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## Explaining Informal Policy-Making Patterns in the Eurozone Crisis: Decentralized Bargaining and the Theory of EU Institutions

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### ABSTRACT

During the Eurozone crisis, the so-called 'Merkozy duumvirate' emerged as an informal, but highly visible EU policy-making pattern. This article asks why such forms of decentralized bargaining emerge and what this implies for the theory of EU institutions. According to an approach based on negotiation theory, the article argues that Merkozy is a strategic tool used by Germany to realize its preferences on EU crisis management. Based on an incomplete contracts theory of EU institutions, instead, the article analyses Merkozy as an informal institution created by France and Germany to avoid being discriminated by supranational institutions. Both approaches are employed to assess Merkozy's role in the decision-making process leading to the adoption of the Fiscal Compact.

### KEYWORDS

EU decision-making;  
institutional change;  
Merkozy; negotiation theory


### Introduction

During the Eurozone crisis, particular informal policy-making patterns emerged in the EU. This regards, among others, new forms of decentralized bargaining and, most prominently, the so-called 'Merkozy duumvirate'<sup>1</sup>. The label 'Merkozy' refers to the tight relationship between the German Chancellor Angela Merkel and the former French President Nicolas Sarkozy, who engaged in sustained coordination beyond the traditional limits of the Elysée Treaty. While the Franco-German coordination in EU policy-making as such is certainly not new, the high visibility of 'Merkozy', the intensity of cooperation, and the claim to steer the EU decision-making process at the time is unprecedented (Schild, 2013).

This article aims at explaining the emergence of such informal and decentralized policy-making patterns like Merkozy, given that the main theory social scientists currently employ to study international organizations (IOs) does not provide an explicit explanation for them. According to neoliberal institutionalism, institutions exist because they mitigate informational problems inherent in international and decentralized bargaining (Broz, Frieden, & Schultz, 2009; Keohane, 1984; Milner & Moravcsik, 2009; Pollack, 2003). Therefore, such highly institutionalized setups as the EU should be necessary and possibly sufficient to promote inter-governmental

cooperation on all matters covered by the corresponding treaties, and perhaps also various germane ones. IOs are a solution, and perhaps *the* solution; they should not be a problem. Yet, the politics of EU crisis management contrast sharply with the theory. Far from being deemed necessary and sufficient to resolve the crisis, formal institutions of centralized bargaining were seen as a problem to be resolved. Thus, policy-making patterns like Merkozy create a puzzle for IO theory: why did some countries resort to informal and decentralized bargaining if there already existed institutions that allowed them to propose and adopt the measures they pushed for? Were the existing institutions more an obstacle than a means to solve the problems that European leaders faced? If this is the case, then the current theories of European integration and the role of IOs might need to be amended.

Hence, this article asks two questions: *Why did the 'Merkozy duumvirate' emerge? What does its emergence imply for the theorizing on EU institutions and institutional change?* Based on the work of Adrienne Héritier (see Heidbreder, 2017; Jensen & Tatham, 2017; Héritier, 2017; all this volume), two different approaches are used, which both appear particularly suited to explain the puzzle. The first approach is based on the rationalist negotiation theory (Héritier, 1999). In this respect, Merkozy is considered to be an instance of a typical negotiation strategy employed by Germany: By striking

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<sup>1</sup>Other prominent decentralized institutions used in the crisis management were the 'Task force' of ECOFIN ministers headed by EUCO President Van Rompuy, and the so-called 'Frankfurt Group'.

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a deal with one or a few crucial actors already ahead of multilateral negotiations, a powerful actor can accelerate the negotiations, pool power resources, and emphasize her own preferences within the pursuit of a final agreement. The second approach relies on incomplete contracts theory. This functionalist institutionalist approach posits that Merkozy is a decentralized, informal institution (Farrell & Héritier, 2003) which is a reaction to the increasing uncertainty caused (rather than mitigated) by the centralized institutions and which occurred in a moment when quick and effective decisions needed to be reached.

The article's primary contribution thus consists of the elaboration of two theoretically informed explanations of informal and decentralized policy-making in Europe. It thereby addresses a gap in the literature: even the latest prominent attempt of theorizing new modes of policy-making in Europe does not address the role of informal ad-hoc institutions, although it puts decentralized policy coordination and informal governance at the center of its analysis (Bickerton, Hodson, & Puetter, 2015).<sup>2</sup> Theoretically, the article adds to the existing literature by relating approaches based on negotiation theory (Héritier, 1999) to the role powerful actors can play in the causation of institutional change (Héritier, 2007, pp. 40–66) and regional integration (Mattli, 1999). Moreover, it is shown that centralized bargaining certainly mitigates some kinds of uncertainties—as relevant theorists of IOs argue—but it also creates new ones. Empirically, the contribution concerns the research on EU policy-making. By examining the Merkozy duumvirate, the article aims at explaining one of the central decision-making modes which emerged during the crisis. The analysis is based on newspaper articles, original documents such as government statements, summit conclusions, and drafts of negotiating agreements, as well as 16 semi-structured interviews with closely involved officials<sup>3</sup> at the EU institutions in Brussels and the German Ministry of Finance in Berlin.

In the remainder, the two theoretical approaches are first presented, before they are applied separately to Merkozy and its role in shaping the Fiscal Compact (FC). In the conclusion, the theoretical and empirical implications are drawn.

