The handle http://hdl.handle.net/1887/31618 holds various files of this Leiden University dissertation.

**Author:** Pan, Wen  
**Title:** Crises and opportunities : strengthened European Union economic governance after the 2008 financial crisis  
**Issue Date:** 2015-01-28
Chapter Seven: Hypotheses Tests of Intergovernmentalism and New Insights Based on Case Studies

7.1 Evidence for H6: A Criticism Levelled at LI’s Predictions of the Impervious Informal Consensus Practice in the Council

Taking Table 6.21 into account, the application of QMV and the voting results in the Council regarding the three new mechanisms are presented in Table 7.1.

<table>
<thead>
<tr>
<th>The outcome of voting in the Council of Ministers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The European Semester</strong></td>
</tr>
<tr>
<td>QMV in the Ecofin Council, 3122th meeting: all 27 member states vote for “Yes”— no “No” and “Abstain”, and the total votes cast are 345.①</td>
</tr>
<tr>
<td><strong>The ESRB</strong></td>
</tr>
<tr>
<td>QMV in the Ecofin Council, 3045th meeting: all 27 member states vote for “Yes”— no “No” and “Abstain”, and the total votes cast are 345.②</td>
</tr>
<tr>
<td><strong>The ESM</strong></td>
</tr>
<tr>
<td>QMV in EU legislative procedures is not applicable to the case of the ESM due to its intergovernmental nature. (see Table 6.6 and Table 6.21)</td>
</tr>
</tbody>
</table>

Sources: ①Council of the European Union-16662/11 (10 November 2011); ②Council of the European Union-16644/10 (19 November 2010).

Obviously, the application of QMV in the Council implies the legislative procedures of the EU, notably the OLP, and the creation of the ESM does not fall into such categories. The case study results presented in Table 7.1, however, do not adequately support that “the Council of Ministers tends to apply the formal rules of QMV rather than take decisions on the basis of informal consensus”, because despite that the rule of QMV was applied in the Council to codify the European Semester and to establish the ESRB, there was unanimous approval by all EU member states to adopt the two new measures, and thus the distinction between the unanimous positions of national governments in QMV and “the basis of informal consensus” was not clear. Therefore, H6, formulated as a criticism to intergovernmentalism, does not gain adequate supporting evidence in the case studies of this dissertation and the traditional
scenario of informal consensus in the Council still appears to prevail; the intergovernmentalist assumption that the informal consensus practices in the Council tend to be impervious to external factors (e.g. the institutional design, the composition of the Parliament, and/or the views of the Commission) (Proposition 18), however, is still subject to empirical tests. Nevertheless, the unanimity displayed in Table 7.1 does indicate EU member states’ common positions on tackling the crisis, another evidence for H5a and Proposition 4.

7.2 Evidence for H7: A Revised LI Three-Stage Framework
Displayed in Figure 3.3, H7 capsulates the LI model which is constructed in accordance with LI arguments presented in Figure 3.2. This dissertation will test H7 in line with the analytical factors listed in Figures 3.2 and 3.3. As H7 can be dissected into a series of sub-hypotheses, this dissertation will check them one by one. As the analyses in section 3.7.4.3 suggest, the first move is to examine the nature of the selected cases and to ascertain whether they fall into LI scope conditions. To begin with, as the LI model was born from the studies of the EC/EU grand bargains where intergovernmental negotiations dominate, the cases of the European Semester and the ESRB do not suggest typical formal interstate bargains among EU member states, but rather they illustrate daily decision-making and developments of the EU during the crisis. Therefore, the European Semester and the ESRB have failed to meet the requirement of the case selection of LI, which is supposed to be generalizable to international negotiations, while the ESM, created by Treaty agreement among the euro states, stands for a major negotiation among the contracting parties, Germany and France in particular (see Table 6.7), and thus the case of the ESM is suitable to be examined against LI. Still, this dissertation also tries to apply stage 1 and stage 3 of LI to the two “unsuitable” cases — the European Semester and the ESRB — to see what light LI can cast on our understanding of the two measures and whether some LI assertions are also applicable to EU daily normal decision-making.

7.2.1 Evidence for H7a: National Preference Formation (LI Stage 1)
Table 7.2 presents the case study results against H7a, the first stage of the LI model, in line with Figures 3.2 and 3.3.
<table>
<thead>
<tr>
<th>(I) The European Semester</th>
<th>(II) The ESRB</th>
<th>(III) The ESM</th>
</tr>
</thead>
<tbody>
<tr>
<td>H7a Not confirmed; (1) The nature and functions of the European Semester — policy coordination of each member state — address national economic interests in general (which shall guarantee a stable and healthy economic and financial environment for individual domestic constituents and national economies) rather than any specific and individual sectoral interests, so interests of specific powerful domestic constituents appear diffuse; (2) Born from the Task Force’s ideas and approved by the Ecofin Council on 7 September 2010, the European Semester started from 1 January 2011 before it was finally codified in an EU regulation of 16 November 2011, and its foundation is</td>
<td>Yes; (1) Various representatives from financial sectors delivered their demands and opinions of the creation of the ESRB (see Table 6.19); nevertheless, the members of financial representatives tend to be transnational rather than national: among the listed representatives, only AMAFI, LIBA, insurance companies of Munich Reinsurance Company, and Aegon and AVIVA plc. appear to be tinted with sort of national “domestic” color; besides due to the tasks assumed by the ESRB, the existing supranational ESAs also participate; (2) The ESRB not only stands for the interests of powerful domestic constituents in financial sectors, but also represents</td>
<td>Yes; (1) The two core euro members, Germany and France, formulated their preferences for the establishment of the ESM on the basis of the national economic interests rather than geopolitical or ideological concerns, as there were contagious risks among the euro countries due to the highly integrated economies among them; the financial turmoil and the sovereign bankruptcy of a euro state shall endanger the interests of the whole euro area countries — a stable financial market is crucial to the eurozone countries’ economies; (2) Germany’s and France’s national preferences for the ESM were expressively enshrined in the bilateral “Deauville Deal” reached by German Chancellor Angela Merkel and French President Nicolas Sarkozy in October 2010, where France “backed Paris in its desire to water down sanctions to be imposed on excessive-spending EU countries” while “[i]n return, Paris endorsed Berlin’s push for a change to the EU treaty in order to set-up an EU bailout fund and default mechanism”; (3) German government preferences were based on the following considerations: first, Germany was “the main bankroller” of the loan of €110 billion to Greece, and it adamantly rejected the idea of endorsing such an emergent bail-out again and “its Constitutional Court would slap down any extension of the Greek-type bail-out on the basis that the current EU treaty specifically rules out member state rescues”; second, the EFSF and EFSM were temporary backstops, and the German government wanted to have “something more substantial” to replace the temporary measures before they would expire; third, the default mechanism upheld by Ms Merkel meant that...</td>
</tr>
</tbody>
</table>

mainly pushed by EU supranational institutions (i.e. the European Council, the Commission, and Econfin Council) rather than specific interest groups (see Table 6.6).

national government general interests in maintaining financial stability among closely interconnected financial markets so as to provide a stable financial environment to foster economic growth.

investors, rather than taxpayers alone, would also bear at least part of the losses of a state bankruptcy so as to avoid “a cascading panic in the markets” caused by sovereign defaults like Greece in the spring of 2010; ①

(4) The Merkel government urged a strict monitoring and sanctioning mechanism of the SGP to avoid similar cases of Greece whose budget transgressions had tottered the entire currency system, and consequently, it “favor(ed) highest possible degree of automatism,” and supported the Commission’s relevant proposals ②; however, in the Franco-German Deauville Deal, “Germany retreated from its position automatic sanctions” so as to “win French support for a permanent mechanism for crisis resolution”; accordingly, decisions made on sanctions would remain the status quo: QMV in the Council, which opposed the Task Force Report’s recommendation and the Commission’s proposal of the automatic sanctions of “the reverse voting mechanism” (i.e. RQMV) ③;

(5) In comparison, the French government had “an entirely different vision” and it “has always tended to side with the southern Europeans who tend to see Germany’s demands for strict stability criteria as a nuisance” ②; for the deal, Germany “gave away [...] firm fiscal discipline [...] of automatic fines for deficit violators” and “also agreed to a French proposal that deficit violators should lose voting rights in the EU’s Council of Ministers”, and the latter, however, “would require wholesale changes to the Lisbon Treaty” ④;

(6) The controversies caused by the German-French deal are that “a permanent fund and the default procedure require a change to the EU treaty”, and furthermore, “spendthrift states to be stripped of their voting rights within the Council of Ministers — a move that everyone agrees would require a treaty change”; among the member states, “Italy, the Netherlands, Portugal, Spain and the UK are believed to be adamantly opposed to” such a voting rights suspension sanctions, while “Merkel publicly
as to reap greater economic benefits, indicating (3a) and (3b), and also encompassing (3c). The ESRB; moreover, the ESRB fills the vacuum of the EU integration project, and it supplements and supports micro-level economic and financial developments. In other words, it serves the economic interests of individual actors and the whole region. remained resolute in her demand for a major change to the treaty” to establish a permanent rescue mechanism; ① (7) The default mechanism agreed by both the France and Germany expressed the economic interests of domestic constituents (i.e. taxpayers), exhibiting the interest formation pattern of investors on the one hand and taxpayers and regulators on the other hand, as Germany and France, being the number one and number two contributors to the EFSF, also bore a large share of the loan to Greece; (8) In addition, Germany and France’s endeavors to setting up the permanent mechanism to safeguard the eurozone and the single currency as well as leading to the agreement on the loans to Greece also had political implications: “the euro’s collapse would be a fatal step backwards for the European project – in which Germany was so key” and “[t]here is a very strong determination among the member states to save what we have done over 50 years all together”, ⑤

Falling into the categories of Stage 1 in Figure 3.2?

| Summary | (1) X; (1c)* Mode 3 (see the notes below) | (1) √ (1a); (1d)* Mode 4 (see the notes below) | (2) X; (2d)* a holistic approach to the general interests of national economies | (2) √ (2a); (2a)* specific domestic sectoral interests (which may also represent the general demands of the national economy as a whole); (2d)* |
|---------|------------------------------------------|-----------------------------------------------|--------------------------------------------|--| |
|         | (3) √; (3d)* (see the notes below)       | (3) √; (3d)* (see the notes below)             | (3) √ (3a) and (3b); (3b)* ruling governmental coalitions’ macro-economic preferences and/or stances on the fate of the EU and/or EMU |

Notes: “√” indicates the fact that the case falls into the range of the categories/predictions of the LI model presented in Figure 3.2; “X” means the concerned is/are out of the categories/predictions of the LI model; “*” suggests that there are modifications and/or new developments adding to the LI model on the basis of the case studies.
(1c)* Mode 3 (an exception to Mode 1): When addressing the general economic and financial environment and/or the interconnectedness across different sectors, the line between producers and taxpayers/regulators tends to become diffuse as national preferences are based on the general economic considerations rather than any specific individual sectoral interests, exhibiting an equilibrium of the responsibility and actions between the national/micro level and the EU/macro level. (Proposition 19)

(1d)* Mode 4 (a mixture of Modes 1 and 2): In terms of issues directly related to the fate of the euro and/or the EU, national preference formation is not only based on economic interest calculations, but also carries political considerations on securing the political project which enshrines more than half a century’s efforts. (Proposition 20)

(3d)* The common sense and the necessity of sound interactions, coordination and cooperation among EU member states and between the national/micro and the supranational/macro levels to serve national economic interests in general.

Sources: ①Phillips (28 October 2010, EUobserver); ②Müller et al. (25 October 2010, Spiegel Online); ③Kovacheva (22 October 2010, Euinside); ④“Brussels Summit: EU Agrees to Merkel’s Controversial Euro Reforms” (Spiegel Online, 29 October 2010); ⑤Alexander (25 June 2011, The Telegraph).

Before conducting the empirical test of LI (H7) with the case of the ESM, this dissertation has tried to apply LI to the two unsuitable cases — the European Semester and the ESRB — to see whether LI is applicable to EU daily normal decision-making. As the evidence presented in Table 6.19 and the overviews of the selected cases in chapter five show, the European Semester and the ESRB have exhibited the EU’s and its member states’ holistic macro-level approaches on the basis of individual micro-level developments to address the crisis (also demonstrating a converged point of economic interests of the member states); consequently, the interests of specific powerful domestic constituents are not prominent. Moreover, the implementation of the European Semester started from 1 January 2011 (which was born from the Task Force’s ideas and approved by the Ecofin Council on 7 September 2010) before it was finally codified into EU regulation of 16 November 2011 (cf. Table 6.6), and the foundation of the European Semester was pushed by national governments and/or the Heads of State or Government before the relevant interest groups were consulted, because the issues concerned by the European Semester (as well as the ESRB) are related to the national economic interests in general (which shall guarantee a stable and healthy economic and financial environment for individual domestic constituents and national economies) rather than any specific and individual sectoral interests. Even in the case of the ESRB where various representatives from the financial sectors have delivered their demands and opinions of the creation of the ESRB, the members of
financial representatives tend to be transnational rather than national: among the listed representatives, only AMAFI (French Association of Financial Markets), LIBA (London Investment Banking Association), and insurance companies of Munich Reinsurance Company, and Aegon and AVIVA plc. look to be tinted with sort of national “domestic” color. Therefore, the interests of specific “powerful domestic constituents” are diffuse in the two cases; instead, the two new measures reflect the necessity of macro-level coordination and supervision, which are considered to be indispensable and beneficial to supplement and support micro-level developments. Those, however, have confirmed part of H7g, a scope condition of the LI, namely that the more diffuse representation of domestic societal interests is, the less predictable and more uncertain national preferences are, and the worse LI works.

Though the cases of the European Semester and the ESRB are not suitable to the LI analysis, the LI does shed light on the explanation of the two cases, and (I)(1) and (2) in Table 7.2 appear to confirm H7g and H7h, the scope conditions of LI: (I)(1) shows that the more diffuse representation of domestic societal interests is, the worse LI works, while (I)(2) (as well as the case of the ESRB) displays EU supranational institutions’ and their leaders’ entrepreneurship when national governments lack critical information, expertise and even legitimacy that the Commission and the EU leaders (e.g. Van Rompuy) can provide so far as the issues of policy coordination (and macro-prudential oversight) across the EU are concerned. Nevertheless, the diffuse sectoral interest representation in the European Semester case does not indicate “the less predictable and more uncertain national preferences”. Rather, national governments support and push for the introduction of this new mechanism — they have a very clear and certain preference, which agrees with the common sense to realize maximal benefits via strengthening macro-level policy coordination and surveillance. This suggests another potential scope condition for the LI application, which can be added as (14) to Figure 3.2: for the policies and measures not addressing a single and discrete issue but dealing with the interconnections and interdependence among various economic sectors, national preference formation is based on a holistic and systemic consideration rather than any particular groups’ interests; under such occasions, interest groups’ positions should be largely in line with national government...
preferences, as the macro-level measures are supposed to facilitate micro-level activities, so even the representation of domestic societal interests may appear weak and diffuse, national preferences for those issues that serve EU economic growth and prosperity tend to embrace further integration; at the same time, EU supranational institutions and EU leaders shall exert their influence on policy formation, as they possess macro-level information, resources, expertise and/or legitimacy that individual governments lack. The implementation of the European Semester and the ESRB actually has spotlighted policy vacuums in the EU: macro-level coordination and supervision and the necessities to address interconnections and interdependence among different policy domains. Those issues have also been underplayed or even neglected by EU integration theories — for example, (12) in Figure 3.2 only stresses sectoral economic interests vis-à-vis geopolitical and ideological concerns. It is clear that along with the micro-level development and integration of discrete policy areas, new challenges to EU economic governance emerge against the trend of globalization: macro-level coordination and supervision across various policy areas from holistic and systemic approaches. Accordingly, the existing LI’s two scope conditions can be supplemented by a third one:

Proposition 21: On the issues cutting through multiple policy domains and addressing the interconnections and interdependence among various economic and financial sectors, the representation of domestic societal interests tends to be weak and diffuse; nevertheless, national governments tend to assume predictable pro-integrative positions, and meanwhile, EU institutions and their leaders tend to exert influence on policy formation as they possess macro-level information, resources, expertise and/or legitimacy that each individual national government lacks.

