Austerity for All

A Liberal Intergovernmentalist and Neofunctionalist Explanation of the Fiscal Pact

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Abstract

In response to the European debt crisis, EU countries, excluding Great Britain and the Czech Republic, agreed in December 2011 on the so-called Fiscal Pact. This agreement entailed that all the Eurozone member states have to adhere to strict budgetary rules, enforced by the European Commission. That budgetary powers were ceded to the European Commission is surprising, because the EU member states have always been reluctant to do so. The goal of this thesis is to try to answer the question of why this specific path of further integration was chosen to overcome the crisis. The research employed two different theories of integration to answer this question: liberal intergovernmentalism and neofunctionalism. It was found that the path taken could be explained on the basis of liberal intergovernmentalism focusing on the economically largest EU countries, particularly the interests of the powerful German and French financial sectors. Having invested heavily in the bond markets of the troubled Eurozone countries, it was in their interest that these loans will be repaid. The Fiscal Pact, with its strict budgetary rules, ensures that the chance of a default in these countries as a result of the debt load would be minimized. Furthermore, the budgetary rules forces these countries to privatize industries and liquidate state assets, leading to investment opportunities for the German and French financial sectors.
Chapter 1: Introduction

“How are we going to build the European Union? Are we going to build it against each other or with each other?”

(Barroso, 2011)

The 2007 crash of the United States housing market sent a financial shock wave around the world, which in its severeness was unparalleled since the stock market crash of 1929 that amounted in the Great Depression (IMF, 2008); it ushered in a period of grave economic and financial crises. Having invested heavily in so-called toxic financial products, US as well as European financial institutions were unable to survive without massive financial injections by governments. These institutions were deemed to be systemic, or ‘too big to fail’, and therefore, were given massive governmental support. In the EU, in the period from 2008 until the end of 2010 only, €4.3 trillion in state aid packages were authorized to keep the troubled EU financial institutions afloat, which is equivalent to 36% of EU GDP and double the German GDP (European Commission, 2011a). These bail out costs, combined with the increase in social security spending and the diminishing tax income, resulted in rising sovereign debt for the US and most of the EU countries. In the Eurozone, this led to what is often referred to as the European debt crisis.

The Economic and Monetary Union (EMU) and the subsequent introduction of the Euro had led to a convergence of the Eurozone countries’ bond rates in the run-up to these events (Ehrmann, Fratzscher, Gürkaynak, & Swanson, 2008). However, starting with the notification of the new Greek government in late 2009 that the previous governments had under-reported the Greek deficit (Nelson, Belkin, Mix, & Weiss, 2012), this convergence of bond rates became undone. The bond rates of Spain, Ireland, Greece, Portugal and Italy, often derogatorily referred to as the PIIGS countries, spiked; there was fear that these countries would be unable to pay back their debts and thus would have to default. For many economists and commentators, the European debt crisis seemed to come as a surprise, like a storm on a bright day. However, that a severe macroeconomic or financial shock would be a great challenge for the Eurozone had already been argued (Feldstein, 1997; Lane, 2006; Wyplosz, 1997). The disconnect between on the one hand the centralized monetary policy from the ECB, and on the other hand the absence of a political and fiscal union disabled individual Eurozone members to use their central bank to save them from bankruptcy by guaranteeing state bonds and
boosting inflation. A first set of remedies sought to keep these countries from defaulting. The European Financial Stability Facility (EFSF) and the European Financial Stabilization Mechanism (EFSM) were set up, which would act as emergency funding programs. In cooperation with the IMF and the ECB, in 2010 Greece and Ireland were saved from bankruptcy, and in 2011, Portugal had to be saved too (EFSF, 2013). When in 2011 it became clear that Italy and maybe Spain too would need to be rescued, both of which being too big to be saved by the EFSF, the sovereign debt crisis seemed to be spiraling out of control, inducing fears of a Eurozone split-up or the downfall of the euro (Elliot, Stewart, & Hooper, 2011; The Economist, 2011b). The prevailing opinion was in line with what German Chancellor Angela Merkel said, that Europe was facing its toughest hour since World War II (Reuters, 2011).

In order to overcome the problems, a EU summit was held on 8 and 9 December 2011. The expectations were that EU member states would finally take measures that enabled them to leave behind the European debt crisis (Emmanouilidis, 2011). The result of the summit was an intergovernmental treaty between 25 of the 27 EU countries, excluding Great Britain and the Czech Republic. This treaty was called the Treaty on Stability, Coordination and Governance (TSCG, 2011), but it is commonly called the Fiscal Compact or Fiscal Pact, which refers to the title of the third and most important section of the treaty (TSCG, 2011, p. Title III). It was agreed that the Eurozone members would have to adhere to strict budgetary rules. These include that every country has to enact into domestic law the so-called golden rule, which entails that the deficit cannot exceed 3% of GDP, as well as that each country is obligated to reduce their debt-to-GDP ratio in order for it to not exceed 60% (TSCG, 2011). To oversee the compliance to these agreements, the European Commission gained far-reaching powers to scrutinize the budgetary process in the Eurozone countries. In case of a breach of the agreements automatic sanction will be activated, which can only be stopped by a reversed Qualified Majority Vote (QMV) in the European Council. Also agreed upon, although not part of the official treaty, was the role that the European Central Bank (ECB) would take by guaranteeing to keep the Eurozone from collapsing, *de facto* making it a lender of last resort (Milliken & Zaharia, 2012). In conclusion, it can be said that the outcome of the EU summit entailed the furthering of fiscal integration in the Eurozone. The Eurozone member states were henceforth not anymore fully in control of their own budgetary policies. The powers over the budgets had shifted towards the supranational European Commission.

The substantive nature of the Fiscal Compact is surprising, because the fiscal domain had since the start of the European project always been a national issue; the member states have always been reluctant to cede budgetary powers to the European Union in general, and the European Commission in particular. The Stability and Growth Pact (SGP), which also contains the so called 3%-rule, had
been introduced in 1998, but non-compliant countries had never been fined. Even more, when France and Germany violated the treaty, a reform was introduced in 2005 that weakened the SGP agreement even more (González-Páramo, 2005). Now in the face of this crisis, the Eurozone countries suddenly do seem to be willing to give up budgetary sovereignty and to take steps towards further European integration. This is begging the question why steps towards further integration have been taken in a domain that used to be the prerequisite of member state authority.

Therefore, in this research, effort will be made to answer the following research question:

How can the furthering of integration that was agreed upon during the EU summit of 8 and 9 December 2011 be explained?

In this thesis, two theories of integration will be employed in order to answer this question. These two theories are liberal intergovernmentalism and neofunctionalism. Liberal intergovernmentalism is not merely a theory of integration. The main focus of the theory is on the explanation of the outcome of international negotiations. The theory tries to explain why states sometimes in some policy areas agree to cooperate and why this cooperation is sometimes formalized by the relinquishing of sovereignty on these policy areas by the nation states to a supranational authority. The element of integration cannot be understood separately from the entire outcome of a negotiation process. Therefore, in order to explain the furthering of integration using liberal intergovernmentalism, the outcome of the negotiations of the EU summit of 8 and 9 December 2011 need to be explained. In short, liberal intergovernmentalism explains the outcome of international negotiations as the result of a two-level game. In the first level the economic interests of the dominant domestic economic groups determine the policy preferences of the states. In the second level, the most powerful states negotiate a compromise. During these negotiation, the states are the only relevant actors. The ceding of sovereignty to a supranational authority is decided upon on the basis of the existence of doubt about the future commitment of the states on the agreements that were made.

The second theory that will be used, neofunctionalism, unlike liberal intergovernmentalism is mainly focused on integration. It explains integration as being a process in which previous instances of integration will logically lead to further integration. This happens because the previous integration will automatically lead to pressure for integration in other sectors, because a supranational authority will successfully influence the states to opt for more integration, and because the governments of the nation states will learn that further integration is an efficient way to manage policy issues. The theoretical puzzle that thus presents itself is that liberal intergovernmentalism and neofunctionalism both try to explain the furthering of integration that was decided upon at the EU summit of 8 and 9
December 2011 in different ways. Whereas liberal intergovernmentalism explains it by looking at the economic interests of the dominant domestic economic groups in the states, the constellation of state power and the doubts about the future commitment of the states, neofunctionalism does so by arguing that the furthering of integration is a logical result of previous instances of integration.

It follows that by answering the research question in this thesis using liberal intergovernmentalism and neofunctionalism, also the following question will be dealt with:

Which theory, liberal intergovernmentalism or neofunctionalism, can best explain the furthering of integration that was agreed upon during the EU summit of 8 and 9 December 2011?

For the literature on liberal intergovernmentalism in this thesis, use has been made of Moravcsik (Moravcsik, 1992, 1993, 1998). For the literature on neofunctionalism, use has been made of the original texts (Haas, 1958, 1961; Lindberg, 1963).

The theoretical relevance of this thesis is that it is a first attempt to construct an analysis of the EU summit of 8 and 9 December 2011 using neofunctionalism and liberal intergovernmentalism. In this way, this research will show which of these theories is best capable of explaining why further integration was decided upon, and thus argue that one of the theories is best capable of explaining certain aspects of the world. The social relevance is that the analysis hopefully will shed new light on the European debt crisis and what is enacted to overcome it. The austerity policies in the Eurozone affect a lot of people. Understanding why they are imposed is important, certainly considering the enormous amount of misinformation on the topic.

The main findings of this thesis is that the outcome of the EU summit is the result of a compromise between Germany and France, and that the policy preferences of these two states were a reflection of the interests of their respective financial sectors and in the case of Germany also of the export sector. The implementation of austerity policies was in the interest of the financial sectors, because this best made sure that the southern Eurozone member states, in which the financial sectors of Germany and France had invested a lot of money via state bonds, would not default on their debts. The analysis shows that liberal intergovernmentalism was best capable of explaining the outcome.

The thesis is structured as follows. First, in the following chapter, the theories that will be used are outlined and critically discussed. Liberal intergovernmentalism and neofunctionalism will be explained first and then the strength and weaknesses of the explanatory power of these theories identified. In this chapter, hypothesis will also be derived from these theories. Then in the following chapter, the epistemology of the theories will be discussed. In this part, the implications of theories
with a positivist epistemology will be debated, and the methods of the research are introduced. Furthermore, the variables of the hypotheses that were formulated will be operationalized. The next chapter contains the empirical analysis and the evaluation of the hypotheses. The final chapter contains the conclusion. In addition to the findings, the shortcomings of this work will also be discussed here, and suggestions for further research will be put forth.
Chapter 2: Theory

In this chapter, liberal intergovernmentalism and neofunctionalism are discussed and theoretical hypotheses are derived from the theories. The ontology of both theories, as well as the causal mechanisms and assumptions are revealed and the differences highlighted. Moreover, both theories are criticized on the basis of strengths, their shortcomings and internal inconsistencies.

2.1 Liberal Intergovernmentalism

The theory of liberal intergovernmentalism, which has been developed by Andrew Moravcsik in the early 1990s, has been declared by some scholars “one of – if not the – most important account of the European integration process” (Cini, 2010, p. 96). Liberal intergovernmentalism theorizes international integration as a two-level game, a concept introduced by Putman (1988), who used it to conceptualize state politics as being played on two levels in the international realm. The first is the domestic level, where states define their preferences, the second is the international stage, where states interact with other states and strike bargains at the negotiation table. Liberal intergovernmentalism departs from the same logic. The central actor in the two-level game is the state, and it can therefore be said that liberal intergovernmentalism is a state-centric theory of international integration. Unlike (neo)realist theories, its approach in understanding the state’s policy preferences is bottom-up, taking the domestic setting into account, rather than black-boxing states such as in the case of (neo)realist theories (Waltz, 1979). Instead of deriving the state’s policy preferences from the power balance in an anarchic system, it uses a liberal theory that theorizes national preference formation by taking the economic preferences of domestic actors into account.

Whereas (neo)realist theories thus focus on the (geo)political interests of the states, the interests of the states are according to liberal intergovernmentalism a result of domestic economic preferences. At the international stage, liberal intergovernmentalism assumes state predominance and that state power and preferences are the most important explanatory variables, which is fairly similar to (neo)realist theories. In contrast to (neo)realist theories, according to liberal intergovernmentalism, international relations is not a zero-sum game, and international cooperation can lead to international stability in the long run, hence the notion ‘liberal’.

According to liberal intergovernmentalism, integration is the “institutionalized international policy coordination” between multiple sovereign states (Moravcsik, 1993, p. 473). States cooperate in this manner in order to manage the costs and benefits that economic interdependence produces for domestic actors (Moravcsik, 1993, p. 485). Integration is thus done for economic reasons, and the main factor that causes it is economic interdependence. Even though integration can entail the
ceding of parts of the sovereign state its powers to a supranational authority, the state will not do so to the extent that a supranational authority becomes a relevant independent player in the international system. The state is thus sovereign and will remain sovereign.

Liberal intergovernmentalism has mainly been applied to explain instances of progress and stalemate in the process of European integration (Moravcsik, 1991, 1998), which is why it is very much associated with post-war European integration. However, liberal intergovernmentalism is not solely applicable to the development of the European Union (EU). According to Moravcsik, it is just as well valid for explaining the occurrence of integration (or the lack of) outside of Europe (Moravcsik, 1993). The theory is, according to Moravcsik, not dependent on Europe-specific features, such as neo-functionalism, which, as will be shown later, draws implicitly on the idiosyncrasies of the EU state apparatus, notably the supranational institutions as the driving agencies of integration.

According to liberal intergovernmentalism, policy coordination develops through intergovernmental bargains (Moravcsik, 1993, p. 473). To explain why these bargains are struck and as well to explain their content, liberal intergovernmentalism uses a so-called “rationalist framework” (Moravcsik, 1998, p. 19). With the use of a rationalist framework, the phenomenon of integration is explained by disaggregating it into three consecutive steps, each of which is treated separately. In each of these steps, the rationality of the relevant actors is assumed. The three stages are as follows: the formation of the national policy preference, the bargaining between the different states, and lastly the decision on the form and scope of international institutions. This is a one-way consecutive process, so only after the preferences are set will there be negotiations, and only after substantial agreements have been reached between the nations will there be a decision about the form of the international institution that has to secure the agreements (Moravcsik, 1998, p. 20). Although liberal intergovernmentalism is a coherent theory, each of the aforementioned stages is explained by using different theoretical elements and mechanisms that originate from different theoretical strands. These different steps will now be explained in the order just given.