## A bargaining perspective: Strategic pre-negotiations

With regard to EU policy-making, Héritier (1999) has shown that actors use informal strategies and policy patterns ('subterfuge') to circumvent formal institutional rules which otherwise would make them end up in stalemate. Transferred to an individualistic perspective, these findings suggest that by using informal strategies, a single actor might achieve individually better outcomes than by relying on formal institutions. However, given that the use of strategies requires resources, strategies cannot be employed by any actor at any time, but are a privilege of the most powerful.

Power is based on resources. They can be differentiated into material, institutional, and ideational resources (Krotz & Schild, 2013). Material resources can be of military or economic nature. Institutional resources refer to procedural rights of decision-making, such as agenda management, veto rights, or executive competences. Ideational resources, finally, comprise information, credibility, and legitimacy. The article posits that actors translate these resources into strategies in order to reach an agreement in their interest.

To this end, powerful actors can either try to shape the preferences of the others ('providing common knowledge'), or they can take them as given and employ negotiation strategies to find a common agreement ('enhancing collective action') (see Table 1).

The first set of strategies (*Providing Common Knowledge*) is of special importance in the early phases of policy-making. In the context of politics, 'common knowledge' is understood as a collectively shared set of beliefs about which policy instrument works best in a certain situation. A group's collective knowledge can be unsettled by exogenous events like crises. In these cases, uncertainty

**Table 1.** Strategies.

Providing common knowledge	Enhancing collective action
Problem definition	Agenda management
Presentation of new ideas	Arena-shifting
Promotion of new ideas	Coalition-building
	Leading by example

Reference: Own illustration

<sup>2</sup>Bickerton et al. (2015) suggest the broad category of 'de novo institutions', but these are neither informal nor ad hoc.

<sup>3</sup>The authors ensured anonymity to all interviewees. Of the 16 interviewees explicitly referred to in this article, 8 were Heads of Unit (HoU) in the Commission, Council, national ministry, or Permanent Representations, 7 occupied positions higher than HoU level, and 1 interviewee was an administrator of the Commission. They were all 'closely involved' in the sense that they carried out one or more of the following activities related to the Fiscal Compact, which is the empirical scope of this article's case study (see below): drafting of conclusions, negotiation agreements and/or treaty texts, 'translating' the general agreement struck by the heads of states into the concrete treaty text, supporting the President of the European Council, assisting in the coordination of the negotiations at several levels, advising the Commission on the Fiscal Compact, communicating the Commission's position on the Fiscal Compact, participating in the negotiations on the treaty text, preparing or representing a member state's negotiating position.

risers and the group suffers a pressure for adaptation. A powerful actor can provide new common knowledge by exposing the drawbacks of the status quo, coming up with new interpretations and ideas, and promoting them as solutions to the defined problems (Schofield, 2002).

The second set of strategies (*Enhancing Collective Action*) serves to “solve or circumvent the collective action problems that plague the efforts of parties seeking to reap joint gains in processes of institutional bargaining” (Young, 1991, p. 285). Agenda-management can be differentiated into agenda-setting, -structuring, and -exclusion (Tallberg, 2006). Through agenda-setting, the zone of agreement can be widened, which is the case when package deals or side-payments are made. Agenda-structuring concerns the sequence different issues or proposed solutions are dealt with. Agenda-exclusion refers either to the subtraction of a particularly divisive issue from the agenda or to the exclusion of possible solutions.

Arena-shifting, or the mere threat of doing so, can also help powerful actors to reach an agreement in their interest (Héritier, 1999, 2007). This does not necessarily require that an alternative arena exists. Actors can also create new arenas by altering the decision-making rules or the eligible participants (Eberlein & Radaelli, 2010). This is closely related to coalition-building: A powerful actor can facilitate the finding of an agreement by adding parties which have interest in a settlement or subtracting those which do not (Lax & Sebenius, 1986). Unilateral action “is exercised whenever one moves to solve a collective problem by one’s own effort, thereby setting the pace for others to follow” (Underdal, 1994, p. 183). ‘Leading by example’, finally, refers to the attraction and co-optation of others to the own way of doing things: either the others switch to the more powerful actor’s policy because it is less costly for them, or the powerful actor contributes resources to a common project, thereby signaling credible commitment (Hermalin, 1998).

In reality, these ideal-typical strategies are frequently combined or merged (e.g. Eberlein & Radaelli, 2010). This article conceptualizes one such combination which is of special relevance in the context of EU politics: *strategic pre-negotiations*.<sup>4</sup> The basic idea is to start negotiations outside the central arena with a few crucial actors in order to shape a compromise which can subsequently be presented to others in the central negotiations.

This kind of anticipated and decentralized bargaining combines the advantages of arena-shifting and coalition-building: if it is expected to be difficult or impossible to reach an agreement in the central arena, the issue(s) can be moved to another arena where the participants are selected according to their importance for a final agreement. This group of participants can strategically be altered by adding or subtracting parties. Thereby a strong coalition can be formed already prior to the actual negotiations. Thus, once an agreement has been reached in this second arena, the chances are considerably higher that it will be accepted also by the remaining parties in the central arena.

A ‘pre-negotiated’ deal function like an already evolved agenda: it structures the negotiation, facilitates the communication and coordination among the parties (which is especially important in larger groups), and already has the support of a significant proportion of the contracting parties. As a consequence, it accelerates the negotiations and increases the prospects of a final agreement. The time-saving effect of pre-negotiations is especially valuable in times of crisis, when swift reactions are normally more important than under ordinary circumstances. In summary, “prenegotiations [...] reduce the transaction costs of complex multilateral negotiations and thus provide efficiency gains” (Schild, 2013, p. 36).