The European Semester and the ESRB do not meet the case selection requirement for LI studies (as they do not contain formal intergovernmental bargains among EU member states), so Proposition 21 should not be added to the LI model; nevertheless, the two cases have exposed the potential topics that LI may encounter in the future, and Proposition 21 then can serve as the third scope condition to justify the first stage of national preference formation of the LI model, which naturally needs to be tested by EU empirical facts in the coming days.

This dissertation now moves to the case studies results of the ESM presented in Table 7.2. H7a is confirmed by the case of the ESM, and stage 1 of LI works well to account for Germany and France’s initial preferences for the ESM. Germany’s strong
demand of establishing a permanent rescue mechanism for the euro countries derives from its general economic considerations. For one thing, the bankruptcy of a euro member state will cause disastrous financial and economic turmoil in the eurozone as well as encroach the credibility of the common currency — the euro, which in turn will definitely harm Germany’s economic interests. For another, the temporary EFSF shall expire soon and the German Court seems not to approve any Greek-style-like bailout again in the future (which, however, looks likely for some euro countries), so a permanent crisis resolution framework is essentially and urgently needed. Besides, the German government has a policy tradition of keeping price stability while avoiding high inflation rates (which also has become the primary objective of the ECB) and it prefers a stable and credible currency; in comparison, the French government has a policy tradition of devaluing national currency to stimulate economic growth while having high inflation rates (Hosli 2005). Contrasting with Germany’s strict sanction demands, the French government prefers a looser sanction mechanism for the countries who broke the SGP rules, and it is explainable: in terms of governmental deficits and debts, France has a poorer behavior than Germany, and France itself has higher possibility to be sanctioned. Tables 6.14 and 15 suggest that, from 2006 to 2012, France’s budget deficit rates were always higher than that of the Germany (and in 2012, the record was 4.8% of its GDP, much above the 3% criterion, while Germany obtained 0.2% surplus in 2012); though both countries’ debt rates were above the SGP requirement of 60% of GDP, the figure of 90.2% for France in 2012 signaled a worsening situation, nearly ten percentage points higher than that of Germany (81.9%). In addition, the France’s economy appears more impotent to walk out of the mire of the crisis, as Table 6.13 shows, there was barely a sign of GDP growth (0.0%) for France during 2012. Accordingly, France has a greater possibility to violate the SGP rules; therefore, it prefers a not-so-strict sanction mechanism. Apart from the realistic and imminent economic interest considerations, the funding of the permanent ESM is also out of political interests: to safeguard the eurozone, to save the euro, and thus to secure the fruit of the EU and EMU. As Table 7.2 indicates, the two core euro member states, Germany and France, have flagged out their choices of establishing a permanent rescue mechanism to replace the temporary EFSF; nevertheless, not every euro member is happy with the Franco-German deal. Table 7.3 further illustrates national divergences on the issue of creating the permanent ESM.
### Table 7.3 From the Deauville Deal to the Finalization of the ESM: Negotiations, Compromises, and National Preferences Redefined

<table>
<thead>
<tr>
<th>Suggestions of the Deauville Deal reached by Germany and France, which require Treaty amendments</th>
<th>Preferences and responses of other EU member states, EU institutions and EU leaders to the Deauville Deal</th>
</tr>
</thead>
</table>
| 1. To establish a permanent crisis resolution mechanism to help the euro countries struck by the sovereign debt crisis so as to safeguard the financial stability of the euro area as a whole. | • The idea to amend the current Lisbon Treaty, which has undergone eight years of tortuous negotiations, arouses wide substantial concerns and “hardly any member state wants to embark on a years-long negotiation and ratification process complete with risky referendums” [2]; particularly, it is “a real horror” to Ireland, as the Lisbon Treaty was approved after two difficult referendums in that country, and the President of the Commission, Barroso, is “firmly against Treaty changes” [4]; nevertheless, as Merkel feared, the permanent rescue mechanism “would contravene rules against EU bailouts already written into the Lisbon Treaty”, so a consensus was reached among the member states that “smaller changes were necessary” [11];

• The Franco-German initiative has gained support, for instance, from Finnish Prime Minister Mari Kiviniemi, because “[t]he euro area needs a credible permanent crisis mechanism to ensure the financial stability of the euro area as a whole,” and Sweden’s Prime Minister Fredrik Reinfeldt agrees with a small treaty change, “because everyone understands if this is to be strong and workable we need Germany inside” [6];

• Slovakia, the only country that in the euro area who once declined to rescue Greece, is happy to see Germany have tabled a legally justified permanent mechanism, and it holds that “the French, Spanish and Italians were only ready for cosmetic changes” and “[n]ow we have the Czechs, Germans and Scandinavians on our side”; [5]

• The EP has a more radical idea: it supports Treaty changes to establish an EMF and wants to create a new post responsible for economic and monetary policy under the charge of a Vice President of the Commission who should at the same time chair the Ecofin. [4]

2. The permanent rescue mechanism should include provisions for “an adequate participation of private creditors” [1], which means “future rescue packages might involve | The intention to have a default mechanism to impose possible losses on creditors in place is that without an insolvency procedure, a rescue fund “would encourage reckless government borrowing and thoughtless investment decisions” ([7], p.1). However, Merkel was under fire for such an insolvency procedure, because to let the private bond holders share the costs of a bail-out would push up borrowing costs and make a bail-out more likely ([7], p.2), and indeed, the later facts show that investors responded to the
a write-down of existing debt” (7, p.1).

German-French deal “by pushing Ireland and Portugal to follow Greece into bailouts” and then Cyprus\(^8\). Strong criticisms come from, for example, ECB President Trichet and Greek premier Papandreou, as the former holds the critical opinion that “this private-sector involvement (PSI, in Euro-jargon) badly spooked the markets about the value of the European debt they were holding” (9), while the latter worries that the insolvency mechanism shall drive some euro countries into bankruptcy; anyhow, the position of Merkel is clear: “to reinforce her own standing with German taxpayers”; still, some Germans, together with EU politicians and economists, disapprove her “saving and punishment” policy, and they argue this could make the crisis worse (7, p.2); it is widely acknowledged that “[a]t a time of acute nervousness in the market, the provisions for PSI were unlikely to help restore calm”. 9

<table>
<thead>
<tr>
<th>3. “[T]he Council should be empowered to decide, acting by QMV to impose progressively sanctions”, ① watering down a proposal of tough sanctions against the states who consistently fail to reduce debt levels.</th>
</tr>
</thead>
<tbody>
<tr>
<td>● It causes “anger in several eurozone countries, particularly the smaller, northern members that had pushed for even tougher rules” and “reopen(s) resentments between small and large countries, and between fiscally restrained northern members and indebted southerners”; originally, smaller countries believed that Merkel shall back up “near-automatic fines against persistent debtors” beyond the political influence, because Germany tends to do so and actually for several month before the Deauville Deal, “the Netherlands, Finland and other northern countries had stood beside Germany”, pressing for the sanctions placed under the Commission’s technocrat charge rather than under the Council’s of national political influence; ③ Germany believes that to gain France’s support is crucial to reach the agreement on budgets rules and a permanent ESM, because “countries such as Italy and Belgium, with their high sovereign debts levels, had gained support in blocking the tougher rules”. ③</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>4. To suspend the voting rights of the member states concerned “[i]n case of a serious violation of basic principles of Economic and Monetary Union”. ①</th>
</tr>
</thead>
<tbody>
<tr>
<td>● Juncker says the Franco-German deal is “unacceptable” as “it does not guarantee a strict course of stability and a stability pact with teeth”, while “Merkel’s plan to temporarily deprive deficit sinners of their voting rights within the EU isn’t just distasteful to Juncker, but also to other leaders, especially those of the smaller EU countries”; meanwhile, Juncker is “also furious about Merkel’s and Sarkozy’s attempt to shape policy without consulting other leaders first”; ② Barroso disagrees with the idea of withdrawing member states’ voting rights, and he believes that it “would never be accepted by all 27 EU governments” ⑥; “[i]f treaty change is to reduce the rights of member states on voting”, “I (Barroso) find(s) it unacceptable and frankly speaking it is not realistic” ⑪.</td>
</tr>
<tr>
<td>● Obviously, this proposal is unacceptable to those bailouts states, and other countries, such as Italy, the Netherlands, Portugal, Spain and the UK also oppose to do so. Politicians believe that it goes too</td>
</tr>
</tbody>
</table>
far away from the reality as well as from the “political games” of the EU, as it is once commented by an EU diplomat: “Do you really believe the Irish prime minister can head back to Ireland and tell his people they have to vote in favour of removing their voting rights?” (25)

II Processes of bargaining, compromising and redefining preferences after the Deauville Deal

- As for the Treaty amendments, “the German finance ministry initially aimed at changing article 125 itself (the “no-bailout” clause)”, but taking the arduous processes of Treaty revisions into account, it shifted the focus to other articles where minor treaty changes are possible via a simplified procedure without convening a European Convention and an IGC (but still requiring ratification all 27 EU member states), and two possible Articles (122, 136) are under lawyers considerations; (7, p.2)
- For the watered-down sanction proposal, “France insisted on maintaining greater discretion for governments”, but later it gave some ground to the EP; (9)
- Regarding stripping of the voting rights provision, it “was soon abandoned”, while the proposal of “adequate participation of private creditors” survived; originally, “haircuts were supposed to apply only to new debt issued from 2013, when the ESM was due to come into force. But this year (2011) the euro zone twice demanded that private creditors take losses on existing Greek debt”; (9)
- Germany and France are still at loggerheads over the degree of PSI: Merkel “wants the private sector to take much of the strain” so as to counter the “fire from voters for the size of Germany’s contribution to the Greek bail-out”, while France “doesn’t want its over-exposed banks to foot the bill”—the reason is that “French banks hold €53 billion of Greek debt — more than those of any other country”; hence, Sarkozy was determined to “keep Greece on track” and reluctant to “make the banks foot more of the bill”, and he suggested a voluntary agreement instead; at the same time, when the German voters angrily opposed to “pull in their belts to pay for Greece’s crisis”, it was stated that “Merkel also faces pressure from Germany’s financiers”, such as the industrial giants ThyssenKrupp, Siemens and Daimler, to “promote the single currency” and “not to let Greece slide” (16). However, as time elapsed, Germany and France made concessions to each and adjusted their positions: “France has agreed with German demands for even greater ‘automaticity’ in the process leading to sanctions; and Germany, in return, has agreed to weaken the articles on restructuring the debt held by private creditors” (9).
- “Germany more or less gave up its long-standing demand that countries in breach of fiscal rules should be taken to the ECJ” and in return, French President Sarkozy “has abandoned his fight for joint Eurobonds” (9).

III Negotiating step by step leading to the formation of the ESM

- As a response to the Deauville Deal concluded on 18 October 2010, the EU summit on 28-29 October 2010 reached the following conclusions (10, p.2):
  A. “a limited treaty change” to establish a permanent crisis mechanism while “not modifying article 125 TFEU (‘no bail-out’ clause)”;
  B. the general features of the new mechanism including “the role of the private sector, the role of the IMF and the very strong conditionality” for the rescue programmes;
- In addition, “the new mechanism would also give the […] Commission new powers to scrutinize national budgets of member nations — and impose fines on so-called deficit violators”, but “the fines will not be automatic”; meanwhile, voting rights in the Council of Ministers won’t be
stripped (1); moreover, on 28 November 2010, the Eurogroup agreed that CACs shall be included in the euro area government securities starting from June 2013 (cf. Table 6.6 E, G), and there will be PSI on a case-by-case basis fully consistent with IMF policies “in order to protect taxpayers’ money, and to send a clear signal to private creditors that their claims are subordinated to those of the official sector” (2); as a result, the provisions of PSI and CACs are written into the ESM Treaty.

- As the “six-pack” enters into force on 13th December 2011, financial sanctions of RQMV to reinforce the SGP rules “can be activated at any moment [...] if and when the conditions are met”; RQMV is a “semi-automatic decision-making procedure”, where “a financial sanction can be imposed by the Council on the basis of a Commission recommendation, unless a qualified majority of Member States vote against it”, while for the cases of a notice under Article 126(9) TFEU, “the financial sanction will be adopted by qualified majority voting as foreseen by the Treaty”. (3)

- Addressing “some of the remaining shortcomings” after the “six-pack” which reinforces EU fiscal governance, a fiscal compact, as a part of the new TSCG (i.e. Articles 3 to 8 of the TSCG), was signed by 25 (without the UK and the Czech Republic) out 27 EU Heads of State or Government on 2 March 2012. This “fiscal compact envisages the mandatory introduction of a balanced budget rule and an automatically triggered correction mechanism at the national level as well as a strengthening of the automaticity of the excessive deficit procedure within the Stability and Growth Pact in case a euro area country breaches the deficit criterion” (4), p.79). The TSCG, including a new fiscal compact and strengthened economic policy coordination, is taken as a complement to the ESM Treaty, and the granting of ESM financial assistance is conditional on the ratification of the TSCG by the ESM member states concerned (ESM Treaty (5)).

- Though agreed by the eurozone countries’ Heads of State or Government on 9 December 2011, the TSCG was also adopted by another eight non-euro member states, and entered into force on 1 January 2013. The provisions of the TSCG are compatible with EU law and shall be incorporated into the EU Treaties within five years after it enters into force. The TSCG contracting parties have agreed to “transpose the ‘balanced budget rule’ into their national legal systems, through binding, permanent and preferably constitutional provisions”, which “should be subject to the jurisdiction of the Court of Justice of the European Union” by the end of 2013 (TSCG; (5)). This means the failure of national transposition can lead to financial sanctions imposed by the Court against the member state concerned (26).