The first stage in the rationalist framework is the formation of national policy preferences, which are to be pursued during the negotiations by the governments in the second stage. As outlined previously, the policy preferences are according to liberal intergovernmentalism endogenous to the state. This means that in order to explain the preferences, a researcher has to look at political processes inside the state. Moravcsik therefore supports on liberal theory of state-society interaction, which assumes that “[s]ociety […] is comprised of individual human agents with autonomous interests and identities, who seek to form private groups, organizations and arrangements to advance their social and political goals” (Moravcsik, 1992, p. 7). It is also assumed
that individual human agents have “a core of rational behavior” and are “self-interested” (Moravcsik, 1992, p. 5). So at the basis of the policy preferences of the state are the preferences of the individuals that make up the society. These then need to be translated into state preferences. It is assumed that the government of a state is a rationally acting actor that is primarily interested in remaining in office (Moravcsik, 1993, p. 483). In order to achieve this, governments require the support of a coalition of “domestic voters, parties, interest groups and bureaucracies” (Moravcsik, 1993, p. 483). The government will thus pursue the preferences in negotiations that can count on the support of a domestic coalition that will keep them incumbent. In order to fully grasp the way in which liberal intergovernmentalism explains the policy preferences, two questions need to be answered: what domestic actors are most powerful and what is it that interests these actors? Liberal intergovernmentalism assumes that “[g]roups that stand to gain and lose a great deal per capita tend to be the most influential” (Moravcsik, 1993, p. 483). This means that the larger the assumed costs and benefits of a certain policy will be on a group, the more influential the group will try to be. According to Moravcsik, the groups that stand the most to gain and lose, and thus the most important domestic groups, are producers (Moravcsik, 1998, p. 36). The policy preferences of a government are thus a reflection of the economic interests of banks, industries, and companies that organize around common issues. An important element is that it is not assumed that the interests of economic groups co-align at all times. For example, a free trade area could mean for some economic groups that they can expand their markets, whereas for others, it could mean that they will have to cope with unwanted competition. Thus, some organized businesses might be free-market seeking, while others strive for protectionist or neo-mercantilist policies, which implies that the specific nature of the economic structure creates different economic interests.

It can be concluded from this that liberal intergovernmentalism states that national preferences are a reflection of those of the dominant economic groups in society that have a stake in the policy, and that the execution of these preferences creates winners and losers among these groups. Furthermore, the manner in which economic interests of domestic groups are shaped is dependent on the specific nature of the economic structure. The relation between the interests of the dominant domestic economic groups and the policy preferences of the states will be tested by using the following hypotheses:

**Hypothesis LI 1:**

*International integration is the result of a two-level game, in which at the first level the policy preferences of the states emanate from the interests of the dominant domestic economic groups.*
In the second stage of the rationalist framework, states enter into negotiations. This part of liberal intergovernmentalism is a continuation of realist and intergovernmentalist integration theory (Hoffmann, 1966; Keohane, 1984; Keohane & Nye, 1977; Krasner, 1991). Much alike these theories, it is assumed that the states act unitary and rational. The first meaning that it is assumed that during the negotiations, states act “as if” with a single voice (Moravcsik, 1998, p. 22). The second maintains that the states act “as if” they are “efficiently pursuing a weighted, stable set of underlying preferences” (Moravcsik, 1998, p. 23). This last assumption entails that states will act in a strategic manner, taking into account the international playing field when presenting their position during the negotiations.¹

During the negotiations, it is assumed that states are the only relevant actors; there is thus no determining influence of supranational institutions with independent policy preferences. Moravcsik argues that states have plenty of resources to identify national preferences, the different policy options and the range of possible policy agreements; the cost of information is thus assumed to be low relative to the gains of agreement (Moravcsik, 1998, p. 61). Therefore, to explain international negotiations, there is no reason to involve supranational policy entrepreneurs or institutions that, according to the supranational view, have information or ideas of their own.

When focusing on state behavior during negotiations, an important assumption is that the negotiations take place within a “noncoercive system of unanimous voting in which governments can and will reject agreements that would leave them worse off than unilateral policies” (Moravcsik, 1998, p. 60). So it is to be expected that a treaty or a policy course will not leave a government worse off than if it simply used unilateral actions to achieve their policy goals. In determining the bargaining power of the different governments during the negotiations, Moravcsik argues that what is most important is the relative value that governments place on an agreement compared to the previously mentioned unilateral action alternative. This relative value, or “preference intensity”, is inversely proportional to the bargaining power or the expected distribution of benefits that results from the agreement, because the more a government will benefit from an agreement, the more it is willing to compromise during the negotiations (Moravcsik, 1998, pp. 61-62). This thus leads to the conclusion that the governments “most satisfied with current unilateral opportunities tend to benefit most from bargaining” (Moravcsik, 1998, p. 63).² Taking this information into consideration, a hypothesis about the expected outcome of the negotiations can be devised.

¹ This is thus much unlike the setting of the national preferences in the first stage in which strategy does not play a role, only the aggregation of domestic preferences do, which reduces states to mere transmission belts for dominant interests.
² This model is formulized by the Nash bargaining solution (Binmore & Dasgupta, 1987).
**Hypothesis LI 2:**

*International integration is the result of a bargaining process at the second level of a two-level game, in which the states that gain the most from an agreement are more willing to make concessions.*

In the third stage of the rationalist framework, states will negotiate about the institutional implementation of the agreements that have been made in the previous stage. The decision to be made by the states is whether they want to retain their prerogative of unilateral action, or whether they want to put a constraint on state sovereignty by pooling or delegating a part of it to the international institution.³ It is thus in this stage that the form of the supranational government, and its powers, are decided upon. According to Moravcsik, the reason why governments in some cases are in favor of putting a check on their sovereignty is because they have the need for “credible commitments” (Moravcsik, 1998, p. 73). Governments that are in favor of cooperation on a certain issue, but that are worried about the possible future decisions of the other governments, thus have a wish “to precommit governments to a stream of future decisions by removing them from unilateral control of individual governments” (Moravcsik, 1998, p. 73). The pooling or delegating of sovereignty in an international institution can bolster the commitments of the different states in multiple ways. It may raise the “visibility of noncooperation” (Moravcsik, 1998, p. 74), it may establish a reputation of the member governments that is easily damaged by non-compliance and furthermore because the reestablishing of unilateral control will damage the legitimacy of the institution, renegotiating the agreements may be costly and risky (Moravcsik, 1998, p. 74). The theoretical prediction of liberal intergovernmentalism concerning the possible preferences of delegation and pooling can be tested by checking the following hypothesis:

**Hypothesis LI 3:**

*International integration is the result of a two-level game, in which at the second level, the following holds: if a state doubts whether the other states will commit themselves to the agreements within the existing enforcement regime, then the state will prefer the pooling and delegation of sovereignty.*

What the previous section has made clear is that the actions of the governments are foremost determined by the aggregation of the domestic preferences and the strategic international setting. The statement by Moravcsik that “[i]nternational agreement requires that the interests of dominant

³ With pooling of sovereignty, a construction is meant in which governments decide on future matters by using a voting procedure that is not based on unanimity like the QMV. With the delegation of sovereignty, a construction is meant in which supranational actors have the ability to act autonomously, like the European Commission (Moravcsik, 1998, p. 67).
domestic groups in different countries converge” is therefore a logical conclusion (Moravcsik, 1993, p. 487). But this leaves us with the question of why domestic actors would prefer integration. According to liberal intergovernmentalism, it is economic interdependence that creates incentives for policy coordination (Moravcsik, 1993, p. 485). Economic interdependence will lead to situations where “the policies of one government create costs and benefits for politically significant social groups outside its national jurisdiction” (Moravcsik, 1993, p. 485). It is assumed that by coordinating their policies, governments can reach outcomes that will leave everybody better off than in a situation where all would resort to unilateral actions. Having concluded the discussion of liberal intergovernmentalism, in the following section this theory will be scrutinized and criticized for its shortcomings.

2.1.1. Strengths and weaknesses

The most important strength of liberal intergovernmentalism is that it opens up a part of the political power game within the state. Instead of treating the state as a black box that simply reacts to the outside world as realist and neo-realist theory does, it allows for a researcher to try to understand the state’s actions by looking inside the state. It becomes possible to identify different groups that operate inside the state and to understand what the powers and preferences of these groups are. Not only does this enable explanations for events that take into account domestic economic structures, but it also allows for explanations that are more subtle than those of realist and neo-realist theory, which often end up explaining events in terms of balance of power politics.

The first weakness of liberal intergovernmentalism relates to its conception of the individual. Liberal intergovernmentalism, being a bottom-up theory, looks at the aggregate of individual preferences. It is therefore important that the conceptualization of the individual in this theory is accurate. However, the conceptualization of the individual is that of a rather atomistic being. This atomistic individual has a larger resemblance to a cog in a machine than to a human being. The sum of what a collection of atomistic individuals want can however be something else than what human beings want. The atomistic individuals of liberal intergovernmentalism are rational and self-interested, while the human beings that make up actual society have identities and interests that are shaped by ideas, ideologies and historically constructed social relations, which thus are in no way conceptualized by liberal intergovernmentalism (Apeldoorn, Overbeek, & Ryner, 2003, p. 25). Failing to recognize this, it can thus be said that liberal intergovernmentalism cannot fully understand the way in which individuals and therefore thus also states construct their preferences.

Furthermore, there is an inconsistency within the theory. Moravcsik has two completely different views of how the world works; two inconsistent ontologies that coexist. The first one relates to how a
state functions internally. He uses a liberal pluralistic theory to model society-state relations. The state is a sort of microcosm, where what the government wants is the aggregate of what the individuals in society prefer. Although these preferences can be influenced by what happens outside of the state, outside actors cannot penetrate the boundaries of the microcosm; the only relevant actors inside the state are domestic actors. In the international system, however, the world works completely different: rationally and strategically acting states are all that matters. Where the inside of a state is thus depicted as a microcosm, richly filled with various actors, the international system is fairly empty in contrast. These two different ontologies that coexist in the same theory is by itself something odd and this should at least have been discussed by Moravcsik. Nevertheless, Moravcsik never came up with the rationale behind this inconsistency. Apart from this fundamental criticism it is also interesting to discuss in what manner the inconsistency reveals itself. Most important is the way in which actors that are according to liberal intergovernmentalism relevant within the state are somehow not relevant anymore in the international system. How can it be that interest organizations are influential within the state, but cease to be so in the international system, even though they are often clearly organized in an international or transnational manner? If interest organizations indeed only can gain influence within the state, then at least it should be expected that these organizations are only organized at state level. The fact that this is not the case seems to point out that they do have influence in the international system. Also, Moravcsik remains convinced that a supranational authority is not relevant in the international system, but if this supranational authority has so many state-like characteristics, like an executive body, a parliament and interest groups organized around it, then in what way does it differ from a state? These unanswered questions illuminate the manner in which the two worlds of liberal intergovernmentalism cannot coexist.

What the last question also hints at, is the inherent conservatism in liberal intergovernmentalism. The theory does allow for the transfer of sovereignty from the nation state to a supranational institution, but at the same time, the dominance of the nation state in the international system is not impeded. There are power struggles going on, within the states and between them, but these struggles are guided by the state-system. In a way this is like water running through pipes; the pipes influence the flow of the water, but the water flow cannot influence the position of the pipes. The state-system itself is the reflection of a power struggle, and has historically shown to be anything but rigid.

Even with the criticism that has been formulated above, liberal intergovernmentalism is still seen as a useful theory for the answering of this thesis. It is clear that liberal intergovernmentalism cannot explain everything and that there are severe shortcomings and inconsistencies in the theory. However, it cannot be denied that the analysis of Moravcsik of previous instances of European
integration were insightful and in a useful way added to the theoretical debate on integration. Therefore, even with the above criticism, liberal intergovernmentalism is used in this thesis.

2.2 Neofunctionalism

When discussing European integration theory, the discussion of neofunctionalism cannot be omitted, because this theory has been integral to the study of European integration and is considered to be the “most elaborate, ambitious and criticized theory of regional integration” (Tranholm-Mikkelsen, 1991, p. 2). There has been and still are a multitude of political scientists that use theories that are called neofunctionalism. Since a discussion of all of these different strands would be too much for the purpose of this thesis, only the foundational texts of neofunctionalism by Ernst B. Haas and Leon N. Lindberg is focused on (Haas, 1958, 1964; Lindberg, 1963). These texts were chosen, because they contain the basic ontological claims and mechanisms of neofunctionalism. Therefore, the testing and scrutinizing of these texts has implications on the other strands of neofunctionalism as well.

That neofunctionalism was developed after the installation of a new supranational institution, the European Community of Steel and Coal, was no coincidence. Neofunctionalism could be seen as an attempt to theorize the strategies that were used by the bureaucratic elites in constructing the post-war institution (Rosamond, 2000, p. 51). Since neofunctionalism predicted that integration would automatically lead to a new a European state, the popularity of neofunctionalism was linked to the success of the European integration. So when a period of euroscepticism arose in the late 60s in response to the empty chair crisis in 1965 (Cini, 2010, p. 90), and European integration stalled, neofunctionalism declined in popularity to the point that even Haas considered it to be “obsolescent” (Haas, 1975). It thus seemed in the mid-70s that neofunctionalism was “all but abandoned” (Tranholm-Mikkelsen, 1991, p. 2). Neofunctionalism, however, made a come-back after in 1986 the signing of the European Single Act ushered in a new period of European integration. Although neofunctionalism is still by some considered to be one of the old European integration theories (Warleigh, 2004), many political scientist still recognize its relevance today (Rosamond, 2005; Schmitter, 2005), as again does its founding father, who now considers neofunctionalism to be “no longer obsolescent” (Haas, 2004, p. liii).

To start off the discussion, we will first take a look at what integration entails according to neofunctionalists. A definition is provided by Haas, who stated that:

“Political integration is the process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations and political activities toward a
new center, whose institutions possess or demand jurisdiction over the pre-existing national states” (Haas, 1968, p. 16).

