

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

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1 **Explaining Informal Policy-Making Patterns in the Eurozone**  
2 **Crisis: Decentralized Bargaining and the Theory of EU**  
3 **Institutions**

4  
5  
6  
7

**Abstract**

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

16

17 **Keywords:** EU decision-making, negotiation theory, institutional change, Merkozy

## Introduction

19During the Eurozone crisis, particular informal policy-making patterns emerged in the EU. This  
20regards, among others, new forms of decentralized bargaining and, most prominently, the so-called  
21‘Merkozy duumvirate’.<sup>1</sup> The label ‘Merkozy’ refers to the tight relationship between German  
22Chancellor Angela Merkel and former French President Nicolas Sarkozy, who engaged in sustained  
23coordination beyond the traditional limits of the Elysée Treaty. While the Franco-German coordination  
24in EU policy-making as such is certainly not new, the high visibility of ‘Merkozy’, the intensity of  
25cooperation, and the claim to steer the EU decision-making process at the time is unprecedented  
26(Schild 2013).

27This article aims at explaining the emergence of such informal and decentralized policy-making  
28patterns like Merkozy, given that the main theory social scientists currently employ to study  
29international organizations (IOs) does not provide an explicit explanation for them. According to  
30neoliberal institutionalism, institutions exist because they mitigate informational problems inherent in  
31international and decentralized bargaining (Keohane 1984; Milner & Moravcsik 2009; Broz, Frieden  
32& Schultz 2009; Pollack 2003). Therefore, such highly institutionalized setups as the EU should be  
33necessary and possibly sufficient to promote inter-governmental cooperation on all matters covered by  
34the corresponding treaties, and perhaps also various germane ones. IOs are a solution, and perhaps *the*  
35solution; they should not be a problem. Yet, the politics of EU crisis management contrast sharply with  
36the theory. Far from being deemed necessary and sufficient to resolve the crisis, formal institutions of  
37centralized bargaining were seen as a problem to be resolved. Thus, policy-making patterns like  
38Merkozy create a puzzle for IO theory: why did some countries resort to informal and decentralized  
39bargaining if there already existed institutions that allowed them to propose and adopt the measures  
40they pushed for? Were the existing institutions more an obstacle than a means to solve the problems  
41that European leaders faced? If this is the case, then current theories of European integration and the  
42role of IOs might need to be amended.

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31 Other prominent decentralized institutions used in the crisis management were the ‘Task force’ of ECOFIN  
4minister headed by EUCO President Van Rompuy, and the so-called ‘Frankfurt Group’.

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, two different approaches are used, which both appear particularly suited to explain the puzzle. The first approach is based on rationalist negotiation theory (Héritier 1999). In this respect, Merkozy is considered an instance of a typical negotiation strategy employed by Germany: By striking 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 and 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 in 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 centre 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: 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,

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<sup>2</sup> Bickerton, Hodson and Puetter (2015: 705, 713f) suggest the broad category of 'de novo institutions', but these are neither informal nor ad hoc.

10

68as well as 16 semi-structured interviews with closely involved officials<sup>3</sup> at the EU institutions in  
69Brussels and the German Ministry of Finance in Berlin.

70In the remainder, the two theoretical approaches are first presented, before they are applied separately  
71to Merkozy and its role in shaping the Fiscal Compact (FC). In the conclusion, the theoretical and  
72empirical implications are drawn.

73

## 74 **A Bargaining Perspective: Strategic Pre-negotiations**

75With regard to EU policy-making, H  ritier (1999) has shown that actors use informal strategies and  
76policy patterns ('subterfuge') to circumvent formal institutional rules which otherwise would make  
77them end up in stalemate. Transferred to an individualistic perspective, these findings suggest that by  
78using informal strategies, a single actor might achieve individually better outcomes than by relying on  
79formal institutions. However, given that the use of strategies requires resources, strategies cannot be  
80employed by any actor at any time, but are a privilege of the most powerful.