- Built upon the budgetary rules outlined in the SGP, the TSCG reinforces EU fiscal and economic governance in four aspects: first, under the balanced budget rule, annual structural government deficit must not exceed 0.5% of GDP — a figure set up by the preventive arm of the SGP — which also must be in line with the country-specific medium-term objective (MTO); second, an automatic correction mechanism of designed measures to reduce the budget deficit over a defined period of time must be in place at the national level of each contracting party by the end of 2013, which shall be triggered automatically in the event of deviations from the MTO or the adjustment path towards it; third, coordination among the TSCG contracting parties gets reinforced, as they agree to inform each other (as well as the EU) their plans of issuing new debt in advance and discuss their economic policy reform plans; finally, euro area governance is further strengthened, as the Heads of State or Government of euro states shall meet informally at least twice a year in the Euro Summit meetings to address the issues related to the single
currency. (TSCG; 15)

IV The creation of the ESM by Treaty conclusions

The final agreement of establishing a permanent rescue mechanism, the ESM, is crystalized in the ESM Treaty which is complemented by the TSCG: the former responds to the first (i.e. Treaty amendments to make the ESM viable) and second (i.e. private creditors’ participation) ideas in the Deauville Deal by carrying out a limited Treaty amendment to Article 136 TFEU via the simplified revision procedure and including PSI and CACs into the operation of the ESM, while the latter deals with disciplining national fiscal behavior via a “balanced budget rule” and an automatically-triggered correction mechanism at each national level of the TSCG signatories; at the same time, the third idea (i.e. remaining the status quo of QMV in the Council to impose sanctions against SGP violators) put forward by the Deal is finalized as semi-automatic RQMV for financial sanctions, and the fourth suggestion entailed in the Deal about suspending concerned member states’ voting rights in the Council has been fully abandoned.

V After signing the ESM Treaty (on February 2012): negotiations and compromises still go on

- On 27 June 2012, in the run-up to the EU summit, Merkel “managed to get new French President François Hollande to sign off on her fiscal pact, which is deeply unpopular in Paris, in return for her support on the €130 billion ($165 billion) European Union ‘growth pact’”. (27)
- At the late Friday evening of 29 June 2012, less than 24 hours before the German Parliament, the Bundestag, approved the establishment of the permanent €700 billion bailout fund (i.e. the ESM) and the fiscal compact included in the TSCG, “Merkel had made some tough and unexpected concessions after a marathon 15 hours of talks at an EU summit in Brussels lasting well into Friday morning”, and the euro area member states agreed the following: (1) the conditions for getting ESM aids are eased — a euro state now can receive ESM help if it fulfills the budget rules laid down by the Commission while “without agreeing to additional tough austerity measures”; (2) “[s]trict oversight by the troika” (i.e. the Commission, the ECB and the IMF) “will no longer apply”; (3) the ESM can directly bailout European Banks after the creation of an SSM, thus avoiding to push the member state concerned into a deeper debt mire via loaning to the government in exchange for austerity commitments(17). Before the summit, Merkel opposed those measures and her preferences stuck to the rules that had already been agreed in the ESM Treaty with strict oversight particularly with the involvement of the IMF; Merkel was sharply criticized for caving in to the demands of the southern euro member states, particularly Italy and Spain, whose Prime Ministers secured the concessions by threatening to veto the €120 billion growth pact originally proposed by French President François Hollande as a promise to French voters during the his presidential election with the aim of stimulating the EU economy and complementing Merkel’s fiscal compact of austerity measures. For Merkel, even if the growth pact may do not have a real impact on EU economies, she “had promised the successful passage of the pact to the opposition back home, as well as support for a financial transaction tax, in exchange for their support in ratifying the ESM and the fiscal pact in Friday’s votes” (17).
- Though on 29 June 2012, the German Parliament, the Bundestag, approved both the ESM and the Fiscal Pact, the two intergovernmental treaties — the ESM Treaty and the TSCG — were still subject to Germany’s highest court’s (i.e. the Federal Constitutional Court) review before they can finally get ratified. Though facing amount of petitions for temporary injunctions which would block the ratification of the ESM, on Wednesday 12 September 2012, the highest court gave a green light to the ESM, but set two conditions/reservations for Germany to ratify the
ESM: the limited German liability of €190 billion and the rights of the Bundestag to obtain confidential information of the ESM; meanwhile, the German court also rules that “the ESM cannot ‘become a vehicle of unconstitutional state financing by the European Central Bank’”, which means that the ECB’s bonds borrowing actions (known as the OMTs) are not permitted — such a ruling shall deprive the ESM of the means to increase its financial capacity, and as a consequence, the ESM fund can offer sufficient support for Cyprus or Ireland, but no longer for the bigger euro countries, like Spain or Italy. Obviously, the two reservations made by the German highest court embody German taxpayers’ interests, as any ESM bailouts suggest German taxpayers’ payment for the bill, while to strengthen the German Parliament’s saying on ESM operation affairs means to check against any potential unlimited and increasing bailout responsibilities allocated to Germany in the future. Germans’ warnings against the adoption of the ESM include: the permanent rescue fund could limit and even damage German parliament authority in budgetary decision-making, as the liabilities through international agreements could be “tying the hands of the budget legislature”; more realistically, if a ESM member failed to fulfil its shares of funding in the future, there would be a high possibility for other ESM members to take more payment obligations. As regards opposition to the ECB’s new initiatives of OMTs via the ESM, the main concern, among the worries such as lacking any parliamentary oversight of the ECB’s operations and possibly a high inflation rate caused by OMTs, is also about the increasing financial risk for German taxpayers as they would be in the end liable to all the ECB bond purchasing.

In order to facilitate Germany to ratify the ESM Treaty, other eurozone member states took a quick response to the German court’s ruling within a week, and the contracting parties of the ESM worked out an legally binding “interpretive declaration” to clarify the ESM treaty so as to meet the two reservations of the German court: first, the upper ceiling of each member state’s liability specified in Annex II of the ESM Treaty shall not be exceeded “without prior agreement of each Member’s representative and due regard to national procedures” (addressing Article 8(5), ESM Treaty) — for Germany, it means that its liability of €190 billion can only be exceeded after obtaining the Bundestag’s permission; second, national parliaments can acquire comprehensive information from the ESM (addressing Article 32(5), Article 34 and Article 35(1), ESM Treaty).

As for the ECB’s bond purchasing, Germany’s highest court has expressed its skepticisms and criticisms. The hearings on such ECB programmes were conducted on 12-13 June 2013 and the court’s ruling was expected to be made several months later. In January 2014, the court was still reviewing the issue, and the possibility of “striking down the most successful tool in combating the crisis” has not been ruled out yet.

Sources: ①Deauville Declaration (18 October 2010); ②“Merkel at the EU Summit: The Iron Chancellor in the Euro Trap” (Spiegel Online, 28 October 2010); ③Chaffin and Spiegel (24 October 2010, Financial Times); ④Kovacheva (22 October 2010, Euinside); ⑤A Comment of the Newspaper Hospodá rske Noviny quoted in Kovacheva (22 October 2010, Euinside); ⑥“EU Leaders Strive for Deal on Budget Discipline” (BBC News, 28 October 2010); ⑦ Barysch (November 2010); ⑧ Neuger (19 March 2013, Bloomberg); ⑨ Charlemagne (5 December 2011, The Economist); ⑩European Council 28-29 October 2010 Conclusions; ⑪“Brussels Summit: EU Agrees to Merkel’s Controversial Euro Reforms” (Spiegel Online, 29 October 2010); ⑫Statement by the Eurogroup (28 November 2010); ⑬European Commission-MEMO/11/898 (12 December 2011); ⑭“A Fiscal Compact for a
As Tables 7.2 and 7.3 show, Germany and its Chancellor Ms Merkel initiated and adamantly pushed through the establishment of a permanent crisis resolution mechanism — the ESM — to replace the temporary one with the aim to safeguard the financial stability of the euro countries. To have a permanent rescue mechanism as well as tougher fiscal rules in place is the core interests of the German government, and as a matter of fact, the two concluded treaties — the ESM Treaty and the TSCG — are designed to complement each other with the former to provide urgent financial assistance while the latter, whose ratification becomes a pre-requirement of receiving ESM aid, to strengthen eurozone fiscal governance and to correct national unsound fiscal behavior. The process leading to the final creation of the ESM, however, is not a straight and an once-time-bargaining and compromise. Rather, there are several bouts of national negotiations and concessions due to the disagreements among the member states and EU institutions towards Germany and France’s proposals, during which member state preferences also get modified and redefined. Nevertheless, Germany’s positions to establish a permanent rescue mechanism while strengthening the SGP rules get unswerving during the course of negotiations, and at the same time, the negotiated results at different stages represent the economic interests of powerful domestic constituents in the two leading euro states well: for both Germany and France, they aimed to meet the taxpayer’s interests on the bailout fund as they have made the largest contributions to the Greek rescue package and to the EFSF, the German government in particular. Meanwhile, the German government also took its multinational industrial giants’ demands into consideration, whereas the French government unequivocally tried to protect the interests of French banks and financial sectors the most. Therefore, even with the changes of national preferences during the negotiation course towards the
finalization of the ESM, H7a is confirmed as the ESM reflects the economic interests of powerful domestic constituents at least in Germany and France.

Nevertheless, besides the economic factors, political considerations also have played a role in the formation of the ESM. Above all, if Greece or other euro member states was forced to leave EMU, it would not only endanger the single currency and EMU, but also mean a political failure of the EU integration project. Meanwhile, EU politicians generally believe that if the euro were to fail, so too would the EU138 — this is the conceptual background for ECB President Mario Draghi to pledge that “the ECB is ready to do whatever it takes to preserve the euro” (Draghi 26 July 2012), paving the way for the ECB’s decisions of the OMTs (see Appendix 2). The political significance of the euro besides the economic benenfits it has brought is well crystalized in Merkel’s televised address to the nation in the New Year 2011:

“We have to strengthen the euro, and it is not only a question of money. The euro is more than just a currency. It is our good fortune that we Europeans are united. A united Europe is the guarantor for our peace and our freedom. The euro is the basis of our economic well-being. Germany needs Europe and our common currency, for our own good, and for coping with global challenges.” (Smith 5 January 2011, The Wall Street Journal)

Second, Merkel’s party, the Christian Democratic Union (CDU), faced regional elections while Sarkozy was running up for his presidential re-elections, so both of them had to take voters’ attitudes on the ESM into account, and the clauses of PSI and CACs built into the ESM Treaty to protect the interests of taxpayers thus become explainable. It is, however, interesting to observe different public reactions towards the Greek bailout in the two core euro member states. In contrast to the German citizen’s 60 percent opposition to the new aid for Greece, the French people “appear to have accepted the bail-out with Gallic resignation” as “[t]hey cannot contemplate letting the country go bankrupt” and consequently, “President Sarkozy has not had to deal with street protests against the bail-out, and the newspapers have refrained from shouting furiously about the terms” (Alexander 25 June 2011, The Telegraph). Such a sympathy, Philippe Moreau-Defarge, a researcher at the French Institute of International Relations in Paris, argues that it is because “France is a Latin country that feels closer to the Greeks; they also feel it could happen to them” (quoted in Alexander 25 June 2011,

---

138 See, for example, “Eurozone Must ‘Resist Alarmism’, Olli Rehn Says” (BBC News, 16 November 2010).
The former may appear symbolic and meta-physical, while the latter touches the spine of France: its economy is not as strong and robust as Germany’s; with an uncertain economic recovery ahead, it also has the risk of debt defaults. German citizens’ (including some prominent politicians’) strong opposition to the measures of bail outing other euro countries plagued by the sovereign debt crisis were fully demonstrated when the permanent rescue mechanism ESM was waiting for the German highest court’s ruling: 37,000 German people lodged their complaints about the ESM bailout, making the case of the ESM “the biggest constitutional complaint in German history” (Wittrock 10 September 2012, Spiegel Online). So apart from economic reasons, Germany’s original propositions have been tinted with strong political sentiments: siding with German taxpayers — a synonym of voters — is a political necessity and strategy. As Tables 7.2 and 7.3 suggest, Merkel’s option for an insolvency procedure to accompany the bailout for the beneficiary states was compelled by domestic pressures, as there were tensions and opposition when Merkel and her coalition government tried to get the Greek bail-out package and the EFSF passed through the German national parliament, the Bundestag, in May 2010. At that time, to secure both measures to be adopted, “Merkel called for an international financial transaction tax and announced a unilateral ban on naked short-selling of certain stocks and bonds” and meanwhile “Merkel is convinced that she cannot return to the parliament with another bail-out package unless it foresees the possibility that private investors, not only taxpayers, are involved” (Barysch November 2010, 3). Naturally, in the Deauville Deal, Germany pressed for the default mechanism of an insolvency procedure involving haircuts of shareholders. This also makes a footnote to Merkel’s determination to establish a legally binding permanent rescue mechanism. Moreover, to secure the ally of France so as to materialize Germany’s basic propositions, Merkel openly campaigned for Sarkozy’s re-election; when the Fiscal Pact had received the necessary support, Merkel was so pleased that she overtly said: “Nicolas Sarkozy supported me during my campaign. In the same way, I will now pay back that which he gave me” (“The Electoral Pact: Crisis Desperation Drives Merkel to Campaign for Sarkozy”, Spiegel Online, 6 February 2012). Another linked reason is that Merkel “fear(s) that a Socialist president in Paris may overturn its strategy to rescue the euro” as Sarkozy’s challenger, François Hollande, is a Socialist, who, leading the election survey, favors euro bonds while opposing “the anchoring of a balanced budget amendment — the so-called ‘debt brake’ — in the French constitution”
— an essential ingredient of the Fiscal Compact (“The Electoral Pact: Crisis Desperation Drives Merkel to Campaign for Sarkozy”, Spiegel Online, 6 February 2012). In May 2012, Sarkozy was defeated by Hollande in the French presidential elections with about 48% against 51.7% of the votes, and it has been hold that two factors lead to French voters’ sanctions against him: France’s economic depression with low growth and high unemployment rates (about 10%) and “his flamboyant personal style” (Deen and Viscusi 7 May 2012, Bloomberg), and some analysts believe that the latter has contributed more to Sarkozy’s failure, but coming to Sarkozy’s management of the crisis, “in fact many consider good” (Poirier 8 May 2012, CNN). As Hollande also opposed the “inevitable” austerity measures to counter the crisis, his victory gave “a sense of relief in many European countries” (“Socialist Hollande In, Sarkozy Out, As France Elects a New President”, CNN, 7 May 2012), which implies that those “grieving” southerners under the programmes of budgetary cuts with austerity measures, such as Greece and Ireland, now have a powerful ally. Hollande’s promises to French voters to revive the French economy and to complement Germany’s demands of implementing austerity measures by the Fiscal Pact, as Table 7.3 suggests, were enshrined in his growth pact proposals, and to make it viable alongside the already-negotiated Fiscal Pact had been prioritized as being an urgent issue on Hollande’s agenda (Poirier 8 May 2012, CNN). Hollande’s proposal was finalized in the EU summit of June 2012, where a Compact for Growth and Jobs of EUR 120 billion (equivalent to around 1% of the EU’s GNI) was reached to promote fast-acting growth measures (European Council 28/29 June 2012 Conclusions). The adoption of the growth pact appears as the new French President’s political success — at least, he fulfills his promises to the French voters, and additionally, he also wants to send a message to his domestic voters that “he was rebalancing ties after the ‘Merkozy’ era” (“Insight: Merkel and Hollande — Building a ‘Grand Bargain’”, Reuters, 10 July 2012). Nevertheless, participants of the EU summit to adopt this growth pact “know themselves that the resolution is little more than a bit of window dressing for voters and financial markets”, and it “contains nothing new” while its effects on the economy are supposed to be “virtually nil” — it just helps the new President “save face” (Volkery 27 June 2012, Spiegel Online). However, the Italian Prime Minister Mario Monti, together with his counterpart of Spain, Mariano Rajoy, took this as a new opportunity to bargain with Merkel — they would not approve the growth pact proposed by France until “concrete measures to fight the high interest rates on Italian
government bonds [...] had been clarified”, successfully forcing Merkel to make concessions in the rules of governing the ESM bailout fund (see Table 7.3) (Volkery 29 June 2012, *Spiegel Online*). The reason for Monti and Rajoy to press for those demands at this moment is also explainable by the domestic political pressure in their own countries: both Monti and Rajoy had to push through unpopular and painful reforms in Italy and Spain respectively, but there was strong domestic resistance to the reforms; government changes in the two countries were not unusual since the crisis, and Italy would have elections in the Spring of 2013 — a vital factor allowing Merkel’s concessions (Rickens 29 June 2012, *Spiegelonline*). Even after the operation of the ESM, Merkel herself also met huge domestic pressures when coming to the terms on the bailout of Cyprus under the ESM in March 2013, as she was campaigning for re-election in September (Neuger 19 March 2013, *Bloomberg*). Generally speaking, addressing the sovereign debt crisis is an economic issue, but at the same time it is closely related to domestic political situations and demands, as national citizens can sanction their leaders by their votes regarding how the politicians respond to the economic downturn, high unemployment rates and climbing up public debts during the crisis. No matter how largely Sarkozy’s personality accounts for his presidential re-election failure, he is just another head of government who falls out of the political altar, joining the long, but definitely unfolding, list of “the victims of the crisis” of the national leaders in Ireland, Portugal, Greece, Italy, Spain, Slovenia, Slovakia and the Netherlands (Deen and Viscusi 7 May 2012, *Bloomberg*). The scenario of domestic political fallout across Europe during the crisis has demonstrated that to address the crisis is not a pure economic issue. Therefore, apart from the specific economic interests, domestic party struggling and national-wide elections also account for national preference formation towards measures to solve the crisis, including the ESM.