So, with integration, the process is meant in which the focus of political actors on the national political center is being shifted towards a supranational center. As has been pointed out by Heathcote (1975), this means that the international society acquires the procedural characteristics of a domestic political system. As will be made clear later on, this process goes hand in hand with an assumed withering of the power of the nation state and a rise in power of a supranational authority.

This definition of integration is different than that of liberal intergovernmentalism in two important ways. First of all, neofunctionalism sees integration as a process, whereas liberal intergovernmentalism tries to describe a condition. This difference becomes clearer if we look at the second way in which neofunctionalism distinguishes itself form Moravcsik’s theory. Liberal intergovernmentalism, as has been discussed above, has a fairly conservative view of the structure of power. According to liberal intergovernmentalism, there can be more cooperation between different states, but this cooperation will not alter the dominance of the nation state. So where neofunctionalism tries to describe the way in which a power structure is being changed, liberal intergovernmentalism does not even considers there to be a possibility that the power structure can alter.

The next part of neofunctionalism that will be discussed is the assumptions that lie at the basis of the theory, on which thus the rest of the theory is constructed. These three assumptions, which are first summed-up and then dealt with in the given order, are as follows: First, politics is a group-based activity. Second, governments operate in a rational-technocratic manner. And last, economic integration is a positive-sum game. Regarding the first assumption, according to neofunctionalism, the state consists of a multitude of groups that try to influence policies of the government. Therefore, according to Lindberg, “[a]ny analysis of political process must give a central place to the phenomena of group conflict” (1963, p. 9).4 This pluralist definition of society is much alike that of liberal intergovernmentalism. Both theories presume that the actions of a state reflect the preferences of internal groups. According to the second assumption of neofunctionalism, governments operated in a rational and technocratic manner. Especially that governments are supposed to act in a technocratic manner is very interesting. It presumes that the activities of the government are not political, but that governing is a “managerial process that utilized rationalistic, scientific and [...] non-dogmatic methods” (Rosamond, 2000, p. 58). This view can be traced back to

4 It can be noticed that this assumption is already implicit in the definition of integration as given by Haas (1958).
the “end of ideology” thesis (Bell, 1962; Lipset, 1960), which was very influential in the 1950s and early 1960s. This thesis adhered to the idea that political conflict was rooted in ideological conflict, and hence that what they perceived to be the end of ideological conflict, the end of the Second World War, meant the end of political conflict. A similar and still popular thesis was devised by Fukuyama, who argued that it was in fact the end of the Cold War that heralded the end of grand political conflict, and that the liberal democracy is the free-of-political-conflict technocratic end-state (Fukuyama & Bloom, 1989). The end of political conflict furthermore meant that the governing of states could be done in a rational and technocratic manner. The last assumption of neofunctionalist theory, that economic integration is a positive-sum game, can be seen as the driving force behind integration. It entails that integration offers “a multitude of different advantages to different groups” (Haas, 1958, p. xiii). So whereas liberal intergovernmentalism sees different winners and losers of integration, according to neofunctionalism, integration is a rational process that enhances wealth for all relevant actors. It is therefore no surprise that according to Haas: “Converging economic goals embedded in the bureaucratic, pluralistic and industrial life of modern Europe provided the crucial impetus [for integration]” (Haas, 1968, p. xix).

According to neofunctionalists, the most important mechanism for integration is spillover. In its most broad definition, it means that “integration within one sector will tend to beget its own impetus and spread to other sectors” (Tranholm-Mikkelsen, 1991, p. 4). It is the mechanism that is used to explain the “expansive logic of sector integration” (Lindberg, 1963, pp. 10-11). Using the original texts of Haas (1958) and Lindberg (1963), Transholm-Mikkelsen (1991) deduced three different forms of spillover, which taken together depict the way in which the before mentioned assumptions will lead to the process of integration. These three different forms are functional spillover, political spillover and cultivated spillover. Important is to note that although the logic of these three kinds of spillover lead to integration, not every case of integration is the result of all these three forms of spillover. Functional spillover is rooted in the idea that different economic sectors are interdependent in such a degree that it is not possible to treat them isolated. Therefore, if one sector is integrated and hence decision-making delegated to supranational institutions, then this will inevitably lead to problems that can only be solved by integrating other sectors. Functional spillover will be tested using the following hypothesis:

*Hypothese neofunctionalisme 1:*

Integration is the result of previous integration in an economic sector, that because of the interdependence with other economic sectors leads to problems that can only be solved by more integration.
Political spillover is based on the assumptions on the pluralist nature of the society and that integration is a positive sum game. It entails that the leaders of the groups in society will undergo a learning process, “developing the perception that their interests are better served by seeking supranational rather than nation solutions” (Tranholm-Mikkelsen, 1991, p. 5). It is thus focused on the socialization of the national actors. Political spillover is relevant when trying to explain why governments are in favor of the delegation and pooling of sovereignty. Whereas liberal intergovernmentalist theory explains the preference of states in favor of delegation and pooling as a way to commit other governments, neofunctionalism explains this by arguing that states want to pool and delegate sovereignty, because a supranational institution is able to more efficiently manage complex issues. Therefore, neofunctionalism expects integration to occur on issues that are complex in nature. This leads to the following hypothesis.

**Hypothesis neofunctionalism 2:**

*International integration is the result of states perceiving a supranational authority as being more able to efficiently manage technically, legally, or politically complex issues.*

Cultivated spillover is focused on the socialization of the supranational actors. It is different in an important sense from the other forms of spillover, since other than functional and political spillover, it implies agency and is thus not an automatic process. According to Haas, although the previous mechanism would rationally lead to integration, the difficulties of international negotiations will result in “minimum common denominator” outcomes (Haas, 1961, pp. 367-368). An autonomous and institutional mediator, like the High Authority or what later became the European Commission, can come up with solutions during the bargaining process and thus accommodate an “upgrading of the common interest” (Haas, 1961, pp. 367-368), and thereby facilitate the process of integration. In the sense that integration is thus dependent on the willingness of a high authority, Haas himself concluded that politics is therefore still present in the process of integration (Haas, 1968, p. xix). Neofunctionalist theory also predicts that there will be elite socialization. This entails that various actors (in the case of the European Union most notably the European Commission), will develop supranational (European) loyalties and preferences through their regular involvement with the supranational policy process (Pentland, 1973). Because of these supranational loyalties and preferences, these actors will be in favor of more integration. It is therefore to be expected that a supranational authority will act as a policy entrepreneur and that it will influence international negotiation outcomes is favor of more integration. This will be tested using the following hypothesis.
Hypothesis neofunctionalism 3:
International integration is the result of a supranational authority successfully influencing negotiations in favor of further integration.

Having concluded the explanation of neofunctionalism, the next section will go into criticizing the theory.

2.2.1. Strengths and weaknesses

The first strength of neofunctionalism is that it allows for domestic actors to organize with other groups from different countries at an international level, allowing them to bundle their forces and to influence multiple states at the same time. This contrasts with liberal intergovernmentalism, which only theorizes that domestic groups influence the states they are located in, thus making the state’s boundary impossible for them to surmount. The way that neofunctionalism theorizes the reach of the domestic actor’s influence is more useful; internationally organized groups exist, and can only be understood by a theory that has incorporated them.

A second strength, which is related to the first, is that neofunctionalist theory takes into account the existence and influence of transnational groups. These are groups that do not identify one single state as their home and operate in many states at the same time, such as certain NGO’s and transnational corporations (TNC’s). Whereas liberal intergovernmentalism only theorizes groups that operate within a single state and have an influence within that same state, neofunctionalism thus allows for an understanding of how TNC’s can influence multiple states at the same time, and how TNC’s can be very powerful due to a strategy of playing out against each other the different states that they operate in.

The last strength of neofunctionalism that will be discussed here is that it does not have a conservative theorization of the state. As has been discussed prior, neofunctionalism defines the state by a certain number of characteristics. Not only does it allow for other entities to acquire these characteristics, but it also tries to explain how and why this might occur. This contrasts strongly with liberal intergovernmentalist theory, which is rigid in its understanding of the state. Most notable is the difference in understanding of the changing character of the EU. Neofunctionalism allows for an understanding of the EU as an entity that can become an independent player in the international system with state-like characteristics. According to liberal intergovernmentalism on the other hand, the EU is not a state, and therefore cannot become a state or even state-like. That neofunctionalism does allow for this kind of change is thus a clear strength of this theory.
The first weakness of neofunctionalism is that it is unable to distinguish between proponents and opponents of integration among social groups and as well governments. It is assumed that the larger market that is created by economic integration will be beneficial for all economic actors. In contrast to liberal intergovernmentalism, this means that a neofunctionalist analysis cannot look inside the states in order to see which actors benefit or lose from integration. Therefore it can be said that neofunctionalism has “no explanation for which groups should succeed, form coalitions, mobilize interests, have access to policymakers, and affect policy” (Caporaso, 1998, p. 9). And since neofunctionalism uses a pluralistic conception of the state, thus that the preference of the state is a reflection of those of the national groups, neofunctionalism is also unable to explain why or when certain states will not favor integration over unilateral action. It therefore “says little about basic causes” of variation in national demands for integration (Lindberg & Scheingold, 1970, p. 284).

Furthermore, what is problematic in neofunctionalism is the assumption of a rational-technocratic government. As was discussed earlier, this assumption is based on the “end of ideology” thesis (Bell, 1962; Lipset, 1960). After the cold war ended, a variation of this thesis was developed by Francis Fukuyama (Fukuyama & Bloom, 1989). The underlying idea of this recurring theme is that the ideological battles are over, and we therefore have arrived at a stable end-state. What is left for the government to do is to administrate the society; the bureaucrat can calculate what the best policies are. This way of looking at society, however, denies that decisions that are made by governments are not just decisions of efficiency, but are questions of who gets what. These questions are political in nature and cannot be decided on by using a utility-maximizing standard; the outcomes of issues of this nature are determined by power struggles. It is as well the case that the fiscal integration is a decision about who gets what. It is only one possible result, and in order to understand it, an analysis of the underlying power struggle is crucial. Neofunctionalism is thus not able to see or understand this power struggle.
Chapter 3: Method and Operationalization

In this chapter, there will first be a discussion on the assumptions that underlie positivism as an epistemology. Then, moving away from the abstract, the methods that will be used in this research are presented. This also includes a discussion on the sources that will be used in the research. Finally, the hypotheses that have been derived in the previous chapter will be operationalized; it will be determined what the conditions are in order for them to be falsified or validated.

3.1 Epistemology

The strand in the philosophy of science that underpins the research in this thesis is most akin to that of positivism. Although positivism is mostly identified with the more exact sciences, it also lies at the basis of a lot of research in the social sciences. In the following paragraphs, some epistemological assumptions of positivism will be examined and debated.

First, an ontological assumption of positivism needs to be discussed. This assumption entails that there is a real world out there and that this world is governed by objective laws. These objective laws are to be found in every aspect of the world around us. So in the same manner that there are laws that describe the motion of an electron in an electric field, there are also laws that describe the way that a civilization develops. Referring to this thesis, this assumption entails that there are objective laws that describe international integration. To say that the motion of an electron in an electric field can be represented by objective laws is not a controversial position in the philosophy of science; the laws concerning the motion have been proved numerous times and no-one expects that tomorrow electrons will suddenly behave in a manner that contradicts these laws. That the spheres of the world that are of interest to the social sciences as well can be described by objective laws is not self-evident.

A critique of the positivist position is that it is conservative and pessimistic. The most important actor in the social sciences is the human being. A positivist position in the social sciences will mean that one also has a positivist position concerning the behavior of a person. If this behavior can be described by objective laws, then this would mean that a person can never really transcend himself. What is more, there cannot be agency – agency understood as transcending existing structures. Humans, according to positivist epistemology, are believed to be puppets on a string. The rules describe the person, and the person cannot alter that he or she is following the rules. If he or she would, then one would not be able to speak of objective rules anymore. In the same manner one can say that a positivist position would mean that a society cannot really change. It can only act within
the objective rules, a society cannot change them. Therefore, real progress is human behavior and in
the way society is organized would not be possible, which as stated above is a conservative and
pessimistic position.

In the previous paragraph, the way the world exists according to a positivist position is discussed, but
not in what way we can know the world. It is thus assumed in a positivist position that the world is
governed by objective laws. But how can these laws become known? Another assumption of
positivism, which is epistemological in nature, deals with this question. It states that the laws that
shape the world, so knowledge about the world, can become known by observing the world, and
that observing the world is the only way in which one can obtain knowledge about the world. Again,
this seems to be a commonsensical position, but this is not the case. This position entails that a
scientist can observe the world in a completely objective manner, and the knowledge that he gains
would therefore not be biased by the culture, ideology or other things that have shaped the
researcher; the researcher and the object that is researched are thus assumed to be completely
independent. Philosophers of science, such as Thomas Kuhn (1962) and Karl Popper (1963), argued
that because the researcher is always influenced by for example the researcher his or hers previous
beliefs or interests in the outcome of the research, that there is no such thing as objective
knowledge. Relating this to the research done by Moravcsik in his book, one could, considering that
Moravcsik would be advantaged by a verification of liberal intergovernmentalism, argue that there
could be a bias in favor of such verification.

The next assumption follows out of the previous two. So, objective knowledge is gained by observing
the world, and with this knowledge, theories are build. It is assumed, however, that this is a one-way
process: the empirics dictate theory; theory does not influence the empirics. Although often being
considered self-evident, it has been questioned for example by Steve Smith (2004), who argued that
the dominance of neo-realism in international relations is the result of US hegemony and also serves
this hegemony. He argues that the way that international relations work is dependent on how it is
perceived to work; that theory thus does influence empirics. This line of argumentation is also to be
found in the works of Foucault, who argued that power structures can influence the way in which
knowledge is perceived (1975). In international relations, the position that theory can influence the
empirics, and that therefore theory itself represents a power structure, is famously represented by
Robert Cox, who said that “theory is always for someone and for some purpose” (1986).

As has become clear, positivism knows many strong shortcomings. Nevertheless, this ontological and
epistemological position will be the used in this thesis. Because it is not within the range of this
thesis, no effort will be put into trying to overcome these shortcomings. Instead, in the conclusion of
this thesis, a short discussion will be added on how these shortcomings affect the final conclusion of this thesis.