At the same time, pre-negotiations offer considerable gains to the actor employing them. By co-opting one or more crucial actors ahead of the actual negotiations, power resources can be pooled and subsequently be used in the central negotiations. This provides more leverage in the central bargaining, be it due to institutional advantages such as a greater voting weight, or due to the increased capacity to compensate potential losers. Finally, pre-negotiations allow powerful actors to ‘split up’ their opponents into more bargaining rounds instead of facing them *en bloc*.

## An incomplete contracts theory of EU institutions

This section seeks to contribute to explaining the emergence of decentralized, inter-governmental institutions, such as the Elysée treaty and Merkozy, in an institutional environment characterized by the presence of a strong network of supranational institutions like the EU. This approach is not intended to be a substitute to the IO theory,

<sup>4</sup>Strategic pre-negotiations, and especially those between France and Germany, are not a new phenomenon in EU politics (e.g. Janning, 2005; Krotz & Schild, 2013; Webber, 1999). According to a bargaining perspective, which is the first of the two theoretical approaches put forward by this article, Merkozy, despite its unprecedented public salience and dominance in EU crisis management, is one instance of such pre-negotiations. The contribution consists of conceptualizing these pre-negotiations based on rationalist bargaining theory (Héritier, 1999, 2007), and showing that this provides a proper analytical tool to analyze the emergence of Merkozy in EU crisis management.

but rather a complement to account for the emergence of ad hoc institutions. Whereas the IO theory answers well why IOs are created, and correctly insists on the far-reaching implications of the fact that contracts between two or more states are never detailed enough to take into account all possible future contingencies, it does not offer much in terms of analyzing actual IOs' behavior. To the extent that the new ad hoc institutions aimed precisely at correcting certain actual features of the existing institutions, the latter forms part of governments' calculus, and should therefore be integrated into the existing theories of European integration and European institutions.

It is worth pointing out that the underlying definition of 'institutions' is game-theoretical. Following Calvert, institution is understood as "an equilibrium of behaviour in an underlying game [...] It must be rational for nearly every individual to almost always adhere to the behavioural prescriptions of the institution, given that nearly all other individuals are doing so" (Calvert, 1995, p. 60). Note that this definition contrasts, for example, with North's (1990) better known understanding of institutions as humanly devised constraints (or 'rules of the game'). Moreover, "incomplete contracts" are understood as institutions that are "vulnerable to reinterpretation *ex post* in circumstances that were not initially foreseen" (Farrell & Héritier, 2007, p. 289).

The theoretical framework proposed here can be summarized as follows. Two national governments seek to cooperate in a game with mixed motives, whereby (a) trading policies with each other produce certain gains, but (b) outperforming each other is an electorally valuable asset. Anticipating opportunistic behavior from each other, these governments consider delegating enforcement powers to an international body enjoying considerable independence—in the EU context, the Commission. Yet, as Principal-Agent theory suggests (Miller, 2005; Pollack, 2003), autonomy comes with information asymmetry that can be used by the agent to pursue its own policy goals. The enforcer can use its power to discriminate between the governments at the implementation stage. Moreover, the collegial nature of the Commission can make its outcomes inconsistent through time and unpredictable.<sup>5</sup>

Therefore, the trade-off is clear. On the one hand, delegation to supranational institutions is necessary in

order to make commitments credible and allow countries to gain from cooperation. On the other, it introduces uncertainty about future policy outcomes. This may not be a problem when the countries' time horizon is relatively long or the national governments perceive the delegated policy as not salient. However, as saliency increases and the time horizon shrinks, uncertainty becomes more and more costly. Also, not all countries have the same to lose from a crisis. Therefore, it can be expected that some Member States, which have much at stake in a given situation, will perceive as particularly acute the uncertainty related to the Commission's institutional design. In this respect, the Eurozone crisis may be seen as a situation in which some countries wanted to avoid as much as possible an involvement of the EC *both* in the decision-making and in the implementation phase. With regard to the first purpose, decentralized *informal* institutions like Merkozy reduced the uncertainty regarding the negotiation outcomes; regarding the second, decentralized *formal* institutions that restricted the enforcement power of the Commission as a whole, like the FC, also served to achieve the same goal.<sup>6</sup>

### Decentralized bargaining in shaping the fiscal compact

In this section, the two theoretical approaches outlined above are used to explain the emergence of Merkozy in the Eurozone crisis. In order to test the plausibility of the theoretical arguments, the emergence of Merkozy needs to be analyzed in the context of a clear-cut event. The FC is particularly suited for this exercise: compared to other eligible cases, it is relatively short, its beginning and end are easily determinable, and the relevant actors can be clearly identified. Moreover, Merkozy played a pivotal role in its shaping (Schild, 2013).

The FC<sup>7</sup> is an intergovernmental treaty outside EU law, which was agreed upon at the European Council of 8/9 December 2011. The negotiations on the details took place in the 2 months after, so that the treaty could have already been endorsed at the European Council of 30 January 2012. It was formally signed on 2 March 2012 by all EU MSs except the UK and the Czech Republic. The signatories commit themselves to a budget which is balanced or in surplus. In order to

<sup>5</sup>According to Arrow's impossibility theorem, if the preferences of the members of a voting body display a modicum of diversity, then majority voting needs not generate a transitive ordering of the alternatives available for choice; rather, the alternatives cycle, even though individual preferences are coherent. Indeed, incoherence will often take the form of the non-existence of a collectively 'best' alternative, and the final outcome will therefore be arbitrary (Hinich & Munger 1997). It follows that neither the individual members of the voting body nor outside observers (in this case, national governments) can know the results before the occurrence of the vote.