Moreover, Germany’s assertion on the creation of the permanent ESM and the strengthened SGP rules also reflects Merkel’s center-right governmental coalitions’ (composed of the conservative CDU, its Bavarian sister party the Christian Social Union (CSU) and the business-friendly Free Democratic Party (FDP)) 139 macro-economic preferences. Before the Deauville Deal, Merkel’s government has expressed its preferences clearly: making Treaty amendments to establish a new “legally unassailable” rescue mechanism for the euro countries while combining it with

139 See Wittrock (10 September 2012, *Spiegel Online*).
the SGP reform as a single package — it seems that Germany adopts an “all-or-nothing” strategy (see Table 7.2). In order to win France’s support, however, Merkel made concessions in the Deauville Deal to Sarkozy, loosening the sanction mechanism against the persistent SGP violators. This bilateral deal nevertheless caused rifts within the German federal Parliament, the Bundestag, and the strong criticisms came from, for example, the leader of the center-left Social Democratic Party (SPD), Frank-Walter Steinmeier, and the Green Party politician Renate Künast (“Merkel at the EU Summit: The Iron Chancellor in the Euro Trap”, *Spiegel Online*, 28 October 2010). On 29 June 2012, members of the Bundestag, including politicians from the opposition parties, approved the package championed by Merkel: a permanent euro rescue fund and a fiscal pact. For the former, the votes were 493-106 with five abstentions in favor of the ESM, while for the latter, the ballots were 491-111 with six abstentions; Merkel’s package requires two-thirds-majority support (i.e. 414 votes) in the Bundestag, because it concerns Germany’s internationally binding fiscal commitments to provide rescue funds in the ESM and correct budget deficits in the Fiscal Compact, which composes a vital part of the TSCG (“Parliament Approves ESM and Fiscal Pact: Merkel Secures Vote for Euro Treaties”, *Spiegel Online*, 29 June 2012). Later on the same day of 29 June 2012, the Bundesrat, Germany’s legislative chamber representing German states’ interests, also approved Merkel’s package of the two measures, with fifteen out of sixteen states in favor, and the only opposition came from Brandenburg, an eastern state under the governance of the coalition of the center-left Social Democrats and the left-wing Left Party (“Parliament Approves ESM and Fiscal Pact: Merkel Secures Vote for Euro Treaties”, *Spiegel Online*, 29 June 2012). The stories of the establishment of the permanent ESM continued. Though the Bundestag approved the ESM and the Fiscal Pact on 29 June 2012, the two intergovernmental treaties — the ESM Treaty and the TSCG — were still subject to Germany’s highest court’s review before they could be ratified. The opponents of the two treaties lodged their complaints to the court as soon as the Bundestag approved them that evening, mainly worrying about German taxpayers’ “unlimited and irreversible liability risks” in the permanent rescue fund (“Green Light for ESM: German High Court OKs Permanent Bailout Fund with Reservations”, *Spiegel Online*, 12 September 2012), including Peter Gauweiler, a Bundestag member of the conservative CSU — apparently a discord within Merkel’s coalition (“Parliament Approves ESM and Fiscal Pact: Merkel Secures Vote for Euro Treaties”, *Spiegel Online*, 29 June 2012). Accordingly, the court announced that it
would hear the complaints on 10 July 2012, \(^{140}\) and its ruling then was expected to be delivered in the coming September, but just a week before the court’s ruling, Peter Gauweiler filed another new “emergency” petition over the ECB’s announcement on 6 September 2012 to purchase unlimited sovereign bonds from the euro member states plagued by the sovereign debt crisis. Accusing the ECB of becoming an “unlimited ultra- and hyper- bailout fund” which gets out of national parliaments’ control, Gauweiler demanded that “the court reject the ratification of the ESM treaty until the ECB revises its decision” and thus the scheduled ruling on the ESM, together with the Fiscal Compact, should be delayed (Wittrock 10 September 2012, *Spiegel Online*). On 11 September 2012, rejecting Gauweiler’s new petition for a temporary injunction, the court announced that it would not delay its ruling on the ESM. \(^{141}\) Reviewing all the petitions against the ESM, the German highest court, on 12 September 2011, still gave its OK to the ESM, but added two conditions to ensure Germany’s limited liability and the German parliament’s rights to be informed with the operation of the ESM; consequently, an “interpretive declaration” was agreed upon by all ESM members to meet the two conditions imposed by the German highest court (see Table 7.3), and after this clarifying declaration, the ESM finally got ratified by Germany. At first glance, the plaintiffs seemed to be the losers, but since establishing a permanent rescue mechanism is unavoidable and a “must” to address the crisis, those opponents of the ESM actually had obtained what they wanted: the two conditions attached to the ratification of the ESM Treaty; Gauweiler himself even called the court’s ruling as a “huge success” (Hipp 13 September 2012, *Spiegel Online*).

The case of the ESM confirms the validity of H7a, exhibiting the classic pattern of national preference formation based on the equilibrium of producers and investors on the one hand and taxpayers and actors who are interested in regulation on the other hand, while also illustrating how a concrete measure has been hammered out by euro states to meet the challenge of globalization. Besides, German government positions on the issue of the ESM mirror Merkel’s ruling coalitions’ macro-economic preferences, which fall into the prediction of the LI model (see 3b in Figure 3.2). Meanwhile, the ESM case also protrudes LI’s national preference formation arguments: national preference formation is not static; rather, responding to new rising situations, they get

---

\(^{140}\) See, for instance, Connolly (10 July 2012, *The Guardian*).

\(^{141}\) See “Petition Rejected: German Court Says It Will Not Delay ESM Ruling” (*Spiegel Online*, 11 September 2012).
modified and re-oriented during the negotiation process; nevertheless, the core assertions of nation states tend to remain unchanged. In addition, the unsuitable cases of the European Semester and the ESRB have revealed an unavoidable aspect that EU policy making must work on in the future: macro-level approaches addressing the interconnectedness and interdependence across various policy domains and sectors. To galvanize its robust analytical and predictive power, LI must take those new challenges into account, and Propositions 19, 20, 21 are attempts made by this dissertation to adapt LI to the future challenges.

7.2.2 Evidence for H7b and H7c: Interstate Bargains (LI Stage 2)
As the European Semester and the ESRB are established in accordance with EU daily decision-making procedures, they embody EU collective decision-making via EU supranational institutions (see Table 7.1), so the second stage of the LI model — interstate bargains — is only applicable to the case of the ESM. From the Deauville Deal in October 2010 to the signing of the ESM Treaty in February 2012, and then to the operation of the ESM in October 2012 after national ratification, the formation of the permanent crisis resolution mechanism, as Figure 7.1 suggests, has undergone several rounds of intergovernmental negotiations before it is finally concluded.

| The initiator of the ESM: Germany; |
| Germany’s preferences: (1) to establish a permanent rescue fund via Treaty changes, with an insolvency procedure involving the losses and risks sharing of private investors (i.e. PSI); (2) to strengthen the SGP rules with tougher budget rules and an automatic sanction mechanism charged by the Commission rather than by the status quo of QMV in the Council (which is in line with the Commission’s and the EP’s positions) |

- How to materialize those national interests?

| Germany’s strategy: forming a coalition with France, the number two in EMU and the EU |
| France’s preferences: (1) a comparatively lenient fiscal sanction mechanism (a strong ally for the southern European states while opposition is coming from the Northern states who have better fiscal records); (2) depriving the voting rights of the persistent deficit violators in the Council (a proposal attracting universal opposition and criticisms); (3) the status quo of sanction decision-making by the Council (opposition from EU institutions and Northern euro states) |

| The first round of interstate bargains: the bilateral Deauville Deal struck by Germany and France on 18 October 2010 |
| Negotiated results: there were interest swaps and compromises between Germany and France and the Deauville Deal represented a merger of both countries’ propositions, where Germany yielded to France’s demands and accepted all the preferences of France, and in return, France agreed to make Treaty revisions to establish a permanent rescue fund with a default mechanism |
| Germany’s strategy: Germany made concessions to secure the support for Treaty amendments to |
establish a permanent ESM with a default mechanism (a thing Germany really wanted) while pressing for budgetary discipline of strengthened SGP rules — the two measures (i.e. establishing a permanent bailout fund and implementing strict fiscal rules) were proposed hand by hand as a package offered by Merkel; France was a potential ally of southern member states who would block tougher SGP sanction rules, so conceding to France’s demands broke the possible block forged by the southern countries while also making Merkel’s package of the two measures viable. From another angle, if not compromising with France’s demands, Germany would lose both measures: France would not support Treaty changes for the permanent ESM, while southerners would possibly ally France to water down the budget rules and the sanction mechanism.

The second round of interstate bargains: various responses to the Deauville Deal, forming a rough line between small fiscally-restrained northern members (together with the Commission and the EP) and large indebted southerners on the issue of a tougher and more-automatic sanction mechanism

Negotiated results: (1) the EU summit of 28-29 October 2010 reached agreement on: (a) a limited treaty change to make a permanent ESM possible; (b) the participation of private sectors; (c) a sanction mechanism not to be automatic; (d) voting rights not to be suspended; (2) on 28 November 2010, the Eurogroup agreed that the ESM shall include PSI and CACs provisions — a specification of the default mechanism persistently demanded by Germany; the semi-automatic RQMV was introduced by the “six-pack”, which became effective as of 13 December 2011 onward

Germany’s strategy: Germany caved in to France’s demands of weakening articles on the haircuts of the private creditor side, and in return, France agreed with a more automatic sanction process.

The third round of interstate bargains: addressing the shortcomings of as well as further strengthening EU (particularly eurozone) fiscal governance after the “six-pack”

Negotiated results: the TSCG (known as the Fiscal Compact) was agreed by the Heads of State or Government of the euro countries on 9 December 2011, and then the non-euro members (except the UK and the Czech Republic) also participated; the TSCG was signed by 25 member states on 2 March 2012, and entered into force on 1 January 2013; the TSCG includes a fiscal compact based on the SGP rules, which introduces a balanced budget rule and an automatically triggered correction mechanism at the national level.

Germany’s strategy: Confronted with the UK’s opposition, the TSCG was concluded as an intergovernmental Treaty rather than an EU Treaty, excluding the “recalcitrant” governments; Germany bound the ESM and the TSCG together, and the TSCG was included in the ESM Treaty as a prerequisite for ESM member states to receive ESM assistance.

The fourth round of interstate bargains: the formation of the ESM Treaty

On 11 July 2011, the 17 euro countries signed the ESM Treaty; later, on 21 July and 9 December 2011, decisions were made by the eurozone Heads of State and Government to increase the effectiveness of the ESM, including (a) “new financing tools”, (b) “more flexible pricing”, (c) “link with fiscal compact”, (d) “new emergency decision-making procedure”, (e) “alignment with IMF practice as regards private sector involvement”, and (f) “timing of capital contribution”; incorporating those decisions, the ESM Treaty was signed again on 2 February 2012.142 The ESM Treaty was subjected to national ratification of the euro countries, and the permanent ESM did not become operative until 8 October 2012.

---

142 See ESM Treaty Factsheet (Council of the European Union, 2 February 2012).
After signing the ESM Treaty, interstate bargains and compromises still continued.

The fifth round of interstate bargains: Newly elected French president Hollande wanted to get his growth pact adopted, a promise he made to the French voters during his presidential campaign to stimulate the French economy and claimed to complement Merkel’s Fiscal Pact which stressed austerity measures; before the EU summit on 29 June 2012, Merkel agreed to support Hollande’s growth pact, and in return, Hollande agreed to sign off the unpopular fiscal pact championed by Merkel.

Negotiated results: Hollande’s proposal was adopted as a Compact for Growth and Jobs on the euro area summit of 29 June 2012; to secure the Growth Compact which is in exchange for the Fiscal Compact, Merkel made concessions to Italian and Spanish Prime Ministers’ demands of easing the conditions for granting an ESM aid, dropping the previously planned troika oversighting, and approving direct bailouts to European banks as soon as an SSM is created.

Italy and Spain’s strategy: forcing Merkel’s concessions on some terms of the ESM (which would help reduce the yield rates of their government bonds) by threatening to torpedo Hollande’s growth pact.

Germany’s strategy: Germany opposed the demands made by Italy and Spain, but it needed the ally and support of France to the Fiscal Compact; meanwhile, a growth pact was also needed by Merkel to placate her domestic opposition in exchange for their support for the ESM and the TSCG.

The sixth round of interstate bargains: responding to the German highest court’s ruling of imposing two conditions for the ESM

Germany was the last ESM member to ratify the ESM Treaty, and other euro states were anxiously waiting for the approval of the ESM by the German highest court after it passed through the German Parliament on 29 June 2012; the petitions against the ESM were backed by 37,000 German citizens; still, the German court finally favored the ESM on 12 September 2012 but imposed two conditions; to meet German highest court’s requirements for ratification, the euro states quickly adopted an “interpretive declaration” issued on 27 September 2012 to clarify the court’s concerns. Thus, the last obstacle for the operation of the ESM was removed.

Another issue petitioned was the ECB’s purchasing of government bonds via the ESM, which, up to January 2014, was still under the review of the German highest court. Uncertainty still hovers over the fate of this powerful tool which can largely amplify the capacity of the ESM, and another round of interstate bargains related to the ESM is still possible in the future.

Due to the uncertainties and new emerging situations/factors, the possibilities of interstate bargains and compromises on the operation of the ESM cannot be ruled out.

Figure 7.1 Interstate Bargains and Compromises Leading to the ESM

Sources: Own compilation based on the previous section 7.2.1 of this dissertation.