3.2 Methods

The method that will be used in this thesis to answer the research question is based on the method that Moravcsik used in his book *The Choice for Europe*. In this work, Moravcsik tries to analyze the history of the European Union and while doing so he also tries to prove the validity of his liberal intergovernmentalism and disprove alternative theories. The European integration process (from the Treaty of Rome to the Maastricht Treaty) is disaggregated into five different cases in which integration progressed each time because of an international treaty, and each of these is studied separately. For each of these different cases, Moravcsik derived a set of falsifiable hypotheses from liberal intergovernmentalism and from competing theories. These hypotheses were then tested using empirical evidence. The goal of this was to provide a “narrative reconstructions” of the integration process, as well as to “asses the importance of causal processes of international cooperation and institution-building which can be applied to a wide range of decisions in the EC and in world politics more generally” (Moravcsik, 1998, p. 78). The method in this thesis will be similar. The research in this thesis can therefore be understood as a theoretically informed analysis of the case study of the negotiation outcome of the EU summit of 8 and 9 December 2011. Using liberal intergovernmentalism and neofunctionalism as competing theories, hypotheses have been derived. The hypotheses of liberal intergovernmentalism and neofunctionalism will analyze the same aspects of the process whenever possible. In this way, it should become clear which of the two theories has the most explanatory power.

Since the intention is to be able to say something in general about international cooperation and institution-building, one possible critique needs to be addressed. Considering that only one outcome of a negotiation is being researched, one could argue that there is only one observation, which cannot be sufficient to make generalizable statements. This is commonly called the ‘n = 1’ problem (King, Keohane, & Verba, 1994). I argue, however, that this critique is not relevant for two reasons. First, the research in this thesis cannot be seen as independent from other case studies using similar theories. The value of this case study lies in that it can add to the existing research testing the explanatory power of liberal intergovernmentalism and neofunctionalism. And second, even within this case study there is variation in the observations. The most relevant variation being that the entire case is disaggregated into three stages and that the focus will be put on three different countries.
3.2.1 Sources
For the research done in this thesis, a wide variety of sources were used. These include primary sources, such as declarations from governments, interviews with government officials, and declarations from interest groups, as well as secondary sources, such as research reports by think tanks and other agencies, and articles by journalists in newspapers and magazines. The newspapers that were used are predominantly British quality newspapers and magazines like The Guardian, The Independent and The Economist. Also the German Der Spiegel and Die Welt have been used. From the United States, The New York Times and Bloomberg were used. From 2011, less than three years ago at the time of writing.

Unfortunately, this was not always possible. If the negotiations were held fifty years ago, then certainly, journalists, historians and political scientist would have produced plenty of work that could be used to gather information. As well, memoirs could be read, and declassified information analyzed. However, the negotiations that are being analyzed here took place during a summit in December 2011, less than three years ago at the time of writing. The amount of reliable information available is thus scarce. However, considering that with the information at hand, already interesting research can be done on the negotiations, the limited amount of credible information has to be seen as an inconvenience instead of as an impediment. It does however mean that in the future, when more information is available, possibly some conclusions of this research need to be augmented, altered or completely revised.

3.3 Operationalization
In the previous chapter, theoretical hypotheses were derived from liberal intergovernmentalism and neofunctionalism. In order to be able to test these hypotheses, they will be reformulated in a less
abstract manner, and the variables in the hypotheses will be operationalized. Then, it will be argued what conditions will have to be met in order for the hypotheses to be confirmed or refuted.

**Hypotheses liberal intergovernmentalism**

*Theoretical hypothesis liberal intergovernmentalism 1:*

*International integration is the result of a two-level game, in which at the first level the policy preferences of the states emanate from the interests of the dominant domestic economic groups.*

During the EU summit of 8 and 9 December 2011, 27 EU member states were present. This hypothesis, which formulates the relation between the states and their dominant domestic economic actors, can therefore be tested 27 times. Because doing so would not be possible in the scope of this thesis, and because it is not necessary in order to test the theory, the hypothesis is only tested on three states; Germany, France and Great Britain. The argument used why only three states are necessary is given by Moravcsik (1998). To understand the outcome of the negotiations, the positions of these three countries are the most important. This is first of all the case because the larger states have in absolute terms the most to win and lose, have the most voting power at the European Council and also because they are able to put pressure on the smaller states. Furthermore, the position of the larger states is enhanced because they have the ability to use financial side-payments as a compensation measure. Financial side-payments have a lower per capita cost for the larger states than they would have for smaller states (Moravcsik, 1998, p. 66). Also, larger states are more capable of implementing unilateral policies in order to realize their preferences, and are therefore less dependent on coordinated policy. The choice to examine the three largest states is also a reflection of Moravcsik his analysis of European integration, in which he focused on the preferences of Great Britain, (West-)Germany and France (Moravcsik, 1991, 1998). To conclude with, it needs mentioning as to why Great Britain is also part of the analysis, even though Great Britain did not sign the treaty. This has been done because liberal intergovernmentalism is not just about cooperation, it is also about non-cooperation. Not including Great Britain will not allow for an answer to the question of why Great Britain did not decide to take part in the final results of the negotiations. Furthermore, although the policies agreed upon were applicable to the Eurozone member states, the inclusion of Great Britain would still have its function, because the signature of Great Britain, being a member of the EU, is necessary for an EU treaty-change. Therefore, the concrete hypothesis is formulated as follows:
Concrete hypothesis liberal intergovernmentalism 1:
The outcome of the EU negotiations of 8 and 9 December 2011 is the result of a two-level game, in which at the first level the policy preferences of Germany, France and Great Britain can be explained by the interests of their dominant domestic economic groups.

To test this hypothesis the policy preferences of these three states will be compared to the interests of their dominant domestic groups. In order to confirm the hypothesis, these need to co-align. If they do not co-align, the hypothesis is refuted. In order to find out whether they match, the policy preferences of the states need to be known, as well as what the dominant domestic economic groups are in these states and what their interests are.

First of all, it needs to be determined how the preferences of a government can be ascertained. This will be done in two different ways. First, use will be made of the communications of the government. This means that press releases, interviews with government officials and speeches will be analyzed for information on the government’s position on the issues that were discussed during the negotiations. As has been discussed above, the communications of governments are not necessarily truthful to the actual preferences of the governments. Therefore, secondary sources will also be used, such as articles from journalists that covered the negotiations and the run-up to it and also analyses provided by think tanks.

The dominant domestic economic groups will be recognized in two ways. First, economic analyses will be used by governmental institutions, think tanks and journalists. In these, evidence can be found on what the most important economic sectors are. Second, the economies of the states will be evaluated. Using data on the size of the financial sector and the size of the import and export, an argument is made on which economic sectors dominate in the states. Having determined what the dominant domestic economic groups are, their interests are found in two ways. First, the communications of organization that represent the interests of these groups, such as lobby groups, collective organizations like employers’ organizations and large companies, are analyzed. These organizations often try to influence public opinion and policy makers by steering the public debate. It is therefore expected that information on the interests of the economic groups can be found in press releases, public statement, opinion articles and interviews that have been produced by these organizations. Second, it is argued what the impact of the different policy options entails for these actors. This will, first, provide for an argument on what the interests of the groups are when communications on the interests is missing, and second, it serves as the basis for an argument on how much the economic groups will gain or lose if certain policy options are implemented. This is
necessary, because according to liberal intergovernmentalism, the economic groups that tend to gain or lose the most from a given policy will be the most influential.

*Theoretical hypothesis liberal intergovernmentalism 2:*
*International integration is the result of a bargaining process at the second level of a two-level game, in which the states that gain the most from an agreement are more willing to make concessions.*

As was discussed in the operationalization of the first hypothesis, to understand the outcome of international negotiations, only an analysis of the dominant states is necessary. In this hypothesis, the result of the EU summit of 9 and 9 December 2011 will thus be explained by taking into account the German, French and British positions in the negotiations. Therefore, the concrete hypothesis reads as follows:

*Concrete hypothesis liberal intergovernmentalism 2:*
*The outcome of the EU summit of 8 and 9 December 2011 can be explained as the result of a bargaining process between Germany, France and Great Britain, in which more concessions were made by the states that had the most to gain from an agreement.*

What this entails is that Germany, France and Great Britain were the only relevant actors during the EU summit. Therefore, in order for this hypothesis to be confirmed, it needs to be possible to explain the outcome of the EU summit as a compromise between these three states. That thus means that the policy preferences of the states are juxtaposed to the outcome of the EU summit, and that the outcome should be policy wise in the range of the policy preferences of the aforementioned states.

This is not enough to completely confirm the hypothesis. It also contains information on the manner in which the states make concessions to reach a compromise. According to the hypothesis, the states that have the most to gain make the largest concessions. The less a state is able to achieve the policy goals it prefers via unilateral actions, the more a state is dependent on the implementation of its policy preferences through cooperation, and the more a state has thus to gain from an agreement. Therefore, it needs to be determined to what degree the states are capable of unilaterally achieving their policy goals. This is something that is difficult to determine. What can be done is to argue for the different issues what the unilateral policy options are for the states, and to what extent these unilateral option will be as effective in achieving the policy goals as international cooperation is. The degree of concessions that the states have made can be ascertained by comparing their policy preferences with the outcome of the EU negotiations. In order for the hypothesis thus to be confirmed, apart from the above mentioned condition, it should be possible to argue that the states
that made the largest concessions were less capable of reaching their policy goals with unilateral actions.

The theoretical hypothesis of liberal intergovernmentalism 3:

*International integration is the result of a two-level game, in which at the second level, the following holds: if a state doubts whether the other states will commit themselves to the agreements within the existing enforcement regime, then the state will prefer the pooling and delegation of sovereignty.*

The concrete formulation of this hypothesis, which is focused on the case of the EU summit, reads as follows:

**Concrete hypothesis liberal intergovernmentalism 3:**

*The outcome of the EU summit of 8 and 9 December 2011 is the result of a two-level game, in which at the second level, the following holds: if a state doubts whether the other states will commit themselves to the agreements within the existing enforcement regime, then the state will prefer the pooling and delegation of sovereignty.*

As with the first hypothesis, focus is put on Germany, France and Great Britain in testing this hypothesis. What is needed, first, is the preferences of Germany, France and Great Britain on the delegation and pooling of sovereignty. How these preferences can be found is discussed in the section above on the operationalization of the first hypothesis. A state is considered to be in favor of a form of delegation and pooling if there is evidence that the states prefers an institutional construction on the implementation of a policy in which it would see its power to influence future decisions diminished. Then, for the state or states that are indeed proponents of this, it needs to be determined whether it can be argued that there was a reason to doubt the commitment of the other states. If indeed this can be argued, the hypothesis is considered to be confirmed. If it is not possible to argue this, then the hypothesis is refuted.

**Hypotheses neofunctionalism**

Theoretical hypothesis neofunctionalism 1:

*Integration is the result of previous integration in an economic sector, that because of the interdependence with other economic sectors leads to problems that can only be solved by more integration.*

In order for this hypothesis to be confirmed, the outcome must be explained in terms of problems caused by previous integration. The goal of the EU summit was to overcome the European debt crisis that hit the Eurozone member states, and the steps toward further integration were also taken by
the Eurozone member states. The previous integration that thus could have led to the integration agreed upon at the EU summit is thus most probably the monetary integration, that is, the introduction of the Euro as a single currency for multiple states. The concrete hypothesis therefore is as follows:

Concrete hypothesis neofunctionalism 1:

*The outcome of the EU summit of 8 and 9 December is the result of the integration in the monetary sector, that because of its interdependence with other economic sectors lead to problems that could only be solved by more integration.*

What needs to be argued to confirm this hypothesis is, first, that the sovereign debt crisis is indeed the result of the introduction of the Euro. One way in which this can be argued, is by making the case that if the Euro was not introduced, that the sovereign debt crisis could not have occurred. To argue this, use can be made of analyses of economists and journalists of the sovereign debt crisis. Second, it needs to be argued that the solution for the sovereign debt crisis needed to be more integration. This can be argued by looking at the different policy options to overcome the sovereign debt crisis. If no reasonable option without further integration exists, then it can be said that the sovereign debt crisis can only be overcome by more integration. If both these conditions hold, then the hypothesis is considered to be confirmed. If one of these two conditions does not hold, then the hypothesis is refuted.

Theoretical hypothesis neofunctionalism 2:

*International integration is the result of states perceiving a supranational authority as being more able to efficiently manage technically, legally, or politically complex issues.*

In order for this hypothesis to be true, what needs to be the case is that the states their position on the ceding of authority to a supranational authority, is a reflection of the complexity of the issue at hand. To test this, an indirect approach is taken, which is similar to the approach Moravcsik used in *The Choice for Europe* (1998, p. 69). If integration indeed occurs on the basis of the complexity of the issues, then this means that delegation and pooling is preferred by states on the basis of issue-specific reasons. If states indeed prefer delegation and pooling for issue-specific reasons, then there should be variation across issues in that preference. There should not be variation across states, because each state reaches its preference following the same line of technocratic reasoning.

This should be true for all 27 EU member states, but in order to test the hypothesis not all the 27 EU member states need to be analyzed. Because Germany, France and Great Britain are already looked
at for the hypothesis of liberal intergovernmentalism, this hypothesis will be tested on these three states. The concrete hypothesis is therefore as follows:

Concrete hypothesis neofunctionalism 2:

*The outcome of the EU summit of 8 and 9 December 2011 is the result of Germany, France and Great Britain preferring delegation and pooling of policy issues, because of their technical, legal, or political complexity.*

This hypothesis is considered to be confirmed if the condition upholds that there is no cross-state variation on the preference of delegation and pooling in Germany, France and Great Britain. If the preferences on delegation and pooling are dissimilar, then the hypothesis is refuted.

