitments – before finally agreeing to do (just) what was necessary to keep the indebted countries afloat under the impression of imminent breakdown. Peter Spiegel’s summary assessment of interviews with numerous participants of euro zone decision-making at the height of the crisis from late 2011 through 2012 is reminiscent of the chicken game metaphor: ‘From mid-level bureaucrats to prime ministers, they tell an unsettling tale of accidents, near misses and seemingly foolhardy brinkmanship. But in the end, these same leaders appear to have prevailed. The euro has been saved.’ (Spiegel 2014)

In the run-up to the Greek bailout in mid-March 2010, the German government tried to deny any need for concrete commitments to aid Greece, insisted on unilateral austerity measures and threatened to exclude deficit countries as the ultima ratio. Only one week later, Germany redefined the ‘last resort’ in a cooperative way: as granting credit to countries that did not have access to capital on the market.19 When this situation occurred and Greece asked for assistance in April 2010, Germany tried to delay again. When financial markets were targeting further countries (whose credit rating was downgraded), the euro zone countries finally granted Greece a 110 billion bailout and established the EFSF. According to unconfirmed Spanish leaks from the negotiations, Sarkozy threatened to walk away from the talks and abandon the euro if Merkel did not agree.20 In turn, Merkel allegedly hinted at the possibility to quit the euro when her demand to strip non-compliant euro zone countries of their voting rights was criticized as undemocratic at a summit dinner in October 2010. The next day, however, her spokesman dismissed such a threat as ‘not plausible’.21 Whereas such exit threats were indeed not ultimately credible, they are indicative of the hard bargaining style.

In their part of brinkmanship, highly indebted governments delayed seeking money from the EFSF or the ESM in order to avoid the strict conditionality and the loss of reputation attached. Irish Prime Minister Cowen denied the Irish government’s intent to seek financial help in November 2010 under pressure from its partners to accept a loan from the EFSF.22 Spain similarly hesitated for weeks during which financial pressure on the country increased before it accepted a bailout and then sought to limit international control to the banking sector.23 Negotiations between Cyprus and the EU dragged on for months; a first agreement was rejected in the Cypriot parliament; and it took a threat by the ECB to cut off liquidity for the Cypriot government to accept a second agreement – not without threats by Prime Minister Anastasiades to resign and even to abandon the euro.24

The most dramatic case occurred in October 2011 when Greek Prime Minister Papandreou announced a national referendum on the bailout plan and the euro in order to close ranks within his own party, force opposition leader Samaras to back the plan, and thereby strengthen his government domestically (Spiegel 2014). This announcement made Greek and Italian bond yields soar and sent the euro zone closer to the brink. At the Cannes G20 meeting shortly afterwards, Sarkozy and Merkel forced Papandreou to choose between the referendum, on the one hand, and staying in the euro and receiving further financial support, on the other.25 In the end, Papandreou’s government was replaced by a national unity government, which called off the referendum and supported the bailout package. Otherwise, however, the G20 meeting failed to bring a solution to the mounting crisis. Italy resisted being put in an IMF program; in turn, Merkel, pointing to the opposition of the Bundesbank, refused to replete the EFSF with freshly created IMF special drawing rights (Spiegel 2014).
In the final crisis episode during the spring and summer of 2012, Merkel came around to tacitly accepting a new role for the ECB as a lender of last resort, which she had vehemently opposed before. At the G20 summit in June 2012, she still refused the plan of Italian Prime Minister Monti envisaging ECB bond-buying for rule-abiding euro zone countries under attack from financial markets (Spiegel 2014). At the European Council meeting the same month, when Monti and Spanish Prime Minister Rajoy warned that they could not sustain funding their states for very long at current interest rates, this was still dismissed as ‘exaggerated panic-mongering’ by a German official. As Italian and Spanish bond yields continued to rise and the Bankia crisis in Spain continued to unfold, a long-term ‘shift of thinking in Berlin’ appears to have come to a close: ‘Germany’s original vision of the eurozone – no bailouts, no shared debts and, in some quarters, no Greece – was becoming unachievable’. In return for her support to the ECB’s Outright Monetary Transactions (OMT) bailout program, however, ‘Berlin was going to ensure that shared burdens came with centralised control’ (Spiegel 2014).