<sup>6</sup>See also Merkozy's attempt to appoint a super-commissioner in charge of the Euro (Karagiannis & Guidi, 2014).

<sup>7</sup>Formally: 'Treaty on Stability, Coordination and Governance in the Economic and Monetary Union'.



**Table 2.** Germany's economic power resources in 2011.

	GDP		Government bond yields (10 years)	Current account balance		Gross public debt
	Million EUR	% of EU-17	%	Million EUR	% of GDP	% of GDP
<b>Germany</b>	<b>2,699,100</b>	<b>27.7</b>	<b>2.61</b>	<b>164,550</b>	6.1	77.9
France	2,059,284	21.1	3.32	-21,245	-1.0	85.2
Italy	1,603,857	16.8	5.42	-50,387	-3.1	116.4
Spain	1,075,147	11.0	5.44	-34,040	-3.2	69.2
Netherlands	642,929	6.6	2.99	58,579	<b>9.1</b>	61.3
Belgium	379,915	3.9	4.23	-4,067	-1.1	102.0
Austria	308,675	3.2	3.32	5,058	1.6	82.1
Greece	207,752	2.1	15.75	-20,634	-9.9	171.3
Finland	196,869	2.0	3.01	n/a	n/a	48.5
Portugal	176,167	1.8	10.24	-10,616	-6.0	111.1
Ireland	171,042	1.8	9.60	n/a	n/a	111.2
Slovakia	70,160	0.7	4.45	-3,497	-5.0	43.4
Luxembourg	42,410	0.4	2.92	2,461	5.8	19.1
Slovenia	63,868	0.4	4.97	84	0.2	46.5
Cyprus	19,487	0.2	5.79	n/a	n/a	66.0
Estonia	16,404	0.2	n/a	222	1.4	<b>6.0</b>
Malta	6903	0.1	4.49	n/a	n/a	69.7
<b>Euro Area (EU-17)</b>	<b>9,748,036</b>	<b>100.0</b>	<b>4.34</b>	<b>n/a</b>	<b>n/a</b>	<b>86.0</b>

Reference: Own illustration.

reach that goal they agree on an automatic correction mechanism established by their national law at a constitutional or equivalent level. The implementation of the provisions is to be monitored by independent national institutions.

### *Merkozy as recurrent strategic pre-negotiations*

According to a bargaining approach as outlined above, Merkozy is an instance of a negotiation strategy employed by a powerful actor. In the context of the FC, Germany used the cooperation with France as a strategic tool to realize its preferences on crisis management, namely a new treaty which shifts the adjustment costs of the crisis to the national level. The validity of this argument relies on the premise that Germany indeed has a dominant position in the Eurozone that allows it to unilaterally employ negotiation strategies to further its ends. Moreover, it needs to be shown that the FC was actually a case in which Germany assumed a pro-active role and employed strategies to realize its goals.

As outlined above, power resources can be distinguished into material, institutional, and ideational resources. Germany's power in the Eurozone relies primarily on its economic resources. The most important

indicator for material resources in the context of the crisis is the aggregate GDP because it determines the capacity to contribute to financial stability in the Eurozone. However, also a MS's refinancing options (government bond yields), its savings potential (current account balance), and its long-term solvency (gross public debt) are relevant. Table 2 shows Germany's superiority in terms of economic power resources at a glance. In 2011, it had the largest GDP in the Eurozone, the lowest interest rates for its debt (decreasing trend), and the biggest current account surplus in absolute terms. Although the debt level of 77.9% was much less impressive, it was still lower than the Eurozone average of 86.0%.<sup>8</sup>

These superior economic resources have an amplifying effect on Germany's institutional and ideational resources. As regards institutional power, Germany's formal resources in the European Council do not exceed those of other MSs because decisions are taken by consensus. Although Germany's formal voting weight in the Eurogroup and ECOFIN Council exceeded those of most other MSs, also in these fora "there is a strong sense to come to joint, common solutions" (Interview 15). This de facto unanimity rule in combination with its economic resources vests Germany with huge institutional power: As a high-level official in Brussels put it: "Germany

<sup>8</sup>The relatively sound public finances in Germany are often traced back to the role of ordoliberalism as guiding principle of German economic policy. However, a closer look reveals that the concepts of ordoliberalism and stability culture do not necessarily determine the German policy as such, but are rather used rhetorically in a strategic manner to legitimize a certain policy whenever this appears to be useful (Howarth & Rommerskirchen, 2013). When it is detrimental, instead, Germany itself has often not followed ordoliberal principles: in 2003 it not only violate the Stability and Growth Pact (SGP), but also halted the application of the Excessive Deficit Procedure; in 2005 it succeeded in relaxing the same rules it had promoted 8 years earlier; and in 2008 and 2009 it reacted to its economic crisis at home by adopting two voluminous stimulus packages instead of implementing austerity measures. At present, Germany's debt level of more than 70% considerably exceeds the limits of the SGP and its huge current account surplus even fosters instability in the Eurozone. Nevertheless, ordoliberalism remains a strategic resource if it comes to the legitimization of German preferences in the Eurozone (Bulmer, 2014).

practically has a veto on whatever is happening at present. And if they don't like it, they don't take it. So you need to rewrite, and rewrite, and rewrite, until the Germans are in agreement" (Interview 13; also Interviews 10, 11).