Theoretical hypothesis neofunctionalism 3:

*International integration is the result of a supranational authority successfully influencing negotiations in favor of further integration.*

In order to test whether the outcome of the EU summit of 8 and 9 December 2011 is indeed the result of a supranational authority successfully influencing the negotiations. Both the European Commission and the European Parliament could be analyzed to see how they influenced the negotiations. The choice is made here to only analyze the role of the European Commission. For the testing of the theory, the choice is not relevant, because both actors are a supranational authority and should thus, according to neofunctionalism, both be socialized in the same manner. Both the actors should thus according to the theory have European loyalties and preferences, and should try to influence the negotiations in favor of more integration. The European Commission was chosen, because it was arguably more present at the EU summit, because whereas the European Parliament is only consulted, the president of the European Commission has an active role in intergovernmental conferences and can thus broker agreements between the different states. Therefore, the concrete hypothesis is as follows:

Concrete hypothesis neofunctionalism 3:

*The outcome of the EU summit of 8 and 9 December 2011 is the result of the European Commission successfully influencing the negotiations in favor of more integration.*

In order to determine whether the European Commission has influenced the outcome of the negotiations, the policy preferences of the European Commission and the dominant states, Germany, France and Great Britain, are needed, as well as the outcome of the negotiations. In order for the hypothesis to be confirmed, first, the position of the European Commission needs to be in favor of further integration. The second condition is that the outcome of the EU summit cannot be explained
by only taking into account the policy preferences of Germany, France and Great Britain. If the policy preferences of the European Commission are not in favor of more integration, or when the outcome of the EU summit can be explained without taking into account the position of the European Commission, the hypothesis is refuted. The downside of this approach is that if the policy preference of the European Commission is in the range of the policy preferences of Germany, France and Great Britain, that it cannot be show whether the European had any influence in the outcome.
Chapter 4: Analysis

In this chapter, an effort will be made to validate or falsify the hypotheses that have been postulated and operationalized in the previous chapters in order to answer the research question of this thesis. The research will be structured as follows: first the research question is reiterated and the dependent variable is discussed. Then the policy preferences of Germany, France, Great Britain and the European Commission are analyzed. Following this, the dominant domestic economic groups in Germany, France and Great Britain are identified, as well as their economic interests. After that, the outcome of the EU summit is explained according to liberal intergovernmentalist theory and the hypothesis of liberal intergovernmentalism are tested. After that, an explanation in accordance with neofunctionalist theory is given, and the neofunctionalist hypotheses are tested.

4.1 The dependent variable

So, to reiterate, the research question is as follows:

How can the furthering of integration that was agreed upon during the EU summit of 8 and 9 December 2011 be explained?

In the research question, the dependent variable is the furthering of integration in the form of fiscal integration in the Eurozone. As was discussed in the introduction, this entailed the implementation of strict budgetary discipline, the centralization of budgetary power and the ECB as lender of last resort. In the next section, these elements are elaborated upon, in order to gain a clearer picture of what was decided upon at the EU summit.

The negotiation outcome can be divided into two parts. First, there is the part that is formalized in the Treaty on Stability, Coordination and Governance. This part contains the budgetary rules and as well the manner in which they are to be enforced. The second part concerns the agreements that were made on the ECB, which were not formalized in a treaty. Now follows first a discussion on the former, after which the latter is discussed as well.

Even though the negotiations on the Treaty on Stability, Coordination and Governance were held with all the 27 states of the EU, not all agreed on the treaty. Great Britain, as well as the Czech Republic, were the two states that abstained from the treaty. This means that the treaty itself cannot be made part of the EU Primary Law, for this, amongst other things, needs the acquiescence of all the member states. The most important part of the treaty, which is its third chapter, contains the budgetary rules and their enforcement. This part is called the Fiscal Compact, and because of its
importance, the treaty itself is often referred to as the Fiscal Pact. The rules set out in this part of the treaty, which will be discussed below, are only applicable to the Eurozone member state. However, the EU Member state that are not part of the Eurozone that have signed the treaty will also be obliged to adhere to these budgetary rules when they become a member of the Eurozone.

The first measure of the treaty that would hold states to enforce stricter budget discipline is that the Eurozone Member state are obliged to introduce a fiscal rule or golden rule into their national law at the constitutional or equivalent level. This fiscal rule entails that a country’s budget deficit cannot exceed 3% of GDP and that the structural budget deficit cannot exceed 1% or 0,5% of GDP. The 1% is applicable if the country’s debt-to-GDP ratio is significantly below 60% (TSCG, 2011). The Fiscal Pact also contained a debt brake rule. This rule entails that if a state its debt-to-GDP exceeds 60% that the country should have an annual budget surplus that equates to one-twentieth of the debt that exceeds this 60% (TSCG, 2011).

If a look is taken at the institutionalization of the treaty, it is clear that the treaty leads to the centralization of power, predominantly to the supranational European Commission. Apart from the expansion of powers to scrutinize the budgetary proposals of the Eurozone Member state, the strengthened position of the European Commission is most notable in the power to interpret the treaty. For example, the European Commission decides what the structural budget deficit is of a state. Considering that it is impossible to objectively determine the structural budget deficit, the European Commission has thus the power to make the financial position of a state look better or worse. Also, when a state its budget is not in line with the rules of the treaty, the European Commission can decide upon in what manner this state has to adjust its budget in the coming years in order to, so to say, get back in line. Refusal to do so by the state will lead to the activation of the so-called automatic correction mechanism. This entails that sanctions are automatically in place.

Another manner in which the European Commission can interpret the treaty concerns the ‘exceptional circumstances’ rule. This rule entails that when a state faces exceptional circumstances, that it is not obliged to adhere to the before mentioned budgetary rules. However, what entail exceptional circumstances is ill-defined. The power to determine what are and what are not exceptional circumstances is centralized at the European Commission. However, there remains also an intergovernmental aspect to the treaty. For the only manner in which the sanctions can be circumvented is by a reversed QMV vote in the European Council. In conclusion, it can be said that the enforcement of the treaty is in the hands of the supranational European Commission, and that the only way in which the states can roll back on the agreements is by building a coalition that is bigger than just a majority coalition.
The next part that will be discussed is the outcome of the negotiations that was not formalized in the treaty. This part entails the role of the ECB as a lender of last resort. Of course, because the ECB is officially independent, this result could not have been part of the treaty, nor could it be communicated as being a result of the EU summit. However, the actions of the ECB speak for themselves. In July 2012, 7 months after the EU summit and four months after the Fiscal Pact was signed in action by the participating states, Mario Draghi, the ECB president, stated that the ECB would do whatever it took to save the Euro, de facto stating that the ECB would be a lender of last resort (Milliken & Zaharia, 2012). These words were strengthened by the actions of the ECB in August 2012, when it introduced the Outright Monetary Transactions (OMT), a new bond-buying program (Black, Randow, & Thesing, 2012; Draghi, 2012). It is thus clear that the ECB would use its powers to ensure that the Eurozone Member state would not default. It would buy-up bonds in order to keep the interest rates manageable. It can thus be concluded that the ECB had become a, at least de facto, lender of last resort.

Thus, what can be said about the negotiation outcome is that it entailed the introduction of budgetary rules for the Eurozone Member state, the these budgetary rules would be enforced by the supranational European Commission, vastly expanding their powers, and that the ECB became a lender of last resort. Reflecting on liberal intergovernmentalism and neofunctionalism, does the outcome of the EU summit entail integration? The definition of integration according to liberal intergovernmentalism is institutionalized international policy coordination (Moravcsik, 1993, p. 473). It is clear that the monetary policies of the Eurozone member states are coordinated and institutionalized via the ECB, and that the budgetary policy is coordinated and institutionalized via the European Commission. Therefore, the outcome is indeed an instance of integration according to liberal intergovernmentalism. The outcome of the EU summit is also integration according to the neofunctionalist definition, which reads that integration is the

“process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations and political activities toward a new center, whose institutions possess or demand jurisdiction over the pre-existing national states” (Haas, 1968, p. 16).

It is clear that the outcome entails she shift of political activity towards the European supranational center, and that this center obtained new jurisdictions, the European Commission on the Eurozone member states their budgetary policy and the ECB on providing liquidity to the Eurozone member states.
4.2. Preferences of states and the European Commission

In this part the preferences of Germany, France, Great Britain and the European Commission concerning the issues at hand at the EU summit of 8 and 9 December 2011 are being analyzed. After dealing with each of these actors separately, in the conclusion the most important preferences are summed up and are visualized in table 1.

4.2.1. Preference of the German government

In the run-up to the EU summit of 8 and 9 December, the German Chancellor, Angela Merkel, has consistently expressed her vision on how the EU should proceed in dealing with the sovereign debt crisis. Merkel had been adamant that the only way to overcome the crisis, and to save the euro, is by austerity measures; deficit spending by the Eurozone member states had to be curtailed. This had to be achieved by a EU treaty change that would create a fiscal union in the EU, on which she elaborated in a landmark Bundestag address on 1 December 2011 (Lichfield & Russel, 2011). The position of Merkel was that the budgets of the 17 Eurozone countries had to be agreed upon according to strict rules, which were to be enforced by the European Commission. Non-compliance with the budget rules should be reason for automatic sanctions, which would limit the possibilities of individual member states to block negative consequences. These sanctions could be in the form of a fine or in withhold EU subsidies. Furthermore, she also was in favor of that the budget rules should be legally-enforceable through the European Court of Justice (Merkel, 2011). All in all, if the position of Merkel would be implemented in totality, it would entail a far-reaching transfer over budgetary policy from the Eurozone member states to the European institutions.

Although the fiscal rules were only to apply to the 17 Eurozone members, Merkel did want a EU treaty change. An intergovernmental treaty outside of the EU treaties was by Merkel considered to be a “second best” solution (Merkel, 2011). In order to achieve an EU treaty change, meaning the alteration of the Treaty on European Union (TEU) or the Treaty on the Functioning of the European Union (TFEU), the signatures of all the 27 EU member states was needed. In a prior meeting with British prime minister David Cameron, she already reassured him that the treaty change would be limited and would therefore not affect the UK or any other non-Eurozone member state in the EU (Peel, 2011a). A treaty change would mean that the adopted measures would be part of the primary EU law, thus embedding them in the fibers of the EU and placing them clearly under the jurisdiction of the European Court of Justice and the area of legitimacy of the European Commission, an issue on which will be elaborated more later on in this chapter.
Merkel emphasized in her address that the confidence in the euro would not return by using “short-term fixes” (Merkel, 2011). This refers to the further involvement of the ECB in the bond market in order to drive down the interest rates as well as the introduction of Eurobonds or stability bonds. According to Merkel, Eurobonds would become only an option after the crisis was over and a fiscal union would be in place (Peel, 2011b).

4.2.2. Preference of the French government

Multiple sources have been used in this thesis in order to find the policy preferences of France. First, a policy speech by French President Nicolas Sarkozy was used, which was given on 1 December 2011, a week prior to the EU summit of 8 and 9 December. This speech took place in a symbolic location, for it was given in the same venue as where Sarkozy three years prior, after the bankruptcy of Lehman brothers, gave a speech in which he denounced what he called capitalism gone wild (Korteweg, 2011). Second, use has been made of statements by Sarkozy made in the period leading up to the EU summit. Being well aware of the fact that these statements might reflect strategic policy positions instead of actual policy preferences, the use has been made of accounts by journalists and analysts in order to get a picture of the actual policy preferences.

Considering the activity of the ECB, Sarkozy strongly favored the extension of the second-hand bond buying program that already was in place (Gatschagen, 2011; Gruyter, 2011; Sarkozy, 2011). This was immediately necessary in order to bring down the interest rates of predominantly the southern countries and thus relieve the Eurozone area of the immediate crisis. In order to put up a defense against what he called “speculation” in the Eurozone area, Sarkozy proposed the creation of an European Monetary Fund (Sarkozy, 2011). However, the manner in which this fund would be different from the EFSF and the ESM is not clear.

Sarkozy indicated that he was in favor of more “rapid, automatic and severe” sanctions for countries that violated the Stability and Growth Pack rules (Sarkozy, 2011). However, the automaticity that Sarkozy envisioned was very much limited. Sarkozy stated that he did not want that the sanctioning power would lie in the hands of a technocratic or supranational body, meaning the European Court of Justice and the European Commission; the control should remain with the national governments. More concretely, this meant that Sarkozy favored the adoption of a golden budget rule by every Eurozone Member State and the extension of qualified-majority decision-making in the Eurozone area (Grice & Lichfield, 2011; Sarkozy, 2011). Sarkozy thus did not favor an EU-treaty that would be signed by all 27 EU-members; instead he wanted an intergovernmental treaty between only the 17 Eurozone member state (Peel & Carney, 2011). This emphasizes Sarkozy’s underlying preference,
which is first to enhance intergovernmental governance as opposed to supranational one, and second to limit the participants to the Eurozone member states.

Concerning Eurobonds, the position of the France government is not wholly clear. According to many journalists, the French did indeed favor the introduction of Eurobonds (Eder & Lehnartz, 2011; EurActiv, 2011; Gaugele & Vitzthum, 2011; Gruyter, 2011; Kollewe, 2011). However, French government officials have not shown their full support for this measure. French Prime Minister François Fillon publicly stated his disapproval of a too timely introduction of Eurobonds, stating that it would not be possible to do so when individual nations are still in control of their own budgets (Fillon, 2011). Also French Finance Minister François Bairon stated that the Eurobonds could maybe after the immediate crisis be introduced. According to Bairon, there were enough tools for the provision of liquidity for the Eurozone area, and that Eurobonds would thus not be an immediate solution for the sovereign-debt problems (Deen, 2011). The French President, Sarkozy, has sent mixed messages concerning France’s preferences on the Eurobonds. During a special EU-summit on the 21 July 2011, he perceived them favorably (O’Grady, 2011). However, only a month later after a bilateral summit between France and Germany, he stated that Eurobonds could be implemented, but at the end of the integration process, not at the beginning (Donahue & Fouquet, 2011). Furthermore, it is noteworthy that the Eurobonds are not mentioned in Sarkozy’s policy speech on 1 December 2011. What seems to be the case is that French did indeed favor the introduction of Eurobonds, albeit when stricter budgetary discipline in the Eurozone is implemented. However, Sarkozy dropped the mentioning of Eurobonds as a compromise to the German staunch resistance to the Eurobonds. Whether this is exactly the case is not completely certain. Therefore, further research should be done in the French preference for the Eurobonds. In this thesis, however, it is thus assumed that France was in favor of the Eurobonds connected to stricter budgetary discipline in the Eurozone.