81Power is based on resources. They can be differentiated into material, institutional, and ideational  
82resources (Krotz & Schild 2013: 22-4). Material resources can be of military or economic nature.  
83Institutional resources refer to procedural rights of decision-making, such as agenda management, veto  
84rights, or executive competences. Ideational resources, finally, comprise information, credibility, and  
85legitimacy. The article posits that actors translate these resources into strategies in order to reach an  
86agreement in their interest.

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113 The authors ensured anonymity to all interviewees. Of the 16 interviewees explicitly referred to in this article,  
128 were Heads of Unit (HoU) in the Commission, Council, national ministry, or Permanent Representations, 7  
13occupied positions higher than HoU level, and 1 interviewee was an administrator of the Commission. They  
14were all 'closely involved' in the sense that they carried out one or more of the following activities related to the  
15Fiscal Compact, which is the empirical scope of this article's case study (see below): drafting of conclusions,  
16negotiation agreements and/or treaty texts, 'translating' the general agreement struck by the heads of states into  
17the concrete treaty text, supporting the President of the European Council, assisting in the coordination of the  
18negotiations at several levels, advising the Commission on the Fiscal Compact, communicating the  
19Commission's position on the Fiscal Compact, participating in the negotiations on the treaty text, preparing or  
20representing a member state's negotiating position.

87To this end, powerful actors can either try to shape the preferences of the others ('providing common  
88knowledge'), or they can take them as given and employ negotiation strategies to find a common  
89agreement ('enhancing collective action').

90Table 1: Strategies

Providing Common Knowledge	Enhancing Collective Action
Problem definition	Agenda-management
Presentation of new ideas	Arena-shifting
Promotion of new ideas	Coalition-building
	Unilateral action
	Leading by example

91 Reference: Own Illustration

92The first set of strategies ('*Providing Common Knowledge*') is of special importance in the early  
93phases of policy-making. In the context of politics, 'common knowledge' is understood as a  
94collectively shared set of beliefs about which policy instrument works best in a certain situation. A  
95group's collective knowledge can be unsettled by exogenous events like crises. In these cases,  
96uncertainty rises and the group suffers a pressure for adaptation. A powerful actor can provide new  
97common knowledge by exposing the drawbacks of the status quo, coming up with new interpretations  
98and ideas, and promoting them as solutions to the defined problems (Schofield 2002).

99The second set of strategies ('*Enhancing Collective Action*') serves to "solve or circumvent the  
100collective action problems that plague the efforts of parties seeking to reap joint gains in processes of  
101institutional bargaining" (Young 1991: 285). Agenda-management can be differentiated into agenda-  
102setting, -structuring, and -exclusion (Tallberg 2006: 24). Through agenda-setting the zone of  
103agreement can be widened, which is the case when package deals or side-payments are made. Agenda-  
104structuring concerns the sequence different issues or proposed solutions are dealt with. Agenda-  
105exclusion refers either to the subtraction of a particularly divisive issue from the agenda or to the  
106exclusion of possible solutions.

107 Arena-shifting, or the mere threat of doing so, can also help powerful actors to reach an agreement in  
108 their interest (Héritier 1999: 20f; 2007: 29f). This does not necessarily require that an alternative arena  
109 exists. Actors can also create new arenas by altering the decision-making rules or the eligible  
110 participants (Eberlein & Radaelli 2010: 789f). This is closely related to coalition-building: A powerful  
111 actor can facilitate the finding of an agreement by adding parties which have an interest in a settlement  
112 or subtracting those which do not (Lax & Sebenius 1986: 228f). Unilateral action “is exercised  
113 whenever one moves to solve a collective problem by one's own effort, thereby setting the pace for  
114 others to follow” (Underdal 1994: 183). ‘Leading by example’, finally, refers to the attraction and co-  
115 optation of others to the own way of doing things: either the others switch to the more powerful actor’s  
116 policy because it is less costly for them, or the powerful actor contributes resources to a common  
117 project, thereby signalling credible commitment (Hermalin 1998).