As regards ideational resources, Germany has roughly the same information and expertise as other MSs. Its credibility, instead, is higher than that of the other MSs because of two different sources. First, the high credibility Germany enjoys in the capital markets is essential to the stability of the common currency. Second, the strong roles of the German Parliament and the Constitutional Court function as a credible commitment at the European level (Interviews 3, 15, 25). Also, as regards legitimacy, Germany was perceived to have the biggest claim to a hearing among the MSs because of its economic weight (Interview 2; Spiegel & Schäuble, 2011). In sum, on all three types of resources, Germany scores the same or higher than the other MSs.

With regard to Germany's use of strategies, the FC largely reflects German priorities and would not even have been on the agenda without Germany strongly pushing for it (Ludlow, 2012a). Since this article focuses particularly on strategic pre-negotiations, only some of Germany's most important strategic moves are highlighted in the following.

Most notably, the German government made use of arena-shifting. By bringing the issue directly to the level of the heads of state and government, the Commission and the European Parliament were circumvented and the signal effect of the legal provisions was considerably strengthened (Ludlow, 2012b). Moreover, when it turned out that the UK would veto a Treaty change, Merkel shifted the arena again by pushing for an international treaty outside EU law (Beach, 2013; Crossland, 2011). As regards agenda-managing, Germany made the financial assistance of the ESM conditional on the ratification of the FC and included the French demand for formal 'Euro summits'. It thus managed to ensure the signature of those MSs which were skeptical with regard to further budgetary restrictions (Interviews 10, 11; Beach, 2013). Furthermore, the German government provided common knowledge: Already in August 2011, Germany and France proposed the incorporation of a 'debt brake' into national constitutions (Bundesregierung, 2011b). In the months after, Germany used all its diplomatic weight to promote the idea: German ambassadors approached the respective governments in the MSs, bilateral meetings took place at all levels,

all possible fora were used to promote the idea of a debt brake (including the IMF and the G7), and the chancellor herself met her colleagues to promote the FC (Interviews 15, 26; Rinke, 2011). In summary, Germany has a dominant position in the Eurozone and used strategies to shape the FC. Thus, the empirical premises for analyzing Merkozy as an instance of strategic pre-negotiations are given.

Especially within the institutional setting of the EU, pre-negotiations play a crucial role (Janning, 2005). With regard to the Franco-German case, it has been pointed out that pre-negotiated deals are particularly effective when the two MSs do *not* share preferences: In this case, they have to compromise, whereby the resulting deal covers a larger range of the other MSs' preferences and is therefore more likely to result in a final agreement (Webber, 1999). In the remainder of this section, it is shown that Merkozy was indeed an instance of this strategy.

The idea of a Fiscal Pact provided ideal conditions for the use of strategic pre-negotiations with France. Although "there was a collective recognition" (Interview 15) that such a signal was needed to calm the markets and stabilize the Eurozone, France was very skeptical at the beginning. Instead of stricter budgetary rules, it would have preferred a rather discretionary '*gouvernement économique*' and the mutualization of risk as firewalls against the markets (Interviews 1, 5, 7, 8, 25, 27; Beach, 2013; Schild, 2013). Hence, Germany and France had divergent preferences, which is why a pre-negotiated deal was an effective means for Germany to push through the desired treaty without getting stuck in the negotiations.

Already the first step was made together with France by writing a joint letter to Van Rompuy in August 2011 (see above). For supporting the idea of a 'debt brake', France was compensated by including the codification of 'Euro summits' into the treaty (Schild, 2013).<sup>9</sup> The Euro summit statement of 26 October 2011, where the Eurozone leaders formalized their summits and agreed on the adoption of 'debt-brakes' in national legislations, was based on this Franco-German compromise (Beach, 2013; European Council, 2011a).

Three days before the decisive European Council in December, the German Chancellor repeated the strategy. On 5 December 2011, she met the French President in Paris (Crossland, 2011). This time the aim was different, though. First, it was becoming evident that the UK would veto a treaty amendment. Thus, Germany needed the French support for a treaty outside EU law without the

<sup>9</sup>By most MSs, the Fiscal Compact was perceived as the counter-price for Germany joining the ESM (Interviews 8, 25). However, Germany and France agreed on a permanent rescue fund (ESM) already at their Deauville deal in October 2010 (Schild, 2013). The Fiscal Compact, in contrast, was put on the agenda by Germany only later. France was initially very skeptical and gave its support only in August 2011 (Schild, 2013) after Germany accepted to formalize regular Euro summits in the same treaty.

UK. Second, based on his mandate to prepare a report on treaty amendments, Van Rompuy was working on own plans how to reform the Eurozone. These plans differed considerably from the German preferences and included the already overruled Eurobonds, a banking license for the ESM, and an alternative legal path instead of Treaty amendments (EurActiv, 2011; Ludlow, 2012a; Wittrock, 2011). Thus, Germany needed to secure French support also against Van Rompuy's initiative. In fact, when the President of the European Council presented his proposal 2 days before the summit started, Germany and France replied within only 1 day by releasing a joint letter, rejecting Van Rompuy's ideas and outlining their own position (Bundesregierung, 2011a; Ludlow, 2012a). In summary, the second Franco-German meeting in the preparation of the FC was not about finding a compromise between the two big MSs, but about pooling power resources in order to circumvent the UK's veto and to side-line the President of the European Council.