At each step of crisis decision-making, Germany was able to shape the terms of integration in return for giving up its opposition to bailing out insolvent euro zone members. Germany prevented the introduction of Euro bonds or any other formally mutualized sovereign debt. Debt would remain national, and financial assistance would come in the form of credits and with the involvement of the IMF. For the same reason, Germany successfully rejected bank licenses for the EFSF and the ESM. In addition, Germany was able to link financial assistance to strict austerity conditionality, the strengthening of the EU’s monitoring and sanctioning of national budgets, and the adoption of the Fiscal Compact including a balanced budget rule to be enshrined ‘preferably’ in domestic constitutional law. Only some of the harsher measures proposed by Germany – fully automatic sanctions and the suspension of voting rights for countries in excessive deficit did not find support. According to an unnamed observer, however, the suspension of voting rights was generally understood as ‘essentially just a bargaining chip on Germany’s part to get what they really want’.

In sum, the evidence from the negotiations is broadly in line with LI expectations. First, the major crisis management and reform deals have been reached in intergovernmental negotiations. This is especially true for the bailout packages, the rescue funds EFSF and ESM and the Fiscal Compact, all based on intergovernmental agreements. The guidelines for the reforms of the procedures to monitor EU budgets and banking union were also hammered out in intergovernmental negotiations before they entered the legislative process. Whereas the Commission launched numerous initiatives and proposals in favor of supranational reform solutions, they were only successful if and when they chimed with the preferences of Germany and its allies: for instance, the proposal for euro bonds did not fly; the proposal for banking union was adopted in 2012 with modifications reflecting German concerns (see below). Finally, the ECB has, of course, made a major contribution to mitigating the crisis and buying governments time to find agreement – but it does not seem to have had a noteworthy agenda-setting role in institutional reform.

Second, there is strong evidence of hard bargaining and brinkmanship. Hard bargaining included threats to abandon the euro, exclude countries from the euro or suspend their rights, and let countries go bankrupt. Brinkmanship is evident in persistent German efforts to avoid or delay coming to the rescue of the debtor countries and persistent efforts by the debtor countries to escape rescue conditionality. Finally, euro zone reform generally bears the hallmark of Germany, the country with superior bargaining power. In return for Germany’s (reluctant) agreement to the rescue of the highly indebted countries, the rest of the euro area largely accepted the terms that Germany preferred.
4. Institutional choice and credible commitment

Governments not only negotiate on the substantive terms of integration but also on its institutional design. In line with functional, neoliberal theory, states establish international institutions to monitor and sanction state compliance and to lock in the substantive negotiation outcomes. To what extent governments are in favor of ceding competences to supranational organizations depends on the value they place on the issues and substantive outcomes in question and on their uncertainty about the future behavior of other governments (Moravcsik 1998: 9, 486-487). For instance, states are more willing to centralize decision-making and delegate powers of monitoring and sanctioning to supranational organizations in the case of enforcement problems, which produce incentives to defect unilaterally, than in the case of coordination problems, which do not. Because the institutional preferences of states are likely to differ as much as their preferences on the substantive terms of integration, intergovernmental bargaining affects institutional choice as well: institutional design tends to follow the institutional preferences of the states with superior bargaining power.

By focusing on the functional exigencies of credible commitment, LI assumptions about institutional choice differ again from those of other theories. In contrast to constructivism, institutional choice is not thought to be shaped by federalist ideology, democratic norms or other standards of legitimacy. In contrast to supranationalism, LI disputes a general tendency towards technocratic governance based on ‘need for centralized expertise and information’ (Moravcsik 1998: 71). Finally, LI does not share the realist assumption that states are primarily motivated by maximizing autonomy (Grieco 1996).

The euro crisis revealed several enforcement problems in EMU. First, the SGP, established to commit countries to fiscal discipline, had already proven malleable and ultimately toothless ahead of the financial crisis. Second, the euro zone crisis demonstrated that even countries without excessive budget deficits (such Ireland or Spain) could be hit by exogenous shocks, sudden stops, and balance of payment difficulties. In this case, the enforcement problem was how to commit other member states to coming to their rescue. Finally, EMU was accompanied by financial market integration based on mutual recognition of national banking regulation. The euro crisis highlighted the inadequacies of national banking supervision and resolution: lax supervision due to cozy relations between bankers and politicians and the sovereign-bank nexus, regulatory arbitrage across member states, and burden- as well as blame-shifting among national regulators when transnationally operating banks ran into trouble.

Thus, institutional choice during the euro crisis was mainly confronted by enforcement problems calling for more supranational delegation and stricter surveillance. Because the asymmetry of interdependence in the euro crisis accords the solvent countries superior bargaining power, however, supranational delegation and enforcement are mainly to be expected in the area of fiscal discipline, which commits the indebted countries, whereas financial assistance and transfers that would commit the solvent countries, should remain under intergovernmental control. LI thus predicts the following pattern of institutional choice in the euro crisis.