To finish with, what has to be taken into account is that during the EU summit the French presidential elections were only a few months away. Above, the position of the administration under Sarkozy was discussed. The French president however was not the frontrunner, this was the socialist contender Hollande, who had already expressed doubts about the austerity policies prescribed by Sarkozy (AP, 2011). Albeit it is not clear whether Hollande once in office would have completely different policy preferences, the opposite is not clear either.

4.2.3. Preference of the British government

The sovereign debt crisis had its largest effect on the countries within the Eurozone. The proposed solutions to the crisis therefore were mostly of importance to these countries. Great Britain, having its own currency and monetary authority, was consequently a less important actor relative to France
and Germany. However, considering that Great Britain nonetheless is negatively influenced by the economic downturn in the Eurozone, and the fact that some of the proposed solutions to the crisis needed the approval of all the EU member state, Great Britain certainly was still of importance during the EU summit of 8 and 9 December 2011.

As a solution for the immediate problems in the bond-market, British Prime Minister David Cameron had voiced his support for a more active bond-buying program of the ECB (Spiegel Online, 2011; Wintour, 2011). According to Cameron, the ECB should be a “lender of last resort” (Peel, 2011a). The British government was as well in favor for the introduction of Eurobonds (Wintour, 2011). According to the British Finance Minister George Osborne, Eurobonds were needed in order to ensure the long term stability of the currency (Osborne, 2011). Furthermore, the position of the British was that fiscal responsibility was needed in the Eurozone (Osborne, 2011).

As has been mentioned before, in order for a change of the EU treaties, the signature of the British government was needed. Even if there would be an agreement that would only affect Eurozone member state, an EU treaty change requires an agreement between all 27 EU member state. The British were, however, against such a treaty change. As Cameron had made clear, he wanted more power to go to national governments instead of to the EU (Cameron, 2011; Wintour, 2011). He was willing to sign a treaty, but only for a price. Cameron wanted predominantly to be compensated in issues in the regulation of the financial sector. This entailed his wish to change from a QMV voting system to one of unanimity in the European Council on issues pertaining to financial affairs (Emmanouilidis, 2011). Also he wanted to add a protocol to the treaty that would protect US financial institutions in London that do not trade with the rest of Europe from EU regulations and that the new European Banking Authority should remain in London (Helm, Boffey, Stewart, & Beaumont, 2011; Parker, Barker, & Spiegel, 2011).

4.2.4. Preference of the European Commission

In response to the sovereign debt crisis, the European Commission formulated its own plan on how the crisis should be overcome. This plan can be divided into two parts: the management of the acute problems on the bond markets and as well a blueprint for future economic integration. With respect to the acute problems, which were the high interest rates in predominantly the southern Eurozone member state, the European Commission proponed the strengthening of the European Financial Stability Facility (EFSF) and the acceleration of the entry into force of the European Stability Mechanism (ESM) (Barroso, 2011). The firepower of these financial institutions would guarantee the solvency of the troubled countries, and would thus lead to the regaining of trust of the financial markets. Furthermore, what the European Commission proponed, was the enlargement of the ECB
bond-buying program (Barroso, 2011). Further involvement of the ECB would entail that the ECB would buy second-hand bonds, thus pushing down the interest rates for the troubled countries.

The second part of the plan entailed the changes that were needed in the functioning of the EU. These changes were needed to ensure the future financial stability of the EU, as well as to tackle the economic imbalances that have been allowed to grow, especially between the Eurozone member state (Barroso, 2011). What the European Commission envisioned was more discipline as well as more solidarity in the European Union (Barroso, 2011). Here, discipline would mean a fiscal union and solidarity the introduction of Eurobonds, or Stability Bonds as the European Commission prefers to call them. The effect of the Eurobonds would be that the euro-area financial system would become more resilient to future adverse shocks and they would as well secure the access of the Eurozone member state to liquidity (European Commission, 2011b, p. 4). However, according to the European Commission, the introduction of Eurobonds would lead to a situation in which the markets are not able to discipline national budgetary policy (European Commission, 2011b, p. 7). And this would imply a risk of moral hazard, that is, that individual countries can build-up debt knowing that their solvency is safeguarded by the other Eurozone member state. In order to counter this, the introduction of Eurobonds would require substantial changes in the framework for economic governance in the euro-area. These changes entail on the one hand the introduction of stronger fiscal discipline and on the other the correcting of macroeconomic imbalances\(^5\) (European Commission, 2011b, p. 8). How the latter was to be achieved, however, had not been made clear by the European Commission in the run-up to the summit of 8 and 9 December 2011. The European Commission did present plans on how a fiscal framework, which was deemed necessary for fiscal discipline, might be shaped.

The fiscal framework that was proposed by the European Commission was meant as a reinforcement of the Stability and Growth Pack, which would go further than the so-called two-pack and six-pack reforms. First, they included the centralization of national budget approval. All budgets of Eurozone member state were to be approved by the European Commission (European Commission, 2011b, p. 22). In order to facilitate the central surveillance of the national budgets, the member state would need to adopt common standards of control and disclosure, and would have to abide to synchronized budget time-lines (European Commission, 2011b, p. 22). The most intrusive proposal entailed a far-reaching transfer of sovereignty to the EU for cases of “severe financial distress” (European Commission, 2011b, p. 22). The proposal was to put the “failing M[ember] S[ate] under

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\(^5\) The macroeconomic imbalances entailed according to the European Commission the “significant and persistent divergence in the current accounts and net external positions of EU member state” (European Commission, 2012).
some form of ‘administration’” (European Commission, 2011b, p. 22). It is not mentioned what is precisely meant by ‘severe financial distress’ or ‘administration’.

4.2.5. Summary of preferences
It is clear that the debated policy preferences of these four actors differentiate a lot. Especially Germany, France and the European Commission each envision a distinct path that needs to be taken. For Germany, this path entails the strengthening of supranational government in the EU through a treaty change with strict adherence to budget rules. The power would be in the hands of the European institutions, but they would not help alleviate the debts, be it by Eurobonds or in any other way. France, on the other hands wants the opposite of this: an intergovernmental solution that would not entail giving more power to the supranational institutions. And furthermore, it does want an extension of European solutions for debt-problems; for certain via the ECB, and possibly too through Eurobonds. The European Commission basically wants the full package. It wants more power to the supranational institutions and as well the introduction of European programs to alleviate the debt problems. This would mean a more active ECB as well as the introduction of Eurobonds. The different positions are furthermore visualized in the following table.

Table 1: The policy preferences of the largest states and the European Commission.

<table>
<thead>
<tr>
<th></th>
<th>Germany</th>
<th>France</th>
<th>Great Britain</th>
<th>EC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extension of ECB bond-buying program</td>
<td>Against</td>
<td>In favor</td>
<td>In favor</td>
<td>In favor</td>
</tr>
<tr>
<td>Introduction of Eurobonds.</td>
<td>Against</td>
<td>Somewhat in favor.</td>
<td>In favor</td>
<td>In favor, albeit</td>
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<td></td>
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<td>connected to</td>
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<td></td>
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<td>centralized budget</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>power</td>
</tr>
<tr>
<td>Supranational or intergovernmental solution</td>
<td>In favor of supranational solutions. Expending the power of the EC and the ECJ via a EU treaty change.</td>
<td>In favor of an intergovernmental solution, where more power is given to the European Council.</td>
<td>Intergovernmental. Great Britain is against a more powerful EC.</td>
<td>In favor of a supranational solution, placing more power at the EC.</td>
</tr>
<tr>
<td>EU treaty change</td>
<td>In favor, wanting to include all EU MS.</td>
<td>Against. Would rather see an intergovernmental treaty in Eurozone.</td>
<td>Against. This would lead to a stronger EC.</td>
<td>In favor.</td>
</tr>
<tr>
<td>Automatic sanctions when violating budget rules.</td>
<td>In favor. Placing more power at the EC and the ECJ.</td>
<td>Partly in favor. Control via reversed QMV and adoption of budget rule in national law.</td>
<td>In favor.</td>
<td>In favor. Even proposing to put non-compliant states under ‘administration’.</td>
</tr>
</tbody>
</table>
4.3. Explaining the policy preferences

In this part, the first hypothesis of liberal intergovernmentalism, that the policy preferences of the countries are determined by the economic interests of the dominant domestic economic groups, will be tested. How this will be done has already been discussed elaborately in the Methodology chapter. In short, for Germany, France and Great Britain, a discussion will be held on what domestic economic groups would be influenced and in what way by implementing different policy options. An argument will be made as to what the economic impact of the discussed policy options will be on these groups, and evidence is gathered as to what the positions of these groups are concerning these policy options.

4.3.1. Explaining the German policy preferences

It was only in the nineties, after the German unification that due to its lagging economy Germany was mockingly called the sick man of Europe (The Economist, 2005). In 2011, this view had changed dramatically. The German economy was, amidst global economic turmoil, doing great. Its GDP grew almost 4% in 2010, which was faster than most rich countries, and its unemployment was with 7.1% the lowest number since 1992 (Rattner, 2011; The Economist, 2011a; Vits, 2011). The German economy was now called a juggernaut and the new Wirschaftswunder (Rattner, 2011; The Economist, 2011a). The success of the German economy came from its position as the world’s second largest exporter (Rattner, 2011). In this export driven economy, it is the export sector that has a lot to win and lose from the possible policy decisions that were to be taken in Europe. Therefore, the first domestic actor that will be looked at is the export sector. The second domestic actor that had a lot to win and lose is the private banking sector. Their interests stem from the enormous amount of state bonds in their possession of Eurozone countries (Popov & Van Horen, 2013).

Starting with the export sector, it is important to mention why it is so successful. Germany had since the start of the millennium a current account surplus (Trading Economics, 2014c). A long-term current account surplus will lead to the appreciation of the country’s currency, which then would make it more expensive to export and more cheap to import. This would stem exports and ultimately annul the current account surplus. This has not happened in Germany, because Germany uses the Euro. Considering that the Eurozone in its totality has a balanced current account, the Euro will not lower in value relative to other currencies because of a current account surplus (Trading Economics, 2014a). It can thus be said that because of the Euro, Germany has an artificially strong currency,
which boosts its export sector (Pisani, 2013). Therefore, the continued existence of the Euro was of the utmost importance for the well-being of the German economy.

In Germany, the export sector is represented by the Bundesverband Großhandel, Außenhandel, Dienstleistungen (BGA). In the run-up to the EU summit, its President, Anton Börner, had repeatedly and publicly discussed the position of the German export sector on the issue of Eurobonds, the ECB and the budgetary discipline of the Eurozone countries. On the first of these, the Eurobonds, Börner was a supporter. He stated that if Eurobonds were not instated, the sovereign debt crisis could lead to a global recession. The introduction of the Eurobonds did however needed to be supplemented with stricter budgetary discipline in the Eurozone countries (Heller, 2011). What Börner was against was the use of the ECB as a lender of last resort (Evans-Pritchard, 2010). These positions are well understood in economic terms. The introduction of Eurobonds will effectively level the interest rates paid in the Eurozone. Whereas this might lead to higher interest rates for the northern states, it will certainly lead to lower interest rates in the southern states (Aßmann & Boysen-Hogrefe, 2012; Carstensen, 2011; Favero & Missale, 2010; J.P. Morgan, 2011). The lowered interest rates will allow these states to borrow money at a lower cost, and thus more effectively invest in their economies, leading to more economic growth in the Eurozone area. The export sector of course benefits from economic growth in the Eurozone are, considering that 60% of the German export is going to EU countries (Gill & Raiser, 2012). Also that the export sector is against making the ECB a lender of last resort is understandable. The printing of money by the ECB could lead to inflation in the Eurozone. The export sector in Germany will be negatively affected by possible inflation, since inflation will make exporting more expensive and importing cheaper.

The second sector of interest is the private banking sector. In Germany, this sector is represented by the Bundesverband deutscher Banken (BdB). The president of this organization, Andreas Schmitz, has publicly stated the positions of the German private banking sector. On the issue of Eurobonds, Schmitz had said that he was against this (Braun, 2011). He had the same negative disposition for making the ECB a lender of last resort (DAWN, 2011). According to Schmitz, the solution of the sovereign debt crisis was for governments to enforce stronger budgetary discipline (Bastian, Köhler, & Landgraf, 2011). Also these positions are economically well understood. The effects of Eurobonds, as had been discussed prior, are that they will lead to more growth in the Eurozone because governments are able to borrow money on the financial markets for a lower interest rate. A lower interest rate, however, means that the creditor of the loan, that is, the banks, will make less money on their investment. For the banking sector, the fragmented bond-market with its diverging interest rates is very lucrative. Furthermore, the banking sector also would want that the money that they have already borrowed out in the Eurozone is repaid in full. Haircuts, as had been done in Greece,
are very damaging to the banks their investments. This explains why the banking sector was in favor of strict budget discipline, for if countries like Italy and Spain would make their budgets manageable through budget cuts, the chances of another haircut in the Eurozone would diminish. The social and economic effects that these budget cuts have on these countries are not important to the banking sector. Also, in order for these countries to manage their budgets, they would have to privatize government owned assets. This makes for good opportunities to invest money in these countries; buying assets at low prices and gaining access to parts of the economy that were formerly not part of the market. That the banking sector was against the status of the ECB as a lender of last resort also makes sense. If the printing of money would lead to inflation, then this would enormously negatively affect the banks. Inflation has winners and losers; the winners are the debtors, the losers are the creditors. Because inflation would mean that the investment returns of the banks will be dramatic, the banks are obviously against measures that could lead to inflation.

In conclusion, it can be said that the policy preferences of the German government can accurately be described by looking at the interests of the dominant domestic economic sectors. The export sector as well as the financial sector were proponents of not making the ECB a lender of last resort and of enforcing stricter budget discipline in the Eurozone. However, there was also a divergence in interest between the export and financial sector, for the first was a proponent and the second an opponent of the introduction of Eurobonds. That the German government took the stance of the financial sector might be an indication of the dominant power position of the financial sector in Germany.