The enormous impact of this second Franco-German initiative on the negotiations and their outcomes corroborates the explanation that Merkozy was actually a strategic tool for the German government to realize its preferences on EU crisis management. As can be seen from Table 3, the joint letter already contains the main elements, partly with identical wording, of the ensuing Euro Area Statement

(European Council, 2011c) and the first negotiation draft of the Fiscal Compact (European Council, 2011b). In contrast, these two crucial documents do not contain the above-mentioned proposals by Van Rompuy. Moreover, the fact that only the codification of Euro Summits is a French preference, while all the other elements reflect German preferences, further strengthens the interpretation of Merkozy as a strategic venue employed by Germany.

Especially the last element listed in Table 3 reveals Germany's impact on the negotiation outcomes through the use of Merkozy. The Fiscal Compact as primary law was an exclusively German preference which originally was neither shared by France nor by other MSs (Beach, 2013; Schild, 2013). Although Van Rompuy, who had the mandate to prepare a basis for negotiation, proposed to realize all changes through secondary law, Merkozy suggested not only treaty change, but in anticipation of a British veto also an international treaty among the Eurozone MSs. The fact that even with regard to this issue, Merkozy's "proposal to our European partners" (Bundesregierung, 2011a, p. 4) prevailed over Van Rompuy's proposal which was backed by the supranational institutions and most other MSs, corroborates the theoretical expectation that pre-negotiated deals can function like already evolved agendas.

**Table 3.** Impact of Franco-German letter on Euro area statement and first draft of fiscal compact.

Franco-German letter of December 7, 2011	Euro area statement of December 9, 2011	First draft of fiscal compact of December 16, 2011
"the adoption by each euro area member state of rules on a balanced budget translating the objectives and requirements of the Stability and Growth Pact into national legislation at <b>constitutional or equivalent level</b> "	"Such a rule will also be introduced in Member States' national legal systems at <b>constitutional or equivalent level</b> "	"The rules mentioned under paragraph 1 shall be introduced in national binding provisions of a <b>constitutional or equivalent nature</b> "
"As soon as a Member State is <b>recognized to be in breach with the 3% ceiling by the European Commission</b> , there should be <b>automatic consequences</b> unless the Eurogroup, acting by qualified majority, decides otherwise"	"As soon as a Member State is <b>recognised to be in breach of the 3% ceiling by the Commission</b> , there will be <b>automatic consequences</b> unless a qualified majority of euro area Member States is opposed."	"The Contracting Parties shall in particular put in place a correction mechanism to be triggered <b>automatically</b> in the event of significant deviations" "the Contracting Parties whose currency is the euro undertake to support proposals or recommendations put forward by the European Commission where a Member State whose currency is the euro is <b>recognised by the European Commission to be in breach of the 3% ceiling</b> [...], unless a qualified majority of them is of another view"
" <b>The European Court of Justice</b> [...] should have the possibility <b>to verify the transposition</b> in the national legislation"	"We recognise the jurisdiction of the <b>Court of Justice to verify the transposition</b> of this rule at national level."	"compliance with the obligation to <b>transpose</b> the "Balanced Budget Rule" into national legal systems at constitutional or equivalent level should be <b>subject to the jurisdiction of the Court of Justice</b> "
" <b>Regular summits—at least twice a year—of the Euro area</b> heads of State and Government with a permanent president. These summits will provide <b>strategic orientations</b> on the <b>economic and fiscal policies</b> in the euro area"	"In particular, regular <b>Euro summits</b> will be held <b>at least twice a year</b> "	" <b>Euro Summit meetings</b> shall take place, when necessary, and <b>at least twice a year</b> , to discuss [...] in particular <b>strategic orientations</b> for the conduct of <b>economic policies</b> [...] in the euro area"
"We propose that those new rules and commitments <b>should be enshrined in the European Treaties</b> . Alternatively, the <b>Member States whose currency is the Euro</b> will have to go ahead"	" <b>The euro area Heads of State of Government</b> consider that the other measures <b>should be contained in primary legislation</b> . Considering the absence of unanimity among the EU Member States, they decided to adopt them through an <b>international agreement</b> "	"The provisions of this Agreement shall apply to the <b>Contracting Parties whose currency is the euro</b> . They may also apply to the other Contracting Parties, under the conditions set out in Article 14"



Finally, while the details of the treaty content were negotiated in January 2012 at the level of high-ranking diplomats and Finance Ministers, Merkel and Sarkozy met several times to discuss the content in parallel to the negotiations (Ludlow, 2012b).

### **Reducing uncertainty: Merkozy and the fiscal compact**

As illustrated above, Merkozy and the FC can be seen as instances of decentralization, in terms of both decision-making (as they reduce the role of the Commission and of the other EU supranational institutions vis-à-vis Member States) and policy implementation (as they reduce the enforcement powers of the Commission and excluding automatic competences of the Court of Justice of the EU). On the one hand, the article argues that Merkozy was ‘set up’ by its two members to reduce the uncertainty of EU policy-making, especially in terms of agenda-setting. On the other, the FC can be interpreted as a means to sideline the Commission (but also the European Parliament) when imposing tougher limits on national budgets. Why did this happen? Following incomplete contracts theory, it is argued that this was due to the nature of EU institutions, and to the particular time constraints that the relevant actors faced in 2011–2012.