As Figure 7.1 shows, the intergovernmental bargains for the formation of the ESM were not finalized at once; instead, negotiations among euro states to create the permanent mechanism have spread over into several rounds, even after the ESM Treaty got signed. Since the UK is not a contracting party of the ESM, it does not participate in the ESM negotiation process, and it seems that there is nowhere to talk about any kind of superiority the UK can exploit during the formation of the ESM. Therefore, this dissertation mainly focuses on the two core euro states: Germany and France.
Still, with regard to the complementary treaty to the ESM — the TSCG — which was concluded by the euro countries while opening up to the non-euro member states, the UK, together with the Czech Republic, decided not to participate. At the very beginning, the Fiscal Compact was expected to be adopted as an EU treaty, but in the EU summit of December 2011, the UK vetoed it, so consequently, it was agreed to be adopted as an international treaty instead. That the UK went to veto the Fiscal Compact as an EU Treaty, and did not even “opt out”, was explained by the UK Prime Minister Cameron as to safeguard the single market and the UK’s national interests, in particular its financial services industry, as well as to prevent the “misuse” of EU institutions by the euro bloc to implement their policies (Miller 27 March 2012). The UK government, however, did not divulge its negotiating positions before the summit — a tactic purposely taken by the UK leaders (Miller 27 March 2012, 4-5). Even after the summit, the “safeguards” proposals upheld by Cameron were not well publicized, and it was not until on 23 February 2012 when David Lidington, the UK Minister for Europe, appeared before the Commons European Scrutiny Committee that the UK’s rationales behind its veto were clearly revealed:

“Our reasons for so doing were that there is a clear relationship between aspects of financial services regulation, in particular banking regulation, and fiscal policy. The purpose of the proposed Treaty amendments in December was to give greater priority within the European treaties to the objective of securing the fiscal integration of the eurozone. We were also concerned, when we approached the European Council in December, about the fact that there were a number of specific financial services measures that we felt were threatening the integrity of the single market in order to safeguard particular interests of members of the eurozone.” (Quoted in Miller 27 March 2012, 6)

As a non-euro member state, Cameron wanted the Eurozone to put its house in order and address its problems properly, but he opposed to “misuse” EU institutions. He said that some uses of the EU institutions in the intergovernmental Fiscal Compact might be “highly questionable”, reiterating that: “we want those institutions to sort out the problems of the European Union, and we want them to stick to fiscal union and not go into single market issues. If they were to go into single market issues and threaten Britain’s national interests, of course we would act” (quoted in Miller 27 March 2012, 15). Originally, the UK put forward its own proposal to seek safeguards, but the French government refused to accept, as Sarkozy said: “in order to accept treaty revision
among the 27 EU states, David Cameron asked us — something we all judged unacceptable — for a protocol to be inserted into the treaty granting the United Kingdom a certain number of exonerations on financial services regulations ... We could not accept this, since we consider, quite on the contrary, that a part of the world’s woes stem from the deregulation of the financial sector” (quoted in Miller 27 March 2012, 5). This led Cameron not to participate and the TSCG took an intergovernmental route. To veto rather than choosing an “opt-out” of an EU Treaty means that there shall be neither obligations nor the binding force of EU law or additional EU law on the UK (Miller 27 March 2012, 15-16). Though Cameron’s rejection of the Fiscal Compact (also the TSCG) attracted both praise and criticisms domestically, the positions of his government were unambiguous: to protect UK’s national interests of the single market as the tighter fiscal integration in the eurozone may imply non-euro members be at the expense, where the UK’s financial sector may bear huge losses (Miller 27 March 2012, 16-17). Some politicians and scholars, however, were doubted that whether Cameron’s veto defended “British national interests in the long-term”, because UK’s veto did not stop other euro states under the Franco-German leadership to go ahead with what they had proposed — on the contrary, some politicians and scholars, however, were doubted that whether Cameron’s veto defended “British national interests in the long-term”, because UK’s veto did not stop other euro states under the Franco-German leadership to go ahead with what they had proposed — on the contrary, France and Germany said “NO” to Cameron’s demands of safeguards for financial services, so some would argue that “that’s not wielding a veto, that’s called losing” (Miller 27 March 2012, 41). According to those, the negotiations for the TSCG confirm part of H7b as the member states (i.e. the UK) who shall economically benefit the least from the agreement tend to impose conditions and make hard bargains. LI’s prediction is correct in the way that the UK, as being a non-euro member state, benefits less from the ESM Treaty, and thus it tends to assume a superior bargaining position and actually it exploits this opportunity to maximize its national interests by imposing conditions — a protocol to protect the UK financial industry. The UK’s strategy, by vetoing an EU Treaty proposal, falls well into the categories of the LI model, indicating 6a in Figure 3.2. Another tactic wielded by the UK government — concealing its negotiating positions from other negotiators — also falls into the prediction of the LI model (see 4b in Figure 3.2); Cameron’s recourse to it meant to increase the UK’s bargaining power, but this time Germany and France, who would economically benefit the most from the TSCG (and the ESM), did not compromise on

---

143 See also, for example, Waterfield (9 December 2011, The Telegraph).
the UK’s demands. The reason is quite obvious: the ESM is for the euro states, and the TSCG containing the Fiscal Compact was meant to complement the ESM, so without the UK, the TSCG can also function as what it means to the euro countries. This illustrates another potential condition to the application of the LI model: the status of negotiating member states should be within the same block, or else the prediction made in H7b that “member states who economically benefit the most from the EU’s new measures and policies tend to compromise the most on the margin to realize gains” is untenable as the euro block can just go ahead on EMU affairs without taking non-euro member states’ opinions. Accordingly, another scope condition for the LI model can be added:

Proposition 22: The LI model’s second stage (i.e. interstate bargains) works better when the negotiating parties belong to the same block in terms of the relevance of the agreement to them.

This proposition can be tested in the following section when we turn to Germany, France and other contracting parties of the ESM, who belong to the same block of the Eurogroup, and to whom the ESM is highly relevant.

As mentioned in section 7.2.1, to establish a permanent ESM contains both economic and political significance. Germany was the initiator of the ESM, and the economic benefits for Germany include keeping financial stability of the euro area and a stable and credible single currency; the adoption of the ESM conveys good wishes as well as pragmatic needs of Germany as well as other euro member states: to achieve a stable and prosperous EMU and the EU. Then here comes the question: why does Germany try its best to secure a permanent rescue mechanism and not kick the “profligate members”, like Greece, out of the eurozone? Apart from the intentions to save the political achievements of European regional integration, which carries endeavors of European politicians, economists and scholars for more than a half century, the realistic and imminent considerations are the economic interests of Germany as well as other eurozone countries. A single common currency in one respect means an enlarged “domestic” market for the euro states, and in another respect, it implies increasing interdependence among those member states, particularly in the financial sectors. For the former point, export-driven Germany, as argued by CNN, needs not only the euro, but also the weakest members to stay in the euro, because intra-eurozone trade has accounted two-thirds of German exports while “a weak currency has been a ticket to prosperity” (Sanati 14 November 2011, CNNMoney). The
Birth of the euro shows that the EMU project with a single common currency has the advantages of streamlining business, reduce transaction fees and guard against foreign exchange risks, while the former Deutsche Mark was once being one of the most stable and strongest national currencies at that time (Hosli 2005); adopting the euro with other 11 EU member states in 1999 (and now with other 17 euro countries in 2014) means the devaluation of Mark, which makes German products more competitive in the worldwide (Sanati 14 November 2011, CNNMoney). A CNN’s report reveals Germany’s economic interests for the euro, the eurozone, and other euro countries:

“[...] Germany [...] is the world’s second-largest exporting country. The euro has played a significant part in this. German exports have more than doubled since they went on the euro in 1999, going from around 469 billion euros to well over a trillion euros in 2010. The rate of growth was also twice as fast as other nations in the zone. While there is no doubt that the Germans make quality stuff, the reason they are able to export so much at competitive price points is because they are operating with a relatively cheap currency. [...] Even though the eurozone is in crisis and the region looks to be headed for another recession, German exports in September (2011) rose nearly 1% from the previous month to 91.3 billion euros, which is the highest level since records began. In August (2011), when the crisis hit overdrive, exports were up 0.2% from the previous month. Meanwhile, imports into Germany fell 0.8% for September, increasing the nations burgeoning current account surplus. Normally that would cause Germany’s currency to strengthen, but since there was trouble down south, the euro weakened, making German exports even more competitive.” (Sanati 14 November 2011, CNNMoney)

At the same time for the eurozone countries,

“An artificially low euro in Germany means an artificially high euro in weaker countries like Spain and Greece. That means those countries can afford to buy German goods. It’s therefore no wonder why German cars, white goods, electronics and machinery dominate the eurozone. [...] German companies like Siemens (SI), Daimler, Deutsche Bahn, and Ferrostaal have been accused of funneling millions of euros to Greek politicians to secure military and civilian government contracts. In one incident, Siemens allegedly paid 100 million euros to Greek officials to secure a contract to upgrade Athens’s telecommunications infrastructure for the 2004 Olympic Games.” (Sanati 14 November 2011, CNNMoney)

144 In general, Germany has also suffered economic recession due to the worldwide economic depression since 2009, but in 2012, its “exports have rebounded sharply from the crisis to surpass their peak of 2008” with a rising wage, a faster growth rate and less unemployment compared with other industrialized countries, see Porter (26 June 2012, The New York Times).
The costs of the exit of the troubled euro states would be huge and unimaginable for Germany. Take Greece for example; if Greece broke away from the eurozone,

“[...] it would cost around 20% to 25% of the country’s GDP or 6,000 to 8,000 euros per German citizen upfront to walk away. It would then cost around 3,500 to 4,000 euros per German citizen every year going forward. In contrast, [...] if the eurozone swallowed 50% of the debt of Greece, Ireland and Portugal it would cost a little over 1,000 euros per German in a single hit. That’s a much better outcome than going it alone. The study did not include extending a bailout to Italy, which has total debt outstanding that is around three times that of all those nations combined. But for the sake of argument, say one takes a 50% haircut on Italian debt – some 900 billion euros, that bailout would theoretically still cost less to the Germans than it would if they decided to leave the euro.” (Sanati 14 November 2011, CNNMoney)\(^{145}\)

Analysts in general believe that the bailout costs for German people are lower than those caused by any euro dismemberment. After all, the purpose of the bailout was to buy time for the beneficiary euro states to pay debts and thus avoid debt defaults, national bankruptcy and financial turmoil, and Germany (as well as other ESM member states) could even make profits by loaning to the beneficiary states, so when a rescue succeeds, Germany would get more back. On this matter, it is calculated that “covering the entire financing needs of Greece, Ireland, Portugal, Spain and Italy through 2015 would cost about $1.6 trillion”; normally, the IMF may contribute 1/3, and the left should be taken by Germany and other euro countries, but even if Germany puts up $500 billion, the money would not be forfeited, and “Germany could even turn a profit” (Porter 26 June 2012, The New York Times).

Besides those visible “dominant” economic calculations, another not-so-visible “recessive” factor that leads Germany’s and France’s agreement to bailout Greece and create a permanent rescue fund is the interconnectedness across the financial sectors: the states plagued by the sovereign debt crisis are also financed by banks “headquartered in the core countries” and any sovereign debt defaults in the euro countries, such as Greece, would definitely impose losses to the German and French

---

\(^{145}\) A countering argument is that stronger and rising demands of the emerging markets such as China and India can effectively outweigh Greece and other periphery countries’ exits from EMU — all these trade flows appear visible and statistically calculable; nevertheless, “the financial interconnectedness between Germany and the rest of Europe makes clear that any notion of being able to act independently of Europe is illusory” (Smith 5 January 2011, The Wall Street Journal).
citizens. This is the reason “why there isn’t a larger ‘Occupy Wall Street’-like movement made up of angry and unemployed young Germans camping out in Frankfurt parks”, despite the fact that German citizens have expressed strong opposition to the bailout to Greece and the ESM. It is unfair to ask German taxpayers to bailout other lavishing euro countries, but to let Greece or any other euro countries to break away, that is, to let them declare national bankruptcy, would be more fatal to the whole German economy and cause more losses to the taxpayers (Sanati 14 November 2011, CNNMoney).\(^{146}\)

It is generally held that Germany has gained economic advantages via adopting the single currency. When a newly emerging political party in Germany advocates a return to the old currency German Mark, some analysts have incisively pointed out that “without the euro, Germany’s GDP would be lower by about 0.5% per year between 2013 and 2025. This equates to a loss of around €1.2 trillion, or €14,000 per citizen” (“Germany Needs the Euro – Report”, New Europe, 30 April 2013). In comparison, even in the hypothetical scenario where Germany would write off 60% of its loan repayments to Greece, Italy, Portugal and Spain, it is argued, “Germany would only see a slow-down in the economy by about 0.5%. This figure is explained by the added benefits Germany would gain from higher exports to the debtor nations, which would see better economic conditions following the write-off” (“Germany Needs the Euro –

\(^{146}\) It is reported that “German banks had $548 billion — or €446 billion at prevailing exchange rates — at risk in the five problem countries of the euro zone as of June (2001) (…) (while) had €392 billion of capital and reserves (…) Thus, it does not matter whether Germany tries to withdraw from monetary union, or have fiscal sinners expelled from it: the credit losses and writedowns caused by the ensuing currency moves would effectively bankrupt the German banking system, even before manufacturers start shifting jobs to cheaper locations as capital that had been stored in the euro gets reallocated to the new D-Mark”, see Smith (5 January 2011, The Wall Street Journal). Another example is that when Goldman Sachs once lent money to the Greek government and helped Greece to cheat so as to meet the requirement to join the eurozone in 2000, Goldman Sachs at the same time purchased another financial derivative: Credit Default Swaps (CDS) from some of Germany’s public-sector banks, known as Landesbanken, to disperse the risk of money lending to Greece. In essence, Goldman Sachs paid German banks for what essentially constituted insurance for 20 years: if the Greek government would default, these German banks would have to take the responsibility to pay for the debt. Through the financial instrument CDS, Germany, the largest economic entity in the euro area, had been linked to the chain of Greek debts. CDS purchased by Goldman Sachs were inexpensive when Greece could manage to pay its debt, but when the Greek government’s capacity to pay was put into question, costs for Greece to borrow money were rising — and so did the CDS prices. In such circumstances, Goldman Sachs was able to sell CDS at a higher price, and thus, was one of the actors who had gained benefits via these exchanges. See Hosli et al. (2011a).
The negative impact of reverting to the Mark would be directly observed in the German labor market and manufacturing sectors:

“Since the advent of the single currency, Germany’s labor costs have fallen more than 15 percent against the average labor costs of all the countries using the euro, and about 25 percent against those of the troubled nations on the periphery. If it dumped the euro for a new deutsche mark, its exchange rate would surge to make up for the difference, potentially crippling its exports, which have fed most of its economic growth over the last decade”.


In essence, if Germany reverted to its old national currency or the euro were dissolved, Germany’s currency exchange rate would increase and thus eliminate its current advantage in exports. In short, the economic benefits brought by the single currency calculated above have crucially decided Germany’s positions, as The New York Times summarizes, “the German government knows it must ultimately cave and open its wallet to save the single currency” (Porter 26 June 2012, The New York Times).