4.3.2. Explaining the French policy preferences

Whereas the German economy was widely lauded due to its resilience in times of economic peril, the French economy was showing signs of weakness. To illustrate, the unemployment was just over 9%, the government was projected to have a budget deficit of 5.7% in 2011 and the debt-to-GDP ratio was projected to rise that year to 85% (Alderman, 2011a, 2011b). Furthermore, the difference in interest between the France and German 10-year bond grew to over 2% (Jolly, 2011). It is therefore not a surprise that there were worries that France would become the next victim of the sovereign debt crisis (Alderman, 2011b; La Monica, 2011; Wigglesworth, 2011). If the economies of Germany and France are compared, one other thing is noticeable: whereas Germany had run a current account surplus for a while, France had had an increasing current account deficit since 2006 (Trading Economics, 2014b). This furthermore means that while the German economy is dependent on external demand, the French economy is heavily reliant on the domestic demand (Alderman, 2011a; Love, 2011). What was similar to Germany, however, was that the French banks were heavily exposed to the fiscally weaker Eurozone countries (Alderman, 2011a; Popov & Van Horen, 2013).
If a look is taken at the most important domestic economic actors, there are two groups that seem to be the most important in France. First, there is, as in Germany, of course the banking sector. As mentioned, they had invested deeply in Eurozone bond market. The second group that is of importance is the French businesses, the group which Moravcsik also used in his book ‘The Choice for Europe’ to understand the formation of French policy preferences (Moravcsik, 1998).

To start off with the first group, the French banking sector. The organization in France that represents the interests of the commercial banks is the Association Française des Banques (AFB), which is as an organization part of the wider banking interest organization the Fédération Bancaire Française (FBF). However, unlike the German counterparts of these organizations, these French organizations had not tried to mix themselves openly in the public debate by interviews, press releases or opinion pieces. The position of the French banking sector can however be assumed to be similar to the German banking sector, because of both their positions in the bond markets of the fiscally weaker Eurozone member states. This thus means that it is assumed that the French banks were against Eurobonds, against making the ECB a lender of last resort and that they were proponents of severe budget cuts in order for the Eurozone governments to adhere to the Stability and Growth Pact.

The French businesses, the second dominant domestic group, are represented by the Mouvement des Entreprises de France (MEDEF). This employers union replaced the Conseil national du patronat Français (CNPF) in 1988. In order to understand French business interest, Moravcsik often referred to the CNPF (Moravcsik, 1998). Other than the AFB and the FBF, the MEDEF did try to influence the public debate. The position of the MEDEF on the issues at hand was summed up in a press release. MEDEF was a proponent of an extension of the bond buying program, it favored caution on the issue of budget discipline and as well, it favored the introduction of Eurobonds (MEDEF, 2011).

Economically, these positions are well understood. As was mentioned before, the French economy was largely dependent on internal demand, which means that the French businesses would be hit hard in the case of budget cuts from the French government. These budget cuts would partly have to be instated by raising taxes, which then will lead to a decline in internal demand. This thus explains the cautionary position of the MEDEF with respect to budget discipline. That the MEDEF favored the extension of the ECB bond-buying program and the introduction of Eurobonds is in line with this argumentation. It has to be taken into account that, as was mentioned before, the French government had a large budget deficit and that there were worries that the sovereign debt crisis would spread to France. If indeed the sovereign debt crisis would had spread to France, and the French interest rate would hike, then the French government would due to the high cost of
borrowing money be forced to implement stricter budget discipline. And this, of course, would thus hit the French businesses.

It is clear that the policy preferences of the two dominant domestic economic actors do not align. Therefore, it is expected that the policy preference of the French government would be a compromise between the two; this indeed seems to be the case. With respect to the issue of the ECB, the French government clearly went for the position of the MEDEF. The French government was partly in favor of stricter budgetary discipline, this thus seems to be a compromise between the position of the MEDEF and that of the French banks. The same can be said of the French position on the introduction of Eurobonds, where the French government seemed to be somewhat in favor, again taking a compromise position. It can thus be said that the policy preferences of the French government indeed can be understood by looking at the policy preferences of the dominant domestic economic actors.

4.3.3. Explaining the British policy preferences

As was discussed before, the policy preferences Great Britain had for the negotiations were that it was in favor of Eurobonds, making the ECB a lender of last resort and of stricter budgetary discipline. However, Great Britain was not in favor of a EU-treaty change, although they did say that their signature, which was needed in order to make a EU-treaty change possible, could be gotten in exchange for some compensations for the British financial sector. If these positions are to be understood, then first it is to be acknowledged that because Great Britain is not in the Eurozone, it will be less affected by the proposed policies; for Great Britain would not have to introduce Eurobonds, adhere to the stricter budgetary discipline nor is it connected to the ECB. It was in the interest of British businesses that the Eurozone sovereign debt crisis would end as quickly as possible, for the British economy was closely interlinked with other European economies (Emmanouilidis, 2011, p. 6). Allowing the ECB to become more active and introducing Eurobonds in combination with budgetary discipline would do just that. In the short term it would lead to lower interest rates in the bond market, while in the longer run the Eurobonds would ensure that there will not be another sovereign debt crisis with the budgetary measures countering the moral hazard of the Eurobonds.

In explaining the policy preferences of Germany and France, the position of the financial sector had been taken into account. However, in the case of Great Britain, the financial sector was less relevant. This was because of the fact that British banks were less exposed to the weaker Eurozone countries (Popov & Van Horen, 2013). Therefore, the interest of the financial sector was less influential upon
the British government than in the case of Germany and France. However, the financial sector did influence the position of the British government, as will be made clear underneath.

As thus is clear, the intensity of the British policy preferences was less strong than was the case for France and Germany. Therefore, in setting the British policy preferences, other electoral interest came to the fore. This was of influence in the setting the British policy preference with respect to a new EU-treaty. In Great Britain, there were strong anti-EU sentiments. A poll by the Guardian/ICM, which was done in 2011, showed that 70% of the British population was in favor of a referendum on the British membership of the EU (Clark, 2011). A staggering 49% of responders said that they were in favor of stepping out of the EU, with 40% preferring to stay in. What was even more troubling for the government, was that the of the largest government party, the Conservatives, 56% was in favor of leaving the EU (Clark, 2011). The anti-EU sentiments were also firmly present in the Conservative party’s members of Parliament. In a vote in the House of Commons on whether Great Britain should hold a referendum on its membership of the EU, 81 Conservative members of Parliament voted in favor of such a referendum, while Cameron was against it. This vote was called the largest such backbench rebellion since at least World War II (Reinhardt, 2011). Cameron was furthermore pressured by Conservative Minister Owen Paterson, and the popular Conservative mayor of London, Boris Johnson, who both said that if the EU-summit would lead to a treaty change, that the British governments was to call a referendum (Watt & Mulholland, 2011). This thus explains Cameron’s position during the EU-summit. Cameron demanded direct compensation for his signature, which was needed for an EU-treaty change. This direct compensation could then be used to sell the treaty change in Great Britain, without having to call a referendum. Now, concerning the content of this direct compensation, the financial sector again plays an important role. As was discussed before, this compensation entailed that there would be no more QMV-voting on issues pertaining finance, so Great Britain could more easily block EU financial sector regulations and also the debated Financial Transaction Tax (FTT).

In conclusion, it can be said that the policy preference of Great Britain is well understood if we look at the economic interest first. Considering the position of the British government on a possible EU-treaty change, it can be said that the economic interest on a treaty change were not very strong. Therefore, it opened to influence of other interest, electoral interest that are lower than the economic ones.
4.4 Liberal intergovernmental explanation

According to intergovernmentalism, the outcome of the EU summit of 8 and 9 December 2011 has to be understood as the result of a two-level game. In the first level, the dominant domestic economic actors determine the policy preferences of the states they are located in, and on the second level, the outcome of the summit is the results of a bargaining process between the largest states with the states that have more to win from an agreement being more willing to make concessions. Therefore, an explanation of the EU summit starts at the forming of the preferences of Germany, France and Great Britain, the largest states in the negotiations.

As has been analyzed, the policy preferences of Germany are as follows: each Eurozone member state has to enact into law that its deficit spending cannot exceed 3% of GDP, strict budgetary rules introduced that will be enforced by the European Commission and the EJC, no introduction of Eurobonds, ECB should not become a lender of last resort, and a EU treaty change. What has been shown in the analysis is that the policy preferences of Germany could be explained by looking at the economic interests of the two dominant economic sectors in Germany; the export sector and the banking sector. Their interests were to save the Euro, to keep inflation low and to minimize the risk of a default in the Southern European states. As liberal intergovernmentalism thus predicts, the policy preferences of Germany are an aggregate of the preferences of the dominant domestic economic actors. That Germany wanted far-reaching ceding of budgetary powers to the supranational institutions of the EU can also be explained with liberal intergovernmentalism. This is the result of Germany doubting the future commitment of at least France. The reason why Germany reasonably can be said to doubt their commitment to budgetary discipline is because of the presidential elections that were to be held only a few months after the EU summit. As was discussed, the then frontrunner, Hollande, had expressed his disapproving of the austerity measurements of Sarkozy. What also sheds doubt about the commitment of the other states is the history of budgetary rules in the EU. In times of economic downturn, these were often ignored (including by Germany). With the European Commission and the ECJ on control of the budgetary policies, the Eurozone member states would be committed to the policies.

The policy preferences of France were as follows: also that each Eurozone member state has to enact a 3%-rule, strict budgetary measurement, but with the states still in control through a QMV in the European Council, making the ECB a lender of last resort, and it was somewhat in favor of introducing Eurobonds. Whereas Germany wanted a EU treaty change, France wanted to formalize the outcome in an intergovernmental treaty between the Eurozone member states. It was found that the French preferences can be explained as a compromise position between the French business
sector and the banking sector. The former wanted to introduce Eurobonds, and as well to make the ECB a lender of last resort, whereas the latter wanted to enforce strict budgetary disciplinary measurements in the Eurozone. The French policy preferences can thus as well be explained by their dominant economic groups.

Great Britain was a case apart, because it was not a member of the Eurozone. Its trade relationship with the Eurozone made it mostly interested in getting the economy of the Eurozone to grow again. This was reflected in its preferences of making the ECB a lender of last resort, the introduction of Eurobonds, and more fiscal responsibility in the Eurozone. It was also concluded that the preferences of Great Britain were not as strong as those of France and Germany. Because the preferences of Great Britain were not that strong, and in accordance with liberal intergovernmentalism, other interest than economic interests came to the fore, most notably the euroscepticism in Great Britain. Therefore, the British government did not wanted to sign a treaty if they did not had not something to show for it.

With this information the first and the third hypotheses of liberal intergovernmentalism can be tested. These were as follows:

**Hypothesis liberal intergovernmentalism 1:**
The outcome of the EU negotiations of 8 and 9 December 2011 is the result of a two-level game, in which at the first level the policy preferences of Germany, France and Great Britain can be explained by the interests of their dominant domestic economic groups.

**Hypothesis liberal intergovernmentalism 3:**
The outcome of the EU summit of 8 and 9 December 2011 is the result of a two-level game, in which at the second level, the following holds: if a state doubts whether the other states will commit themselves to the agreements within the existing enforcement regime, then the state will prefer the pooling and delegation of sovereignty.

The policy preferences of Germany, France and Great Britain can indeed be explained by looking at the interests of the dominant domestic economic groups. Therefore, the first hypothesis is confirmed.

The analysis has shown that Germany preferred delegation and pooling the most. It favored not only the use of the European Commission, but also to empower the ECJ. This preference can indeed be explained by doubts about the commitment of the other states. It was shown that the frontrunner for the French presidential election, Hollande, had expressed his doubts about the implementation of austerity policies. Therefore, it can be said that the Germans had to take into account that the next
president of France was not going to adhere to the agreements made with Sarkozy. Furthermore, because the French economy is more dependent on the internal demand, with the German economy being more dependent on external demand, overall the French preference of austerity politics was less strong then that of Germany. It can thus be concluded that the German preference for the pooling of sovereignty at the European Commission and the ECJ can be explained as a reaction to doubts about the commitment of other states.

France preferred the delegation of budgetary powers to the European Council, with the instatement of a QMV. However, because France itself has a lot of voting power in the European Council, this entails that France would be able to influence the budgetary policy by making a coalition with other states that oppose the budgetary rules. Therefore, relative to Germany, France its position entailed the transfer of budgetary powers to a lesser extent. Because France preferred the instatement of the budgetary rules less than Germany, the position on the transfer of budgetary powers can be explained as to ensure that France does not commit itself to the budgetary rules.

As liberal intergovernmentalism thus explains, the position of Germany and France on delegation and pooling can be explained as a reaction to doubts about the commitment of other states. Whereas Germany wants to commit other states, and therefore prefers a large transfer of budgetary powers, France did not want to commit itself, and therefore did not prefer the transfer of budgetary powers to the same extent as Germany. The latter hypothesis is thus also confirmed.

In the second part of the two-level game, the states bring their policy preferences to the international arena. According to liberal intergovernmentalism, the states will ensuing in a bargaining process, in which the largest states are the only relevant actors. International institutions like the European Commission have a neglectable influence on the outcome of the negotiations. During the negotiations, the states will reach a deal that can be best explained as the result of a bargaining process in which the states that have the most to agree from an agreement are most willing to make concessions. This thus means that the outcome of the EU summit of 8 and 9 December 2011 can be explained as a the result of a bargaining process between Germany, France and Great Britain. The policy preferences of these states, as well as the outcome of the EU summit, are visualized in the table below. As was discussed, the agreements made were not signed by Great Britain. Therefore the treaty outcome should according to liberal intergovernmentalism be a compromise between the German and the French policy preferences.
The outcome of the negotiations, which were that the ECB became a lender of last resort, no introduction of Eurobonds, and stricter budgetary rules that were enforced by the European Commission. This can indeed be explained as a compromise between Germany and France. The concessions made by Germany are that it allowed to make the ECB a lender of last resorts, the concession made by France was that it let go of its wish for the introduction of Eurobonds. The two states reached a middle position on the institutional implementation of the agreement. There was no EU treaty change as Germany wanted, and the ECJ was not ascribed the role that Germany wanted it to have. France also had to give in on its position, because the treaty was enforced by the European Commission. So liberal intergovernmentalism correctly predicted that the outcome is the result of a compromise between the largest states.
Liberal intergovernmentalism can also explain why Great Britain did not enter into the agreements. According to the theory, states that have most to gain from an agreement are most willing to make concessions. Since Great Britain is not in the Eurozone, and thus it did not had to adhere to the treaty, Great Britain would not gain anything from signing the treaty. Therefore, it was not willing to make concessions.