The financial crisis of 2008–2009 had turned into a sovereign debt crisis in Europe, with countries like Greece, Ireland, and Portugal that needed to be bailed out between 2010 and 2011, while the situation of much bigger economies like Italy and Spain (whose failure would have most likely meant the end of the Euro as such) was more and more uncertain. EU MSs needed to act quickly in order to restore credibility. It was clear that credibility alone was not sufficient to solve the crisis—indeed, Draghi’s “whatever it takes” of July 2012 was probably more effective than all the legislative and institutional changes of the previous months.<sup>10</sup> However, it must be stressed that without a clear commitment to fiscal discipline from all the MSs, the ECB would have probably been unable to announce the ‘Outright Monetary Transactions’. The perception that the EU was doing “too late and too little” (Fabbrini, 2013) boosted financial speculation and appeared to make a recovery more troublesome.

In line with the theoretical argument presented above, Germany and other countries indeed perceived EU

institutions more as an obstacle than as a useful tool for bargaining a way out of the crisis. As is evident from the interviews conducted by the authors, the EU institutions were perceived as ambivalent and too prone to the interests of ‘Euro-losers’ (see below). For Germany and France, the decentralized institutions, and Merkozy in particular, were a way to ‘neutralize’ extreme positions and to make it impossible for the centralized, collegial institutions to exert excessive influence on the result of the negotiation—which might have been discriminatory for them. Merkozy was, therefore, employed in order to restrict the number of possible outcomes.

The fact that already in June 2010 the European Council delegated the task of drafting proposals for reinforcing the governance of the Eurozone not only to the Commission, but also to a ‘Task force’ composed by the ECOFIN members and the President of the European Council, corroborates this interpretation. As Chang (2013) argued, this was a way to monitor the EC and avoid shirking. Although the ‘Sixpack’ measures were formally decided under the Community method, the influence of decentralized institutions on its development and drafting is not comparable with what normally happens under the ordinary legislative procedure (see Bressanelli & Chelotti, 2016). From the underlying theoretical point of view, the ‘Task force’ was a first attempt to create an informal, decentralized institution in charge of steering the reform process. However, its heterogeneity largely reproduced the pitfalls of the centralized institutions that it was supposed to monitor. Hence it is not surprising that Germany and France soon had recourse to a more cohesive and effective institution.

Moreover, although as an institution it was quite short-lived, as long as the ‘duumvirate’ existed it was rather effective in imposing its own agenda on such diverse matters as the Tobin tax, the super-commissioner for the Euro, the hair-cut on the Greek sovereign debt, the strengthening of fiscal governance. Apart from its role in shaping the FC as described in the previous section, Merkozy set the agenda on a number of other issues: it repeatedly called for strengthening the governance of the Eurozone (coupling traditional French proposals like a European Tobin-tax and regular Euro summits while insisting on fiscal discipline as Merkel wanted)<sup>11</sup>; it proposed ambitious reforms of the structure of the Commission in the form of a commissioner in charge of

<sup>10</sup>In a speech given at a conference in London on 25 July 2012, Draghi stated: “Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough.”

<sup>11</sup>The Guardian, “Sarkozy and Merkel call for ‘true economic government’ to save eurozone”, 16 August 2011, <http://www.guardian.co.uk/business/2011/aug/16/sarkozy-merkel-economic-government-eurozone>. See also Frankfurter Allgemeine Zeitung (‘FAZ’), “Berlin und Paris übernehmen die Führung”, 2 December 2011, <http://www.faz.net/aktuell/wirtschaft/merkozy-berlin-und-paris-uebernehmen-die-fuehrung-11549225.html>; Reuters, “Sarkozy and Merkel’s letter to Van Rompuy”, 7 December 2011, <http://www.reuters.com/article/2011/12/07/us-eurozone-france-letter-idUSTRE7B612Y20111207>.

vetoing national budgets (Karagiannis & Guidi, 2014)<sup>12</sup>; it took a common stance on rejecting the Greek government's proposal of a referendum on the bailout agreement.<sup>13</sup> Though it was not always successful, it undoubtedly monopolized the EU agenda-setting in 2011 and the first half of 2012. For the purpose of this analysis, it is important to highlight that, regardless of its achievements, Merkozy was recognized as an institution, both by the two members and by their opponents.<sup>14</sup>

Turning to the FC, it must be noted that, even though the UK's opposition can explain why the MSs could not choose to change the Treaty on the Functioning of the EU, it does not explain why they chose to adopt an international treaty. According to several accounts, the provisions contained in the FT might have been passed through the Community method (see Kocharov, 2012; Miller, 2012). The choice of adopting an international treaty, rather than EU secondary legislation, was strongly contested by the Commission and by the members of the European Parliament.<sup>15</sup> While it can be questioned whether this makes enforcement more effective, it is evident that the FC was mainly a matter of form rather than substance: the negotiations for the FC and the 'Twopack' proceeded in parallel, and it would have been very simple to adopt most FC provisions as EU secondary law (Interview 33). It was Germany that strongly insisted for having a separate treaty (Interview 11). This interpretation is corroborated by the fact that the Commission, conversely, did not oppose the substance of the FC but only the legal means used (Interview 12).

The FC itself is a *formal* institution whose aim is similar to that of Merkozy and other decentralized institutions (like the 'Task force' headed by Van Rompuy or the 'Frankfurt group'<sup>16</sup>), i.e. limiting the discretion of the Commission. The FC, in particular, limits the Commission's discretion in budgetary supervision, in that it anchors fiscal discipline in *national* law (Interview 6). A general distrust of a group of countries toward the EC in this instance appears as the most rele-

vant explanatory factor. Several interviewees (Interviews 6, 10, 27) pointed out that enforcement at the European level was not considered to work necessarily better than national enforcement, as the former "depends ultimately on the Commission's courage and rigour" (Interview 10). The EC's attitude during the crisis, in particular, had been judged too hesitant and lenient by Germany and other countries (Interview 27).