In comparison, France’s benefits from the euro and then the ESM are dwarfed by those gained by Germany, and in a certain sense, Germany has made profits from all other euro countries. France’s Industry Minister Arnaud Montebourg once openly complained the comparatively low wages in Germany: “Germany has a giant export surplus over its trading partners and that is a fact,” and “German industry has created for itself a competitive advantage by keeping a lid on pay raises. This situation, this imbalance, is not sustainable economically. It is indeed dangerous” (“French Minister Says German Wages Need to Rise to Help Euro Zone”, Reuters, 16 April 2013). Some economists agree that “the generally low wage growth in Germany over the past decade has contributed to the imbalances that have exacerbated the euro zone’s sovereign debt crisis,” and it is reported that from 2007 to 2011, the average wage growth rate in Germany was 1% while the figure for the whole euro area was 2.7% (“French Minister Says German Wages Need to Rise to Help Euro Zone”, Reuters, 16 April 2013). Obviously, there is an asymmetrical benefit distribution of the single currency and then the ESM agreement, and thus LI (H7b) correctly predicts that national asymmetrical interdependence to the ESM determines the relative bargaining power of the nation states: Germany, who economically benefits the most from the

---

147 See also Petersen et al. (2013).
ESM, has compromised the most on the margin (e.g. France’s demands in the Deauville Deal, France’s growth pact proposal, and southerners demanding for easing the accessions to the ESM fund) so as to realize its core interests (a permanent bailout fund for the euro countries complemented by a Fiscal Compact of strict budgetary rules and an automatic correction mechanism at the national level of the euro states). Meanwhile, those who benefit the least from the strict accession to the ESM, for instance, Italy and Spain who have to pay much higher and almost unsustainable interest rates for government securities, have imposed conditions and made hard bargains (see the fifth round of interstate bargains in Figure 7.1). Such a hard bargain is also well predicted by LI, as the strategy used by the Italian and Spanish Prime Ministers falls into the category of 6a: vetoing a proposal in Figure 3.2. Additionally, that the TSCG goes without the UK and the Czech Republic illustrates the strategy of 6c in Figure 3.2, as Germany and France finally opted for an intergovernmental Treaty excluding the “recalcitrant” governments. All those prove the explanatory and predictive power of the LI model, and the validity of H7b in the case of the ESM also confirms Proposition 22, which, of course, shall remain ever open to further research and empirical tests.

As for H7c, the formation of the ESM reflects the will and interests of the big member states (Germany and France in particular) rather than the supranational entrepreneurship, not only because EU entrepreneurs rarely possess information or expertise unavailable to the euro states to form the ESM — the predecessor EFSF, concluded by the eurozone countries as a private company, was already in operation, offering experience for the ESM contracting parties — but also because Germany and France are the number one and number two contributors to the loans to Greece. It is interesting to observe that among the six rounds of interstate bargains as illustrated in Figure 7.1, the fifth round is probably the hardest interstate bargain for Germany as Merkel made several concessions, where Italy and Spain, the number three and number four contributors to the EFSF and the ESM, successfully forced Germany to accept their demands. This not only shows a linkage between capital contributions (which is based on the economic power) and the voice rights and political influence, which has already been asserted by Proposition 11 in Chapter six, but also suggests the importance of forming coalitions to increase individual party’s negotiating power. To sum up, H7c is confirmed while other causal mechanisms can be added to H7c:
**H7\textsubscript{c}\textsubscript{extended}:** The EU’s new measures and policies to solve the euro area sovereign debt crisis tend to reflect big countries’ will rather than supranational entrepreneurship, because EU entrepreneurs rarely possess information or expertise unavailable to the member states; the amount of financial contributions to the new measures and policies, which is proportionate to member states’ economic powers, decides each member state’s political influence and bargaining power over the formation of the new measures and policies — the measures and policies concerning only EMU countries tend to reflect Germany’s and France’s national interests, which, however, can be challenged by a coalition of other EMU member states, particularly by the coalition forged by Italy and Spain.

**H7\textsubscript{c}\textsubscript{extended}** as well as Proposition 11 implies that the scenario of Franco-German dominance on EMU affairs will not get changed easily but is not impossible — forming a coalition is an effective means, and the decisive factor contributes to the current Franco-German leadership is the economic power of the two member states. In general EU affairs, the UK, together with Germany and France, has a great say (e.g. the establishment of the ESRB, see Table 6.7); since the ESM concerns the euro countries only, Germany and France can go with their decisions without the participation of the UK. Taking the situation of the sovereign debt crisis into consideration, the economic power of any other (euro) member states seems most unlikely to challenge Germany’s number one status in the foreseeable future. Obviously, according to Figure 7.1, Germany has played a leading role in the formation of the ESM, and only the coalition of the southerners and France could successfully challenge Germany’s dominating power, as the fifth round of interstate bargains in Figure 7.1 illustrates. So from another perspective, to make an alliance with France was crucial to secure Germany’s national interests, and the Franco-German or German-French compromises shall be the prominent pattern for EMU affairs in the foreseeable future. Nevertheless, Germany tends to exert more leverage than France in their bilateral relationship, as it is described that in the Deauville Deal, “Sarkozy knuckled under to Merkel’s demands that investors be made to pay for buying the wrong countries’ bonds”, which “marked the end of German-French parity in handling the crisis”; after the Deauville Deal “the balance shifted continually toward Berlin” (Neuger 19 March 2013, *Bloomberg*). A nation state’s political leverage is closely related to its economic power, and France’s relatively declining political weight was due to its economic slide. This suggests that crises also offer the possibility to reshuffle economic power distributions and
consequently political clout within the EU system; however, the eurozone sovereign debt crisis this time appears to further have strengthened Germany’s leading role while weakening France’ and other euro countries’ political influence on EMU affairs. Anyhow, according to Tables 7.2 and 7.3 and Figure 7.1, from the Deauville Deal to the final formation of the ESM, Germany has successfully materialized its core interests, while France’s proposals outlined in the Deauville Deal were almost totally abandoned (e.g. the QMV progressive sanction mechanism and voting rights suspension), and even the growth pact offered by new French President Hollande as a counteract to Merkel’s fiscal pact of budget discipline was generally regarded as only “a symbolic victory for Hollande” (“Insight: Merkel and Hollande — Building a ‘Grand Bargain’, Reuters, 10 July 2012). Though Germany repeatedly made concessions, the interstate bargain results represent Germany’s will and interests (i.e. setting up a permanent rescue mechanism with PSI and CACs together with a fiscal compact with stricter budgetary rules and automatic-triggered national deficit correct mechanisms for euro countries) more than France’s and that of other euro countries. We will see whether Germany’s dominating role in EMU affairs gets further strengthened or not in the future.

As shown in Figure 7.1, throughout the spanning of several rounds of intergovernmental negotiations, the core interests of Germany have not been changed and moreover, finally got materialized, though Germany has made several concessions to the demands of other ESM contracting parties. Figure 7.1 exhibits Germany’s tactics and strategies to secure its core interests: (1) formulating package deals (i.e. binding strengthening the SGP rules and establishing a permanent rescue mechanism together, binding the ESM with the insolvency procedure involving PSI and CACs), (2) building a coalition with France, (3) making concessions on the margins to other euro states in exchange for the establishment of the ESM and stricter fiscal rules, and (4) also meeting the demands of the domestic opposition (e.g. insisting on a default mechanism coming along with the bailout mechanism, promoting a financial transaction tax, and promising the adoption of the Growth Pact to stimulate economic recovery) to gain their support to the ESM and the TSCG. From the Deauville Deal in October 2010 to the EU summit of 29 June 2012, Merkel’s repeated concessions did not go without strong criticisms from both the German citizens and politicians; nevertheless, the final formation of the ESM demonstrates a diplomatic victory for Merkel, because accompanying the placement of the ESM, “she has received a pair of important
trade-offs”: the fiscal pact and the growth pact — a second thought will see Merkel’s compromises are “pretty clever”: “a clever retreat to secure greater gains” (Rickens 29 June 2012, Spiegel Online). As a matter of fact, the tactic to meet the demands of the domestic opposition is tricky. According to Reuters reports, before the EU summit of 29 June 2012, Merkel and Hollande had already reached an agreement in Paris on a possible direct bank bailout by the ESM with a single and centralized supervision mechanism of the European banks (i.e. the Bank Union with a Single Supervisory Mechanism (SSM)), but “they kept the pact secret”, because Merkel’s side feared that the leaking of this deal might add extra difficulties for Merkel to secure the two-thirds parliamentary majority votes on the ESM and the Fiscal Compact two days later; anyhow, Merkel “had to show German lawmakers and the public she was being tough” (“Insight: Merkel and Hollande — Building a ‘Grand Bargain’, Reuters, 10 July 2012).

Though the German economy is the number one in the euro area and it seems that Germany always plays a leading role in EMU affairs, it still needs to take other eurozone countries’ demands into account; more realistically, the German government alone cannot secure enough support for its proposals, and consequently, it pragmatically tends to ally with France, the number two in the euro area. Forming a coalition with France has twofold effects: in one respect, Germany gains France’s support and then German interests gets guaranteed, and in another respect, the southern member states which tend to have different positions shall lose France’s support, and thus it becomes much harder for southerners to challenge the German-Franco decisions. Figure 7.1 also reveals the essence of German interstate bargains: swapping marginal interests to secure the core national interests. Based on those analyses and taking (6a), (6b) and (6c) into consideration, another proposition can be added to the second stage of the LI model:

Proposition 23: Interstate bargains consist of (several rounds of) national interest swaps and compromises; negotiating parties can make use of various strategies to secure their national interests the most, such as (a) offering package deals, (b) forming an alliance with other powerful parties, (c) making concessions in the marginal interests in exchange for support for core interests, (d) meeting certain demands of domestic opposition, (e) threatening to veto, (f) withdrawing from financial commitments, and/or (g) excluding recalcitrant negotiators.

Table 7.3 and Figure 7.1 suggest that forming a coalition with France was crucial for Germany to achieve its goals. Meanwhile, the road to the formation of the ESM has
been made up of several rounds of interstate bargains, which challenge the unitary nature of “interstate bargains” proposed by the LI model. In addition, Germany’s core interests and its basic baseline in negotiations have reflected the German government’s long time policy-orientations: a stable and credible currency, strict budgetary rules and low inflation rates. Meanwhile, France’s propositions on the creation of the ESM have also indicated a policy continuity of the French government: increasing governmental spending to stimulate economic growth and thus accepting higher government deficits with higher inflation rates. Consequently, regarding their attitudes towards the southern debt-ridden countries, Germany made strongly demands on budgetary cuts with austerity measures, while France possessed a lenient position tinted with sympathy to the southerners, and as a counter to Germany’s Fiscal Compact, France tabled a growth pact. Due to each government’s particular policy traditions, German-French cooperation or compromises would repeat history, and similar German-French packages would on the one hand express a German stickiness to stricter budgetary discipline while on the other hand would convey France’s growth obsessions. As pointed out by Spiegel, Merkel’s fiscal pact and Hollande’s growth pact is similar to the case of the negotiations for the Amsterdam Treaty in 1997, and at that time, German “Chancellor Helmut Kohl insisted on a stability pact for the soon-to-be-introduced euro”, while in exchange for France’s support, “the freshly elected French Prime Minister Lionel Jospin, a Socialist like Hollande, received a pact aimed at creating jobs and growth”; the comments go on: “‘That is nothing new. EU summits have promised similar packages … dozens of times over the years’. And this year once again” (Volkery 27 June 2012, Spiegel Online). Two points can be drawn from this: first, the core interests of a nation state tend to be stable and not easily changed, and current national policies are rooted in government policy traditions; second, since the formation of the single currency, the German-French style of interest swaps to gain mutual support defines the general framework of EMU. The first point can be restated as follows:

Proposition 24: National core interests are the bottom line of interstate bargains, which tend to be unwavering during negotiations while exhibiting national policy tradition over time.

The second point, together with the previous analyses for H7b and H7c_{extended}, implies the following:
Proposition 25: The eurozone sovereign debt crisis further strengthens Germany’s leading role while weakening France’s political leverage in EMU affairs; nevertheless, Germany must form a coalition with France so as to materialize its national interests. Consequently, on the one hand, the new EMU policies and measures tend to start from and/or end at the merger and/or compromise of the propositions of the two core euro states, which normally are characterized by a German-French style of stricter v.s. lessened fiscal rules and of budgetary cuts v.s. spending growth emphases; on the other hand, Germany tends to make concessions to France’s demands, but the negotiation results tend to represent Germany’s national interests more than France’s due to asymmetrical national economic powers.

Proposition 24 stresses the resistant nature of core interests to get changed during intergovernmental negotiations as well as over time — an assertion and confirmation of HI, while Proposition 25 can be regarded as a specification and further elaboration of H7b and H7c extended.

7.2.3 Evidence for H7d, H7e and H7f: Institutional Choice (LI Stage 3)

Though the first two cases are not suitable for LI analyses, this dissertation will also check to what extent the third stage of the LI model is applicable to EU daily decision-making. Table 7.4 presents the case study results in line with the LI model in Figure 3.2.

<table>
<thead>
<tr>
<th>Purposes</th>
<th>Factors contributing to institutional designs</th>
<th>Forms of sovereignty delegation</th>
<th>Means to guarantee domestic commitments</th>
<th>Non-compliance caused by high costs for powerful domestic actors</th>
</tr>
</thead>
<tbody>
<tr>
<td>The European Semester</td>
<td>(7b) to provide information for governments to estimate other actors’ future preferences and behavior; (7c): by setting up rules to</td>
<td>(8a): the severity of enforcement problems of the SGP rules; (8d)*: the necessity of addressing</td>
<td>(9a): to only set up norms and procedures with the purpose of “pure coordination” and reducing the transaction costs for determining a</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
reduce coordination costs and monitor governmental non-compliance; issues of coordination and surveillance from the EU/macro level with a holistic approach; common solution; economic interests of the member states and the whole EU (cf. Table 5.3); national parliaments have the final say on national budgets and the implementation of CSRs; CSRs by the Council follows “comply-or-explain” principle, as no legally binding decisions shall be adopted under the European semester; so “non-compliance” requires further examination. There are a low implementation rates of the CSRs, “as for 2012 only 15% of the recommendations had been carried out” ①. Nevertheless, “the majority of the key challenges addressed are unlikely to be overcome in a single year”, which require “the continuity of reform efforts over time”, and a final assessment will be delivered in 2014 CSRs ②. Moreover, it is assessed that compliance in the eurozone is higher than that in the non-euro area, “[y]et, it is impossible to ascribe this to the European Semester as very significant market pressure
| The ESRB | √ | (7c): by setting up rules to reduce coordination costs and monitor governmental non-compliance; | √ | (8c): the future states of the world; (cf. Table 6.25) | X | (9c)*: to establish a new EU body to serve the interests of both member states and the whole EU, delegating national sovereignty via a simple majority and/or two thirds of the votes cast or other forms of voting module; (cf. Table 5.4) | X | (10c)*: soft tools at the macro level without legally binding powers and being subject to national implementation, which nevertheless are indispensable and beneficiary to micro level prosperity; (cf. Table 6.6 and Table 6.19) | NATN+FR | Till January 2014, only one follow-up report is available: *ESRB assessment of the implementation of Recommendation ESRB/2011/1 on lending in foreign currencies*, and the overall level of national implementation is high: no member state falls into the category of “non-compliant”, only Bulgaria is classified as “partially implementing”, while other 26 member states are evaluated as being “fully or largely compliant”. ③ (cf. Table 6.19) |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| The ESM | √ | (7a): to help governments to reduce the transactions costs of future interstate negotiations on the same issue; 7(d)*: via establishing new mechanisms to give member states substantial support so as to | √ | (8c)*: the future states of the world and the international discourses. (cf. Table 6.25) | X | 9(d)*: to found an intergovernmental institution among (parts of) EU member states, using the existing EU institutions, being subject to the ECJ judicial power, and choosing sovereignty delegation form of unanimity, qualified majority | √ | (10c): strengthening the domestic groups that support the operation of the ESM (vis-à-vis other domestic forces favoring non-compliance) so as to help nation states to cope with globalization; (10f)*: national | NATN+FR | On 31 December 2013, Spain, the first ESM beneficiary state, successfully exited the ESM financial assistance programme (€41.3 billion in total) for recapitalizing the country’s banking sector, which means Spain has meet all policy conditionality attached to the |
| meet global challenges. | and/or simple majority. | parliaments as both guarantors of domestic commitments and a power checker for national executives. | assistance; ④ The second country covered by the ESM is Cyprus: on 8 May 2013, the ESM agreed an FFA to Cyprus, and by the end of 2013, four times of disbursement had been released in accordance with the Cypriot government’s fulfillment of the conditions set out in the MoU. ⑤ |

Notes: “√” indicates that the concerned aspects fall into the categories/predictions of the LI model presented in Figure 3.2; “X” means the concerned are out of the categories/predictions of the LI model; “*” suggests there are new modifications to and developments of the LI model based on the case studies; “NATN” stands for “not applicable till now (at the end of 2013)”, and the concerned are still subject to the tests of the EU empirical developments in the coming days; “FR” represents “further research”, which deserves a separate detailed study.