(5) New and reformed institutions increase the credibility of the member states’ commitment to euro zone stability.

(6) Institutions of financial assistance are more intergovernmental than institutions of supervision.
Institution-building and institutional reforms during the euro crisis were, indeed, to a large extent motivated by strengthening – or avoiding – credible commitments. Institutional preferences were strongly linked to material preferences. Germany and the solvent countries sought to limit their own financial commitment but to strengthen the credibility of the highly indebted countries’ commitment to fiscal discipline. That explains Germany’s preferences for intergovernmental rescue funds based on fixed limits of lending capacity. Whereas supranational funds or euro bonds would certainly have strengthened the credibility of the euro zone’s commitment to rescuing insolvent countries, they would also have meant higher costs and less control for the solvent countries. On the other hand, Germany’s proposals for harsh and automatic sanctions of countries violating the excessive deficit rules and for embedding balanced budget rules in constitutional law were intended to invest the earlier rules of the Excessive Deficit Procedure and the SGP with the credibility they had lacked or lost in the first decade of the euro. In these cases, Germany was also willing to invest non-majoritarian supranational institutions, the Commission and Court of Justice, with new monitoring and enforcement competencies. In the case of banking union, the mix of commitment-enhancing and commitment-avoiding preferences and proposals is apparent, too. Whereas the German government strongly favored supranational banking supervision (even though it tried to exclude many German banks), it opposed a supranational resolution and recovery mechanism underpinned by a Europe-wide fund fearing massive transfers to countries with ramshackle banks. Conversely, the highly indebted countries sought to limit their commitment to fiscal discipline and to strengthen the credibility of the solvent countries’ commitment to put their financial clout behind the euro zone. Accordingly, they favored supranational bailout solutions that could not be undermined by the veto of Germany and other solvent countries and did not require a new intergovernmental agreement every time a crisis flared up in one of the member states. At the same time, they opposed the automaticity and harshness of the sanctions proposed by Germany for countries not complying with the EU’s budget deficit rules, and favored more flexibility. Their institutional preferences on banking union also reversed those of Germany: their priority was a supranational resolution and recovery mechanism and fund, not supranational banking supervision.

In spite of these divergent institutional preferences, there was a common interest in creating institutions that would enhance the member states’ credible commitment to the common currency. This corresponds to their common interest in stabilizing the euro zone. The three major blocks of institutional reform are clearly linked to the three major problems that together made the euro zone crisis possible: the financial crisis, the sovereign debt crisis, and the lack of instruments to counter loss of financial market confidence and sudden stops. The Fiscal Compact and the legislation on the surveillance of member states’ fiscal and economic policies are designed to overcome the enforcement problems of the SGP; the legislation on banking union is designed to tackle the sovereign-bank nexus and the enforcement problems of national regulation in an integrated financial market; and the ESM is designed to overcome the problem of committing solvent countries to the rescue of insolvent ones.

Whereas these institutions reflect a common interest of the euro zone governments in strengthening the credibility of their commitment to the euro, their design generally matches the preferences of Germany, the country with the strongest bargaining power: intergovernmental financial assistance, supranational fiscal and economic surveillance, and a banking union that combines supranational supervision with more intergovernmental resolution. First, the ESM is an intergovernmental organization whose Board of Governors generally decides by unanimity. Even under the Emergency
Voting Procedure, which is used when the Commission and the ECB conclude that a failure to grant financial assistance would threaten the stability of the euro area, a majority of 85 per cent of the voting shares is required: this means, in effect, that the big member states retain a veto. Second, the surveillance of fiscal and economic policies now includes an earlier and stronger involvement of the Commission in the budget planning process of member states, stronger balanced budget rules, and earlier and more credible sanctions. Most notably, enforcement is based on ‘reverse qualified majority voting’, i.e. a qualified majority of member states is required to reject (rather than to adopt) a Commission proposal. Finally, whereas the ECB is vested with the power to supervise system-relevant banks directly and may also look into smaller banks, the resolution mechanism retains more national and intergovernmental elements. Decisions on bank resolution will be taken by an independent board of national authorities; finance ministers can overturn resolution decisions; and the build-up and mutualization of the fund is phased in over an 8-year period.