This lack of trust is evident if one analyses articles from 6 to 8 of the FC, where the Commission is delegated some powers, but with all kinds of limitations and checks. See for instance Article 7, which gives the Commission the power to submit recommendations "where it considers that a Member State of the European Union whose currency is the euro is in breach of the deficit criterion in the framework of an excessive deficit procedure". While the parties commit to implement these recommendations, a qualified majority of them can make the recommendation not binding. Similarly, the EC and the Court of Justice's powers in sanctioning countries for not complying with the treaty obligations are subject to a sort of "authorization" of at least one national government: only "one or more Contracting Parties", and not the Commission, can bring the matter to the Court of Justice (Article 8.1).

As argued above, the 'instability of outcomes' caused by the collegial nature of the EC is, in most cases, beneficial to the MSs, because it guarantees cyclical outcomes and it ensures that no country is permanently discriminated in the long run. This is why a relevant delegation of powers to the EC in almost all the EU policy fields (for instance, the Common Agricultural Policy, Competition Policy, Environmental Policy, and so forth) is perfectly rational according to this logic. These are policies whose decision-making procedure and enforcement is carried out through a sufficiently long period of time. What was different in the sovereign debt crisis was the time constraint: the perception that little time was available and that the solution had to be *immediately* effective. This 'urgency' made those negotiations look like a one-shot game (not a repeated

<sup>12</sup>See also Spiegel Online International, "Battle to Save the Euro: Summit Seen Backing 'Merkozy' Plan—But Then What?", 7 December 2011, <http://www.spiegel.de/international/europe/battle-to-save-the-euro-summit-seen-backing-merkozy-plan-but-then-what-a-802221.html>.

<sup>13</sup>Der Spiegel, "Tough Words: Merkel and Sarkozy Halt Payments to Athens", 3 November 2011, <http://www.spiegel.de/international/europe/tough-words-merkel-and-sarkozy-halt-payments-to-athens-a-795638.html>.

<sup>14</sup>See The Economist, "The driver and the passenger", 15 October 2011, <http://www.economist.com/node/21532283>; The Economist, "Beware the Merkozy Recipe", 10 December 2011, <http://www.economist.com/node/21541405>; The Guardian, "French election could spell end of Merkozy alliance", 22 April 2012, <http://www.theguardian.com/world/2012/apr/22/france-election-end-merkozy-alliance>. Le Figaro, "Le couple «Merkozy» sort gagnant du sommet", 9 December 2011, <http://www.lefigaro.fr/conjoncture/2011/12/09/04016-20111209ARTFIG00683-le-couple-merkozy-sort-gagnantdu-sommet.php>.

<sup>15</sup>See Euractive Press Release, "Verhofstadt on EU summit: 'Eurozone needs action not words'", 31 January 2012, <http://pr.euractiv.com/pr/verhofstadt-eu-summit-eurozone-needs-action-not-words-91988>.

<sup>16</sup>See for instance: "A crisis? Call the F-team", The Economist, 4 November 2011, <http://www.economist.com/blogs/charlemagne/2011/11/euros-frankfurt-group>

one, as is usually the case in EU politics). Having just one shot available, Germany and France needed to be sure that it hit the target.

## Conclusions

According to an approach based on negotiation theory, Merkozy emerged because it was an instance of a particular strategy employed by Germany to further its ends in crisis management: strategic pre-negotiations. By striking a deal with one or a few crucial actors ahead of the negotiations, a powerful actor can reduce transaction costs, accelerate the decision-making process, and increase its leverage in the central bargaining. According to an incomplete contracts theory of EU institutions, in contrast, Merkozy was a decentralized institutions aimed at reducing the unpredictability of outcomes related to the collegial nature of the EC.

Thus, the two approaches elaborated and applied in this article agree that Merkozy served to avoid undesired consequences of central institutions to the advantage of one or a few powerful actors. At a theoretical level, this implies that both informal strategies of policy-making ('subterfuge') and ad hoc institutions of decentralized bargaining are ways of circumventing formal institutions.

Moreover, these results bear implications for the theory of EU institutions and institutional change. Firstly, by relating the entrepreneurial role of powerful actors to bargaining-oriented approaches of EU policy-making, the article adds to the strand of distributive and power-based bargaining theories of institutional change (Héritier, 2007).<sup>17</sup> More precisely, it is argued that the employment of 'subterfuge' strategies (Héritier, 1999) by single powerful actors (here: strategic pre-negotiations in the form of Merkozy employed by Germany) considerably affects the existence, direction, and extent of institutional innovation. The empirical analysis strongly suggests that the FC as it stands today is hardly conceivable without Germany's intense employment of these strategies. Secondly, an approach based on incomplete contracts theory shows that not all 'exchanges of policies' between states are best served by centralized institutions. In particular, the article shows that, independently of whether international regimes economize on transaction costs and make commitments credible, their institutional design matters, and probably does so to a greater extent than liberal institutionalist authors argue. Institutions like the Commission, it is argued, carry with them the in-built uncertainty of organs whose decision-making rule is majority rule with no restrictions on amendments. It

follows that, although such institutions eliminate some kinds of uncertainty, they also generate new ones.

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<sup>17</sup>Héritier (2007) distinguishes between functionalist and distributive (power-based) bargaining theories of institutional change.



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