Sources: ① European Parliament-20121019BKG54051 (20 January 2014); ② European Commission-SWD(2013) 800 Final (13 November 2013); ③ ESRB Recommendation on Lending in Foreign Currencies (ESRB/2011/1) Follow-up Report – Overall Assessment (November 2013); ④ See “Spain’s Exit” (ESM); ⑤ See “ESM Financial Assistance for Cyprus” (ESM); ⑥ Hallerberg et al. (September 2012).

Table 7.4 shows that the first two cases fall into the LI prediction to a certain degree, and it also points out the potential weakness of the LI model in accounting for the recent development of the EU projects to meet the demands of increasing economic interdependence and integration: policy coordination and surveillance from the supranational level with holistic approaches to serve national economies and the interests of the whole EU — a tendency has been stated in Propositions 19 and 21. The new factors derived from the case studies — (8d), (9c), (10d) and (10e) — can be taken as supplements to the possible situations that LI may encounter in the future. The LI model’s validity and power, however, get better confirmed and clarified by the case of the ESM. Table 7.4 displays that among the five items checked, LI has largely accounted for the ESM in three aspects, with one out of LI expectations (i.e. forms of
sovereignty delegation) and one requiring further tracing and research (i.e. non-compliance caused by high costs for powerful domestic actors). Accordingly, new theoretical developments are derived from the case study of the ESM: first, 7(d) underscores the necessity for the EU to have substantial, concrete and effective measures in place rather than general and unspecified EU Treaty prescriptions, fulfilling some vacuums of the EU integration project which have been exposed and acerbated during the crisis; second, the extension of (8c) emphasizes the impact of the external environment and world-wide general practice over EU development — a point has already been elaborated by neo-functionalism (see H5d); third, 9(d) adds another possible form of sovereignty delegation to the LI repository, implying different speeds of the integration pace among EU member states; fourth, (10f) supplements the means to guarantee domestic commitments via strengthening national parliament involvement in the new measures, which shall enhance national democratic accountability in both guaranteeing credible domestic commitments and checking national executives; finally, the checking of the relationship among national non-compliance, high costs and powerful domestic actors’ interests evolves over time, suggesting LI’s resilience and its historical point of view, the changeable environment and the uncertainties in the EU project. In short, H7d and H7e can be modified as follows:

**H7d modified**: In order to solve the debt crisis, nation states make institutional choices to delegate and pool sovereignty to EU supranational institutions and/or intergovernmental institutions among (part of) EU member states so as to guarantee the credibility of intergovernmental commitments, and the latter may cause differentiated integration speeds among EU member states.

**H7e extended**: Member states’ credible commitments can be guaranteed and realized via strengthening the national executive, the national judicial branch, the national parliament and/or the very domestic groups that support the policy in the first place vis-à-vis other domestic forces favoring non-compliance.

The case of the ESM confirms the validity of H7d in the way that first, it is an intergovernmental institution concluded by the ESM member states; second, ESM member states delegate their sovereignty to this new intergovernmental institution (instead of EU supranational institutions): the ESM Board of Governors and Board of Directors via the voting modes of unanimity, qualified majority or simple majority — a different situation out of the prediction of (9a) and (9b) of the LI model; third, any ESM grants are accompanied by strict conditionality, and till the end of 2013 the two
assistance ESM programmes to Spain and Cyprus have not witnessed national defections from the agreed national commitments in carrying out reforms. As regards H7e, a new element is added: securing credible national commitments via strengthening national parliaments (though it has twofold effects), which has been vividly illustrated by the German Parliament’s approvals of the ESM and TSCG (see Table 7.3). The fact is that the Bundestag “already has the right to vote on whether a country should receive ESM aid” (Wittrock 10 September 2012, Spiegel Online).

Finally, it is noticeable that among the five sub-propositions of “institutional choice” illustrated in Figure 3.2 and Table 7.4, the aspects of institutional designs (cf. H5d) and non-compliance caused by high costs (cf. H3) have illustrated the convergence of the two traditionally competing European theories — neo-functionalism and intergovernmentalism — at HI. Nevertheless, the different orientations of the two grand theories are also obvious: neo-functionalism emphasizes institutional restraints on national commitments based on transaction-theory (e.g. H3), while LI stresses specific domestic actors’ determination on national commitments (e.g. national executives, courts, parliaments, and/or certain domestic interest groups). Nevertheless, the bases where the integration theories build up their theoretical frameworks are the same: economic activities and interactions among the European nation states.

7.2.4 Evidence for H7g and H7h: Two Limitations to the LI Model
H7g and H7h set up two limitations for the application of LI. To check the validity of the two sub-hypotheses, this dissertation first presents a summary on the explanatory and predictive power of the LI model regarding the three selected case.
Table 7.5 Summary of the Explanatory and Predictive Power of the Three Stages of LI

| Checking the three stages (1-11) and the LI hypotheses presented in Figure 3.2 |
|---------------------------------------------|---------------------------------------------|---------------------------------------------|
| Stage 1: National preference formation (1)-(3); H7a | Stage 2: Interstate bargains (4)-(6); H7b and H7c | Stage 3: Institutional choice (7)-(11); H7d, H7e, and H7f |
| The European Semester | The ESRB | The ESM |
| NSC | NSC | NSC |
| (1) X; (2) X; (3) √; MND: (1c)*; (2d)*; (3d)* | (1) √ (1a); (2) √ (2a); (3) √; MND: (2a)*; (2d)*; (3d)* | (1) √ (1a); (2) √ (2a) and (2b); (3) √ (3a) and (3b); MND: (1d)*; (2c)*; (3b)* |
| (1) X; (2) X; (3) √; MND: (1c)*; (2d)*; (3d)* | (4) √ (4a) and (4b); (5) √ (5a); (6) √ (6a) and (6c) | (7) √ (7a); (8) √ (8c); (9) X; (10) √ (10c); (11) NATN+FR; MND: (7d)*; (8c)*; (9d)*; (10f)* |
| (7) √ (7b) and (7c); (8) √ (8a); (9) √ (9a); (10) X; (11) NATN+FR; MND: (8d)*; (10d)* | | |
| Hypothesis Test Results | | |
| H7a: rejected; H7b: NA; H7c: NA; H7d: rejected; H7e: rejected; H7f: NATN+FR | | |
| Notes: “√”: falling into the categories and the predictions of the LI model; “X”: out of the expectation and categories of LI; “*”: modifications or new developments based on the case studies; “NSC”: not a suitable case for an LI study, but a tentative attempt to apply the LI model to account for EU daily decision-making; “NA”: not applicable; “MND”: modifications and/or new developments; NATN: “not applicable till now (at the end of 2013)”, which remains to be checked by the EU empirical developments in the future; “FR”: “further research”. |
The summary above indicates the following:

First, the LI model appears not to explain EU daily decision-making well. Though part of the elements in LI Stage 1 and Stage 3 can account for the cases of the European Semester and the ESRB, the two cases nearly reject all the three sub-hypotheses (H7a, H7d, and H7e) while indicating several out-of-LI-prediction situations (see “MND” (modifications and/or new developments) in Table 7.5). The rejection of H7a, H7d, and H7e by the European Semester, however, is accounted for by the LI scope condition H7g, while the confirmation of H7a and rejection of H7d and H7e by the ESRB suggest the validity of the other scope condition of H7h: Commission President Barroso exerts influence on the establishment of the ESRB, because national governments lack critical information, expertise and the legitimacy that the Commission nevertheless can provide. From such a perspective, LI, though failing to account for EU daily decision-making, is a rigorous theory as the two scope conditions safeguard the most suitable cases for LI examination. Nevertheless, the two limitations (i.e. H7g and H7h) appear not fully to account for the failures of the hypothesis tests by the two cases. Proposition 21, derived from the case studies of the European Semester and the ESRB, can be added to the LI model as another new scope condition, as the issues addressed by the two cases indicate potential new topics and situations LI may deal with in the future; accordingly, the “MNDs” based on the case studies of the two measures can be integrated into the LI model illustrated in Figure 3.2.

Second, as for the ESM which was finalized by several rounds of intergovernmental bargains, the LI model works well to explain the creation of the ESM: H7a, H7b, H7c and H7e are confirmed, while H7d is partially confirmed, leaving H7f for further research as the situation indicated by H7f has not happened yet. The extension of H7c and H7e and the modification of H7d suggest the new rising situations falling out of LI’s predictions as well as possible supplements to the LI model illustrated in Figure 3.4. As Table 7.5 shows, except (9) (which leads to \( H7d_{\text{modified}} \)) and (11) (which remains open for further tests), the case of the ESM falls into all other LI explanatory and predictive categories, with several new propositions developed from the case studies, which supplement and should be integrated into the LI model. All those newly added elements and propositions, as part of the LI model, also are subject to empirical tests of the ongoing EU developments. As for the two limitations of the application of LI, the ESM confirms both H7g and H7h: for the
former, the ESM exhibits a mode of national preference formation based on producers/investors vis-à-vis taxpayers and regulators; for the latter, the ESM is an intergovernmental institution concluded by hard interstate bargains, and EU leaders (e.g. Barroso and Van Rompuy) and the Commission, the ECB and other EU bodies have exerted influence because some parts of the formation of the ESM need their expertise and the legitimacy that the individual member states do not have, such as making Treaty revisions to lay down the legal basis for the creation of the ESM and the finalization of CACs. Barroso, Van Rompuy and the Commission played the role of facilitating intergovernmental negotiations and helping materialize the agreements reached by the national governments (see Table 6.6), and Table 7.3 and Figure 7.1 show that national governments are the core actors and deciders of the formation of the ESM. Moreover, another scope condition is derived from the case study of the ESM — Proposition 22, which points out the possible situation where not all member states participate in an interstate bargain (i.e. block-ins v.s. block outs), connoting different relevance and weights of importance of the agreement concerned to each member state as well as differentiated integration speeds among EU member states (see H7d_modified).

To sum up, the two scope conditions of the LI model demonstrate its theoretical rigor. Though the European Semester and the ESRB are not suitable cases for an LI analysis (and consequently, they almost disconfirm all the LI hypotheses), some elements of the LI model do appear effective to explain the two cases. Meanwhile, representing the new developments after the 2008 crisis, the two cases shed light on the potential topics and situations that may impose challenges to LI in the future, and the new elements and propositions, including two new scope conditions Propositions 21 and 22, derived from the two cases’ studies (e.g. Table 7.5) can be viewed as valuable supplements to the LI model illustrated in Figure 3.4. In comparison, the ESM forged by intergovernmental bargains is a suitable case for an LI examination. The research results show that the LI model works well to account for the EU’s recent developments: among the six LI sub-hypotheses, only one (H7d) is partially confirmed and another will be evaluated through the evolving time (which suggests an HI perspective). In addition, two hypotheses (H7c and H7e) get extended, one modified (H7d) and four extra Propositions (22-25) are formulated via the case study of the ESM, among which Propositions 21 and 22 are newly derived scope conditions for the application of LI. All in all, the ESM demonstrates intergovernmental bargains as well as national leaders’ rational choices, that is, their rational calculations on both the economic benefits and
political implications of the euro countries’ financial stability as well as the EMU project (see sections “7.2.1” and “7.2.2”), and H7 as a whole is almost fully confirmed by the ESM. Moreover, the ESM enlarges the spatial dimension of the LI model. Originally, H7 presents a simple process of decision making by intergovernmental negotiations:

![Diagram of the LI Model]

Figure 7.2 A Simple Steady Process of the LI Model

The ESM, however, exhibits an extended and more elaborated flow from Stage 1 to Stage 3:
Rational choices of national leaders

National preference formation (stage 1) → Interstate bargaining (stage 2) → Institutional choice (stage 3)

Compromises and interest swaps
More than one round of bargains (stage 2', 2'', 2''', …)

Modifying, adjusting and even redefining national preferences (stage 1', 1'', 1''', …)

The core national interests tend to be stable and difficult to get changed throughout the negotiation processes.

Compromise, national interest swaps and/or forming a coalition with other member(s) are necessary during bargains so as to secure the (core) interests the most.

Figure 7.3 An Elaborated Process of the LI Model
According to Figure 7.3, interstate bargains concerning the same issue may occur again due to new rising situations, and both institutional choice finalizations and national commitments evolve over time, displaying dynamics as well as uncertainties in the EU integration process (see Figure 7.1). The global context (such as the financial crisis of 2008) would influence the development of the EU, and the eurozone sovereign debt crisis triggered by the financial crisis, as a matter of fact, pushed the recent institutional establishments and reforms of the EU (see Table 1.2). The post-2008 crisis era spurred national leaders and supranational institutions to make rational choices to safely drive the EU from the crisis; consequently, the crisis imposed challenges, which at the same time also offered an opportunity for the EU to develop and reform — a point of view which has already been stated in chapter six on neo-functionalist studies (see Propositions 4 and 9). Moreover, Figure 7.3 and Figure 6.17 show the convergence of the neo-functionalist and LI case study results: the efforts and choices made by the elites (i.e. subjective initiatives), and the EU’s interaction with the external world (i.e. the objective environment). The proposition of “rational choices made by national leaders” in H7 highlights the fact that the EU is also propelled by the elites, particularly when confronting a sudden and severe crisis which requires decisive and swift response. Though uncertainties persist in the future, one thing is sure: the trend of European integration is irreversible, and various efforts are expected to save the achievements of the EU and EMU.