Institutional choice thus broadly fits LI expectations again. Institutional reform generally conveys a concern for a more credible commitment to the stability of the euro area. In addition, however, the design of the common institutions has largely followed the preferences of the solvent countries and Germany in particular. That supranational institutions have seen their competences strengthened during the crisis is not an argument against LI – if it can be shown that competence growth was a response to important enforcement problems and followed the preferences of the most powerful governments.

5. Conclusions: putting liberal intergovernmentalism in perspective

The main process characteristics and outcomes of European integration decision-making in the eurozone crisis match LI assumptions and expectations well. National preferences reflected international interdependence as well as the fiscal position of the state (with France being a partial outlier). Governments agreed on more integration in order to manage a common condition of negative interdependence and in order to avoid the prohibitive costs perceived to result from a breakdown of the euro (area). In doing so, however, they sought to shift the costs of adaptation and reform as much as possible to other states. This preference constellation resulted in a chicken-game situation characterized by a strong joint preference to avert a breakdown of the euro (zone) – while flirting with disaster at the same time. Negotiations included hard bargaining and brinkmanship. The new institutions and policies are designed to stabilize the euro area by vesting policies of financial assistance, fiscal surveillance, and banking regulation with a more credible commitment of member states to stick to and enforce the rules. Both the terms of stabilization in the euro area and the design of integrated institutions largely follow the preferences of Germany, the country with superior bargaining power. By correctly retrodicting the basic features and outcomes of European negotiations in a decisive phase of EU development, LI buttresses its claim to explain the major steps toward European integration.

Yet, critics of LI have rightly pointed out that LI is best at accounting for isolated, individual intergovernmental negotiation processes and treaty outcomes but fails to account for the endogeneity of the integration process, i.e. how current integration decisions are shaped by the effects of earlier integration decisions. In the words of Paul Pierson, ‘Attempts to cut into ongoing social processes at a single point in time produce a “snapshot” view that is distorted in crucial
respects’ (1996: 127). According to his historical-institutionalist analysis, any integration decision produces unanticipated consequences, adaptations of preferences, and endogenous interdependencies, which shape and constrain the next integration decision and create a path-dependent process over time. Most importantly, the common interest of euro zone countries in preserving and stabilizing the euro and their preparedness to engage in institutional reforms strengthening the credibility of their commitment to the euro is best explained as endogenous to the previous decision to create a common currency. Faced with unanticipated negative consequences of integration and realizing that the earlier decision to join EMU had increased international interdependence and put them in a situation without credible exit options, the member states reluctantly agreed on new rules and institutions that they had rejected in the original negotiations on EMU and would not have agreed to had the financial crisis occurred in a pre-EMU institutional setting. This counterfactual argument is supported by the factual observation that EU member states outside the euro zone have in general not committed themselves to the rescue or banking resolution funds, the stricter sanctioning of excessive deficits, or supranational banking supervision. The decision for more integration in the euro crisis is thus dependent on the path that states embarked on 20 years before. Moreover, the intergovernmental bargaining highlighted by LI is likely to recede together with the acuteness of the crisis and as institutional reform moves back from intergovernmental settings to the ordinary legislative procedure, Commission initiative, and parliamentary co-decision. This could already be seen in the concessions Germany had to make during the legislative process on banking union.

The euro zone crisis suggests that LI is best embedded as a theory of intergovernmental negotiations and decisions in a supranationalist theory of long-term, path-dependent development of integration. Whereas supranationalism explains how earlier integration decisions create endogenous interdependence and preference updates, LI captures how governments negotiate and decide on the basis of the changed constellation of interdependence and preferences. It also shows that divergent national preferences, hard intergovernmental bargaining, asymmetrical interdependence, and differential bargaining power remain consequential even in a path-dependent integration process.
References


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1 Moravcsik has not provided a published Li interpretation or explanation of the crisis and its outcomes so far. Moravcsik (2012) is a current affairs commentary mainly analyzing the roots of the crisis and discussing the adequacy of the reform steps taken to solve it.

2 I use north and south as convenient shortcuts even though Ireland is not geographically in the south.

3 Compare the scenarios in Straubhaar (2011: 30-31) and *The Economist*, 26 May 2012, 26-27.


10 http://www.ft.com/intl/cms/s/0/db2dd602-2914-11df-972b-00144feabdc0.html#axzz2r26Tgv00, 6 March 2010.


17 I thank one of the reviewers for alerting me to this point.

18 Li does not follow any formal game-theoretic assumptions but its rationalist underpinnings are compatible with such an analysis. I do not present a formal game-theoretic analysis of the crisis but use the basic intuition of the chicken game heuristically to point to the dynamics of the bargaining situation.