With this information, a look can be taken at the following hypothesis of liberal intergovernmentalism:

*Hypothesis liberal intergovernmentalism 2:*

*The outcome of the EU summit of 8 and 9 December 2011 can be explained as the result of a bargaining process between Germany, France and Great Britain, in which more concessions were made by the states that had the most to gain from an agreement.*

Indeed, the outcome of the EU summit can be explained by looking at the policy preferences of Germany, France and Great Britain. Furthermore, that Great Britain did not agree on the results is interpreted as a reluctance to make concessions. Therefore this hypothesis is as well confirmed.

In conclusion, liberal intergovernmentalism correctly explained the outcome of the EU summit as the result of a two-level game, in which the policy preferences of the Germany, France and Great Britain were determined by the economic interests of the dominant domestic economic actors. The transfer of sovereignty furthermore can be explained as the results of Germany doubting the commitment of France with respect to the budgetary rules.
4.5 Neofunctionalist explanation

According to neofunctionalist theory, an explanation of the furthering of integration as a result of the EU summit of 8 and 9 December 2011 starts with the effects of functional spillover. It was agreed by the Eurozone member states to cede budgetary powers to the European Commission and to allow the ECB to act as a lender of last resort. Are these measures indeed the result of functional spillover? To answer this question, it needs to be argued whether these measures were the result of pressure from previous instances of integration. As will be argued here, this does seem to be the case. The European debt crisis cannot have occurred without the Euro. The monetary union without fiscal union diminished the capacity of the Eurozone member states to withstand macroeconomic and financial shocks, because the states were not able to devaluate their currency (Lane, 2012). Also, if the Eurozone member states would have had control over national monetary policies, then the national central banks could act as national lenders of last resort. This would reassure the financial markets, and thus lead to lower interest rates. However, in the monetary union, the European Central Bank was legally forbidden to act as a lender of last resort, and thus was not able to reassure the financial markets that the Eurozone member states would not default. This argument is underlined by the fact that the non-Eurozone member states of the EU also faced the same economic problems and also had rising national debts, but did not undergo rising interest rates. Therefore, it can thus be concluded that the problem that the EU summit was set out to overcome, the European debt crisis, was indeed the result of instances of previous integration. Did the solution also needed to be further integration? If a look is taken at the policy options that were discussed at the EU summit, it is clear that they all entailed further integration. The policy options preferred by each of the four actors analyzed entailed further integration. Each of the four actors preferred some sort of more strict budgetary control and the transferring of budgetary powers to the European Commission. France was the state that preferred integration the least, but it also understood that in order to overcome the crisis, some sort of central budgetary control was necessary. Therefore, it can thus be concluded that a solution for the European debt crisis indeed needed to be further integration.

This leads to the evaluation of the first hypothesis of neofunctionalism:

Hypothesis neofunctionalism 1:

The outcome of the EU summit of 8 and 9 December is the result of the integration in the monetary sector, that because of its interdependence with other economic sectors lead to problems that could only be solved by more integration.

As has been discussed above, the outcome can indeed be explained as the result of functional spillover. This hypothesis is thus confirmed.
According to neofunctionalism, integration is a positive sum game. It does not result in winners and losers, as liberal intergovernmentalism says. Furthermore, the governments manage the states in a technocratic manner. Therefore, neofunctionalism explains the outcome of the EU summit of 8 and 9 December not as a reflection of a power, and cost and benefit constellation. Instead, the outcome can best be explained as the result of considerations on how the problems in the EU can optimally be tackled. The furthering of integration is thus, according to neofunctionalism, the result of the complexity of the issue area. This does however not reflect what was found in the analysis. In order for it to be the case, the governments, acting in a technocratic manner, all would have to have the same policy preferences with regard to the delegation and pooling of authority. As was shown, however, the positions of France and Germany were quite the opposite. Whereas Germany wanted to centralize budgetary authority at the European Commission and at the ECJ, France wanted to retain its powers by institutionalizing the agreements on budgetary policy at the European Council with the prerogative of the states to block sanctions with a QMV. The second hypothesis can now be evaluated:

*Hypothesis neofunctionalism 2:*

*The outcome of the EU summit of 8 and 9 December 2011 is the result of Germany, France and Great Britain preferring delegation and pooling of policy issues, because of their technical, legal, or political complexity.*

As was discussed, this is not the case. Therefore, the second hypothesis of neofunctionalism is refuted.

According to neofunctionalism, and in disagreement with liberal intergovernmentalism, the states are not the only relevant actors in the international system. A neofunctionalist explanation of the outcome of the EU summit of 8 and 9 December 2011 would apart from the states also include the European Commission. The European Commission, as the most powerful supranational authority, plays an important role in the negotiations. As an independent actor with European preferences and loyalties, the European Commission acts as a policy entrepreneur. The effect of this being that it influences the negotiations in favor of more integration. This, however, does not reflect the findings in the analysis. Below, the policy positions of Germany, France and the European position are placed in a table, together with the outcome of the EU summit.

It was already discussed in the previous section that the outcome of the EU summit can be perfectly explained as compromise between the policy preferences of Germany and France. The policy preferences of the European Commission are thus not necessary to explain the outcome. Furthermore, with respect to the outcome, the European Commission did not get what it wanted.
The European Commission was a strong proponent of the Eurobond, which were not introduced. Also, it was strongly in favor of a EU treaty change, because this would enhance its legitimacy as an enforcer of the agreements, this was also not agreed upon. With this information, the last hypothesis can now be discussed.

**Hypothesis neofunctionalism 3:**

*The outcome of the EU summit of 8 and 9 December 2011 is the result of the European Commission successfully influencing the negotiations in favor of more integration.*

As was shown, it is not necessary to include the position of the European Commission in an explanation of the outcome of the EU summit. Therefore, this hypothesis is refuted.

**Table 3: Policy preferences of Germany, France and the European Commission, and the outcome of the EU summit.**

<table>
<thead>
<tr>
<th></th>
<th>Germany</th>
<th>France</th>
<th>European Commission</th>
<th>EU summit outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Extension of ECB bond-buying</strong></td>
<td>Against</td>
<td>In favor</td>
<td>In favor</td>
<td>Yes.</td>
</tr>
<tr>
<td>program**</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Introduction of Eurobonds.</strong></td>
<td>Against</td>
<td>Somewhat in favor.</td>
<td>In favor, albeit connected to centralized budget power</td>
<td>No.</td>
</tr>
<tr>
<td><strong>Supranational or intergovernmental solution</strong></td>
<td>In favor of supranational solutions. Expending the power of the EC and the ECJ via an EU treaty change.</td>
<td>In favor of an intergovernmental solution, where more power is given to the European Council.</td>
<td>In favor of a supranational solution, placing more power at the EC.</td>
<td>Predominantly supranational.</td>
</tr>
<tr>
<td><strong>EU treaty change</strong></td>
<td>In favor, wanting to include all EU MS.</td>
<td>Against. Would rather see an intergovernmental treaty between Eurozone MS.</td>
<td>In favor.</td>
<td>No, intergovernmental treaty.</td>
</tr>
<tr>
<td><strong>Automatic sanctions when violating budget rules.</strong></td>
<td>In favor. Placing more power at the EC and the ECJ.</td>
<td>Partly in favor. Control via reversed QMV and adoption of budget rule in national law.</td>
<td>In favor. Even proposing to put non-compliant states under ‘administration’.</td>
<td>More automatic sanctions with golden rule and more power at the EC. Reversed QMV in place.</td>
</tr>
</tbody>
</table>
Chapter 5: Conclusion

The goal of this thesis was to explain it was agreed upon to further the integration at the EU summit of 8 and 9 December 2011 in response to the European debt crisis. The results of the EU summit, that is, the strict implementation of budgetary discipline, the centralization of budgetary authority at the level of the supranational European Commission and the upgrading of the ECB to a lender of last resort, were surprising for multiple reasons. First, the European economy was in a slump, with rising unemployment rates. Common sense says that a policy of austerity would not help overcome this, that a policy of investing by the governments was needed. Second, because the states in the EU have always been reluctant to relinquish budgetary authority to the European Commission.

As was shown in the analysis, the outcome of the negotiations can best be explained as a two-level game, in which the dominant domestic economic actors determined the policy preferences of the states. It is shown that a policy of austerity was chosen, because this best fitted with the interest of the French and German financial sectors, and with the interest of the German export sector. The financial sectors in France and Germany had heavily invested in the state bonds of the weaker Eurozone states. A policy of austerity was in their interest, because it best safeguarded that there states would fully repay the invested money. Furthermore, the financial sectors also would benefit from the economic opportunities that arise in these weaker states, as a result of privatizations. It was shown that the reason for a transfer of budgetary sovereignty to the European Commission, so what made it a furthering of integration, can best be explained as a strategy to ensure future commitment of the participating states. This result thus underlines that integration is not a positive sum game. Integration knows winners and losers. The alternative policies, like the introduction of the Eurobonds, were not disregarded because they were not economically sound, but because the groups that gained the most of their implementation were not the most powerful.

The second goal of this thesis was to determine which of the two theories, liberal intergovernmental or neofunctionalism, best could explain the negotiation outcome. The results on the testing of the hypotheses were clear. All four hypotheses of liberal intergovernmentalism were found to be correct, and all but one hypotheses of neofunctionalism were found to be incorrect. It can thus be concluded that the negotiation results of the EU-summit can best be explained with liberal intergovernmentalism. The analysis showed neofunctionalism did correctly say that the outcome of the EU summit can be explained as a result of the incomplete monetary union, via the functional spillover effect. This hints at the possibility of using the functional spillover thesis to augment liberal intergovernmentalism.
Even though that with the use of liberal intergovernmentalism a good narrative can be given to the events, the explanation is total is not completely satisfactory. This is the case, because the main explaining factor, that is, the existing economic structure, cannot be explained itself. Liberal intergovernmentalism cannot explain the dominance of the financial sectors in Germany and France, or why the German economy was so export oriented. All this has to be considered as given, and cannot be explained or understood. Thus, in order to gain a full understanding of the events, either liberal intergovernmentalism has to be augmented in a way that it can explain how economic structures evolve, or maybe use has to be made of a separate theory that deals with this.

However, it is not just liberal intergovernmentalism that deserves criticism, for this thesis too is all but perfect. To start off with, what could be expanded on is the relation between France and Eurobonds. As was made clear in the analysis, there were signs that France wanted Eurobonds, as well as that it didn’t. In this thesis it was therefore assumed that France somewhat wanted Eurobonds, it might be interesting to find exactly what the position of France was. The fact that it was difficult to find the preference of France regarding Eurobonds could also be a sign that there were internal disagreements within the French government. Furthermore, what could be expanded upon are the economic argumentations that were used. For example, the assumption was made that the financial sector was not interested in economic growth in the weaker Eurozone countries. However, that completely disregards the fact that if there is no growth, that there might be a loss on investments in these countries. It was thus assumed that the financial sector was more interested in getting a return on the state bonds, and by buying up privatized assets, than on business investments that were made, which would give more return with more economic growth. Furthermore, in this thesis, neofunctionalism had been somewhat underexposed. Especially the mechanisms of spillover could have been used in more ways in order to try to find an explanation for the negotiation outcome. Lastly, the arguments made in this thesis are predominantly based on indirect evidence, by looking at the input and output, but not at the processes. This weakens the overall strength of the arguments. The manner in which this can be addressed is evaluated upon below.

A suggestion for follow-up research, is thus first of a more in-depth analysis of some processes that have been discussed. For example, the interaction between the European Commission and the states during the negotiations could be researched in order to find new evidence of possible influence of the Commission during the summit. A look could be taken as a possible role for the Commission as a mediator or agenda setter. Process tracing as a research method serves these purposes very well. Furthermore, this thesis could be strengthened by research on the interaction between the states and the economic lobby groups. Because liberal intergovernmentalism states that only national lobby groups are of influence, and only prior to the negotiations, it is interesting to look at whether this is
indeed the case. One could thus try to find evidence of lobby groups influencing the negotiations directly, and as well try to find evidence for influence by transnational or international lobby groups.

What has not been discussed yet, but is in fact illuminated by this thesis, is the disconnect between the public debate on the merits of the policy options on the issues debated at the EU summit, and the actual motivations behind the policy preferences of the governments. In this thesis it was found that the German dislike for inflation can best be understood as a reflection of the interests of the German financial and export sector. However, this was not the narrative that was often used to explain the German’s aversion of inflation. Large newspapers, as well as German politician, explained this dislike as being a reaction to the Weimar era hyperinflation (Czuczka & Deen, 2011; Heffer, 2011; Inman, 2011; Von Petersdorff, 2011). The argument is basically that the hyperinflation during the Weimar Republic caused the German society to derail and thus paved the way for the Third Reich. This is something the Germans would not like to see again. Apart from the fact that a far more plausible explanation of the German disposition toward inflation has been given, it must be said that this specific argumentation is inconsistent, not in agreement with an understanding of the complexities of history and also can be found insulting. The assumption of the argument is first of all that the German society is very fragile and a disturbance of this unstable society could usher in a new period of a nazi-like regime; in it there is thus a very dark view of German society. At the same time, the argument seems to assume the innocence of the German society, for it is the deterministic process of inflation that causes the evil. Not even going into the absurdity of saying that hyperinflation caused Hitlerism, it is clear that this reading of the German preference is an inaccurate or even absurd narrative.

To end with, what has been shown by this thesis is that the policies enacted by the states in the EU has largely been a reflection of economic structures in Germany and France. The, so to say, objective research leading to this conclusion does raise some subjective questions on the way the EU operates. It was shown that the sovereignty over budgets went from the democratic domain of the nation states to the non-democratic European Commission. Is this worrisome? The French and German financial sectors have enforced the policies they preferred, but at the cost of a stagnating economy in the EU, with human suffering as a result. How just is this? What is thus implied is that the objective research on the processes is not sufficient. A discussion that goes into these questions is also needed.
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