### 7.3 Evidence for H8: Impact of Exogenous Shocks from an LI Perspective

In accordance with the analysis after the formation of H8 in chapter three, this section shall check whether the post-2008 crisis era (the eurozone sovereign debt crisis in particular) caused EU substantive reforms or incremental policy–making changes suggesting a “European constitutional settlement”. Following the elaboration of section 3.7.6, the test of H8 suggests the following indicators:
Table 7.6 Substantive Reforms or Incremental Changes?

<table>
<thead>
<tr>
<th>Substantive reforms? (Three indicators)</th>
<th>Incremental changes? (Two indicators)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indicator 1: Developing and improving policies outside the current EU institutional framework? (Cf. Tables 6.6 and 6.22)</td>
<td>Indicator 4: Strengthening the Council and/or the EP?</td>
</tr>
<tr>
<td>Indicator 2: Changing the scenario that member states rule the EU by quasi-consensus? (Cf. Table 7.1)</td>
<td>Indicator 5: Deepening and/or enlarging certain EU policies?</td>
</tr>
<tr>
<td>Indicator 3: Changing the scenario that the fiscal, administrative, and coercive powers have been decentralized to the nation state level? (Cf. Tables 6.1 and 6.19)</td>
<td></td>
</tr>
</tbody>
</table>

The European Semester

| No; | No; | No; |
| First proposed by the Commission in May 2010, then approved by the Council on 7 September 2010 and then finalized in Regulation (EU) No 1175/2011 via the OLP on the basis of the TFEU. | National parliaments have the final decisions on member states’ budgets, economic policy legislation, and the implementation of CSRs. (Cf. Table 5.3) | Yes; |

The EP’s involvement in the European Semester is gradually strengthened over time (②, pp.23-24). Initially, the first Communication (COM(2010) 250 Final) only suggested that the EP should be “appropriately engaged” in the final stage of the formulation of the CSRs. The second Communication (COM(2020) 367/2) proposed the EP’s involvement at the beginning of the process, where the AGS shall be presented to the EP for internal debate and orientations ahead of the Spring EU summit. So during the first Semester cycle in 2011, the EP had very little institutionalized involvement, but throughout 2011, the EP played an important role in strengthening EU economic governance and influenced the new mechanism mainly in two ways (see Table 6.12), among which the European Semester and the Economic Dialogue were codified in the “six-pack”. As a mechanism bringing various surveillance elements under the same umbrella, the European Semester enlarges EU policy coordination and surveillance,
Semester, indicating a risk of softening the CSRs as well as quasi-consensus by the member states.

| The ESRB | Yes; (see Tables 5.4 and 7.1) | No; This new EU body’s mission, objectives and tasks, according to ESRB Regulation Article 3, have nothing to do with the fiscal, administrative, and coercive power distributions between the EU and the member states. Rather, it provides necessary and supportive macro-level surveillance, warnings, and recommendations to the micro-level economic activities and such as the surveillance of macroeconomic imbalances (see section 5.2.1). | Yes; The ESRB is held accountable to both the EP and the Council. (See ESRB Regulation; Table 6.12). | Yes; It brings the scattered macro-prudential supervision at the national level together and fills the vacuum of an integrated EU-wide macro-prudential oversight mechanism (see Table 6.19). The de Larosière Report makes a clear suggestion of “towards stronger coordinated supervision – macro-prudential and micro-prudential. Building on existing structures” (p.4), |

Via the OLP, the ESRB was established by REGULATION (EU) No 1092/2010.
The establishment of the ESRB means to “upgrade macro-prudential supervision in the EU for all financial activities” (p.44).

| The ESM | Yes; The permanent ESM is an intergovernmental institution concluded by the euro countries rather than an EU body set up by EU Treaties, and it becomes viable only after Treaty amendments. | No; First, the ESM is not an EU body, but it makes use of the existing EU institutions such as the Commission, the ECB and the CJEU; Second, the ESM Board of Governors and Board of Directors rule the ESM via the modes of unanimity, qualified majority and simple majority as specified in the ESM Treaty, so in some cases, it changes the quasi-consensus scenario. Nevertheless, in reality, ESM financial assistance to a euro state might be a part of an assistance package of intergovernmental and international negotiations (e.g. the case of the ESM assistance to Cyprus), and an | Yes; The beneficiary states must implement reforms laid down the MoUs as conditions to receive the ESM assistance. | Yes; The EP is not involved in the ESM, but the Council, together with the Commission, is responsible for the ESM post-programme surveillance (ESM Treaty. (17)) | Yes; It provides as well as fills the vacuum of a permanent rescue mechanism for the euro countries, which is modelled on the basis of its precursor — the temporary EFSF. |
ESM assistance is subject to national parliament approval, such as by the German Bundestag.

Sources: ① European Commission-MEMO/12/386 (30 May 2012); ② Hallerberg et al. (September 2012); ③ Regulation (EU) No 473/2013.

In light of Table 7.6, the European Semester shows incremental changes rather than substantive reforms, and so does the ESRB with the exception that the voting rules adopted by the ESRB change the consensus scenario. The peculiarity of the ESM is that it is not an EU body but an intergovernmental institution established by only part of the EU member states. On the one hand, the ESM represents a substantive reform as the ESM was established via Treaty amendments, and it also enables the decentralized fiscal, administrative and coercive powers of the beneficiary states to be subject to the ESM conditionality at a more centralized level (to the degree of carrying out economic reforms and implementing reducing-budget-deficit measures agreed in the MoUs), but it does not change the quasi-consensus practices as the assistance package to the beneficiary states is still hammered out via (hard) intergovernmental and international negotiations; on the other hand, the ESM indicates an evolution from the temporary financial backstop — the EFSF — to the permanent crisis resolution mechanism. As a consequence, H8 is not fully confirmed by the three cases, but the ESRB and the ESM do exhibit certain features of substantive reforms and the latter confirms H8 in the aspects of indicators 1 and 3. At the same time, all the three cases present evidence for incremental changes in terms of indicator 4 and 5, which in another way around, supports LI’s assumption of a “European constitutional settlement”, that is, when reaching at a certain plateau, the EU shall move along with incremental changes rather than substantial reforms like those once brought by the creation of the single market and the single currency. As a result, the ESM represents both a substantive reform as well as an incremental change, and the latter aspect also indicates policy learning and continuity from the previous practice of the EFSF — a historical point of view.

Evidence for incremental changes indicated by the three cases and the OLP to adopt the first two measures suggests that the EU has developed a stable and comparatively “mature” institutional framework to solve the crisis — a constitutional settlement claimed by LI. Treaty revisions, even being a prerequisite to the creation of the ESM, have been carried out in accordance with EU institutional procedures.
prescribed in the Lisbon Treaty. The adoption of the three new measures follows the already laid-down EU rules and procedures, exhibiting the resilience and stability of the EU institutional framework when confronting the severe crisis. Still, several explanations are needed to clarify the indicators of substantive reforms. First, “the current EU institutional framework” in indicator 1 can mean two things: one refers to the rules and working procedures of the EU, while the other can indicate the concrete operative EU institutions and bodies, such as the Commission and the ECB, and this dissertation defines the “institutional framework” in the first sense.¹⁴⁸ Second, as for indicator 2, the evolution of QMV in the Council via EU Treaty revisions (see section 2.5.1 and Table 6.23) actually has changed the legal basis for the EU and its member states to make decisions and adopt policies; nevertheless, the quasi-consensus scenario in practice appears unchanged in the decision-making patterns under the European Semester — even though the causal mechanism remains to be further clarified (see section 7.1) — and the ESM. Two kinds of discrepancies are observable: the first one is the discrepancy between the rules that lead to the adoption of the new measures (e.g. the legal basis provided by the EU Treaties) and the rules that shall operate under the new measures;¹⁴⁹ the second discrepancy is related to the rules governing the new mechanisms on paper and those in practice. Judging from EU legalistic rules to adopt the European Semester and the ESRB, the OLP means changes to the unanimous voting mode in the Council, but anyhow consensus scenarios are still present (see Table 7.1); while judging from the rules adopted by the concrete measures, the decision-making patterns prescribed in the three new mechanisms imply deviations from consensus decision-making, but in practice, the European Semester and the ESM still resort to the quasi-consensus ruling.¹⁵⁰ This dissertation, as Table 7.6 suggests,

¹⁴⁸ If the EU’s institutional framework is explained in the second sense, then both the European Semester and the ESRB would say “Yes” to the first indicator of the substantive reforms; even with those confirmations, both cases still lack evidence for the second and third indicators. This dissertation regards the two senses of “institutions” as two layers of the EU institutional framework, with the former being more substantial and invisible, while the latter is more superficial and observable. So this dissertation sticks to the first sense.
¹⁴⁹ Such a discrepancy has been encountered and addressed by the neo-functionalist analysis in chapter 6, see tests for H1 and H4.
¹⁵⁰ As regards the European Semester, the EU’s surveillance of budgetary policies started from the SGP laid down by the Council Regulation (EC) No 1466/97 of 7 July 1997 by QMV in the Council, according to which the Council shall deliver an opinion on the Commission’s recommendations on the broad guidelines in accordance with Article 103 (TEU, 92/C 191/01) by QMV; with the effectiveness of Regulation (EU) No 1175/2011, the Council, in accordance with Article 121 TFEU,
defines “the current EU institutional framework” (indicator 1) as the EU’s institutional rules of decision-making rather than any concrete institutional body, while it also prescribes the subjects of indicator 2 and indicator 3 as the rules operating under the new measures in empirical practice rather than on paper, or rather than the EU decision-making rules leading to the adoption of the new measures. Accordingly, among the three new measures, only the ESM meets indicator 1 as a creation outside the current EU institutional framework, while in practical operation, both the European Semester and the ESM display discernible quasi-consensus decision-making — a national control scenario. All in all, H8 is confirmed by the ESM in two aspects (out of three) of substantial reforms, while it gets full and partial rejections from the European Semester and the ESRB, respectively. Those confirmations and rejections, in one respect, justify LI’s proposition of EU constitutional settlement and possible substantial reforms due to unforeseen exogenous shocks, while in another respect, they prove that crises can also be opportunities, for incremental changes or for substantive reforms. In addition, the case studies show that the EU’s recent developments do not challenge much of LI’s assumption of the national control scenario over the core national issues, but a crack on the national control over their fiscal activities (which are expected to remain national) has been signaled by the operation of the ESM.

7.4 Evidence for H9: LI Assumptions on a Salient EU Issue Increasing the Turn-Out Rate of the EP Election (a Preliminary Analysis)

As the analyses after the formation of H9 in chapter three have pointed out, H9 shall be tested after the EP election in May 2014. What can be done in this dissertation is to check whether the on-going sovereign debt crisis has become a salient EU issue in the minds of the European citizens.

also shall act with QMV defined by Article 238(3)(a). As for the operation of the ESRB, the actual vote casts are not available.
Q: What do you think are the two most important issues facing (OUR COUNTRY) at the moment? (Max. 2 Answers)

Figure 7.4 a) Top Concerns of European Citizens-% EU①

①Q: What do you think are the two most important issues facing (OUR COUNTRY) at the moment? (Max. 2 Answers)

Figure 7.4 b) Top Concerns of European Citizens-% EU②

②Q: What do you think are the two most important issues facing (OUR COUNTRY) at the moment? (Max. 2 Answers)
Q: And personally, what are the two most important issues you are facing at the moment? (Max. 2 Answers)

Figure 7.4 c) Top Concerns of European Citizens-% EU

Q: And personally, what are the two most important issues you are facing at the moment? (Max. 2 Answers)

Figure 7.4 d) Top Concerns of European Citizens-% EU

Notes: * Aggregated data of energy related issues (9%) and protecting the environment (5%).
According to Figure 7.4 a), in the course of 2013, the most important two things in the mind of the European citizens at the national level were unemployment and the economic situation — two direct impacts of the sovereign debt crisis — with the former registering at 49% in the autumn of 2013 with two percentage points lower than the figure in spring 2013 (51%). As for the concern rate of 49% of unemployment, it is “the first time this item has lost ground since the Standard Eurobarometer of spring 2011, EB76” (Standard Eurobarometer 80, 11). Compared with these figures in the course of 2008 before the EP election in 2009, concerns of unemployment in autumn 2008 took the third place, counting 26%, while inflation and the economic situation were listed as top one and two issues, both marking 37% (see Figure 7.4 b)). At the personal level, according to Figure 7.4 c), the top concerns of the European citizens are inflation and unemployment, reaching 40% and 20% in the autumn of 2013. In comparison, when the same survey was carried out in October-November 2008 for the first time by the Eurobarometer, the top two personal concerns were rising prices (50%) and the economic situation (23%) due to the influence of the global financial crisis, and at that time, the concerns for unemployment made up of 14%, ranking the fifth place after the concerns for the health system and pension. Therefore, in 2008, the European citizens regarded rising prices/inflation and the economic situation as the most important issues at both the personal and national level, while the EP election turnout rates, amid the global economic recession, continuously declined in 2009 (45% for the 27 member states) since 1979 (of 66% for the 9 member states) (e.g. Lelieveldt and Princen 2011, 120-121), so this dissertation rules out the causal relationship between citizens’ concerns for inflation and the economic situation and a higher EP turnout rate in the logic of H9. Observing the changing ranks in Figure 7.4, this dissertation proposes a causal chain between people’s concerns for unemployment and the turnout rate of the EP election. The rationale is as follows: in recent years, due to the on-going eurozone sovereign debt crisis, the unemployment records registered worse during 2009 to 2012 across the EU (see Table 6.17 and Figure 6.12), while the issue of unemployment tops the list of people’s concerns for their country, far ahead of the economic situation, and at the same time, it ranks the second for the most two important things at the personal level; so unemployment can be regarded as a salient
issue in the minds of the Europeans, and this dissertation assumes that people also understand the unemployment situation is directly caused by the on-going sovereign debt crisis, and in such a way, the sovereign debt crisis can be regarded to have become a salient EU issue to the EU citizens.

However, the empirical test for H9 in the future may also need to take other factors into account, among which a new institutional rule was introduced by the Lisbon Treaty: the EP is entitled to elect the president of the Commission from the “top candidates” of the EU-level political parties entering the 2014 campaign (cf. Article 17(7) TEU) — a factor might “reverse the familiar pattern of low turnouts” (Stratulat and Emmanouilidis September 2013, 1). Moreover, the salience of the sovereign debt crisis may also unleash negative campaigns and more protests against European integration, which “could consolidate the bloc of populist Eurosceptic lawmakers in the next European Parliament” (Stratulat and Emmanouilidis September 2013, 1). Besides, according to an *EP Eurobarometer Summary* (EB77.2) (21 May 2012), public opinion towards the ways of tackling the crisis has exhibited a clear difference between the euro countries and the non-euro member states. So the general EP election turnout can be divided into two sub-categories: the turnout in the euro countries and in the non-euro countries. Finally, other conceptual factors and trends may play a role in accounting for the test results of H9. For example, as for the survey question in 2013: “My voice counts in the EU?”; less than a third of the Europeans have considered that their voices do count in the EU, while the disagree rates keep rising, going up from 52% in 2004 to 66% 2013 (Standard Eurobarometer 80, 7). The research about the turnout of the 2014 EP election is interesting and multifaceted, and so far, this dissertation can only offer a preliminary analysis for the test of H9.