118 In reality, these ideal-typical strategies are frequently combined or merged (e.g. Eberlein & Radaelli  
119 2010). This article conceptualizes one such combination which is of special relevance in the context of  
120 EU politics: *strategic pre-negotiations*.<sup>4</sup> The basic idea is to start negotiations outside the central arena  
121 with a few crucial actors in order to shape a compromise which can subsequently be presented to  
122 others in the central negotiations.

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

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254 Strategic pre-negotiations, and especially those between France and Germany, are not a new phenomenon in  
26 EU politics (e.g. Janning 2005: 826; Krotz & Schild 2013; Webber 1999). According to a bargaining perspective,  
27 which is the first of the two theoretical approaches put forward by this article, Merkozy, despite its  
28 unprecedented public salience and dominance in EU crisis management, is one instance of such pre-negotiations.  
29 The contribution consists in conceptualizing these pre-negotiations based on rationalist bargaining theory  
30 (Héritier 1999; 2007: 40-66), and showing that this provides a proper analytical tool to analyse the emergence of  
31 Merkozy in EU crisis management.

130A ‘pre-negotiated’ deal functions like an already evolved agenda: it structures the negotiation,  
131facilitates the communication and coordination among the parties (which is especially important in  
132larger groups), and already has the support of a significant proportion of the contracting parties. As a  
133consequence, it accelerates the negotiations and increases the prospects of a final agreement. The time-  
134saving effect of pre-negotiations is especially valuable in times of crisis, when swift reactions are  
135normally more important than under ordinary circumstances. In sum, “prenegotiations [...] reduce the  
136transaction costs of complex multilateral negotiations and thus provide efficiency gains” (Schild 2013:  
13736).

138At the same time, pre-negotiations offer considerable gains to the actor employing them. By co-opting  
139one or more crucial actors ahead of the actual negotiations, power resources can be pooled and  
140subsequently be used in the central negotiations. This provides more leverage in the central  
141bargaining, be it due to institutional advantages such as a greater voting weight, or due to the increased  
142capacity to compensate potential losers. Finally, pre-negotiations allow powerful actors to ‘split up’  
143their opponents into more bargaining rounds instead of facing them *en bloc*.

144

## 145       **An Incomplete Contracts Theory of EU Institutions**

146This section seeks to contribute to explaining the emergence of decentralized, inter-governmental  
147institutions, such as the Elysée treaty and Merkozy, in an institutional environment characterized by  
148the presence of a strong network of supranational institutions like the EU. This approach is not  
149intended to be a substitute to IO theory, but rather a complement to account for the emergence of ad  
150hoc institutions. Whereas IO theory answers well why IOs are created, and correctly insists on the far-  
151reaching implications of the fact that contracts between two or more states are never detailed enough  
152to take into account all possible future contingencies, it does not offer much in terms of analysing  
153actual IOs’ behaviour. To the extent that the new ad hoc institutions aimed precisely at correcting  
154certain actual features of the existing institutions, the latter forms part of governments’ calculus, and  
155should therefore be integrated into existing theories of European integration and European institutions.



156It is worth pointing out that the underlying definition of ‘institutions’ is game-theoretical. Following  
157Calvert, institution is understood as “an equilibrium of behaviour in an underlying game [...] It must be  
158rational for nearly every individual to almost always adhere to the behavioural prescriptions of the  
159institution, given that nearly all other individuals are doing so” (Calvert 1995: 60). Note that this  
160definition contrasts, for example, with North’s (1990: 3) better known understanding of institutions as  
161humanly devised constraints (or ‘rules of the game’). Moreover, “incomplete contracts” are understood  
162as institutions that are “vulnerable to reinterpretation *ex post* in circumstances that were not initially  
163foreseen” (Farrell and H  ritier 2007: 289).

164The theoretical framework proposed here can be summarized as follows. Two national governments  
165seek to cooperate in a game with mixed motives, whereby (a) trading policies with each other  
166produces certain gains, but (b) outperforming each other is an electorally valuable  
167asset. Anticipating opportunistic behaviour from each other, these governments consider delegating  
168enforcement powers to an international body enjoying considerable independence – in the EU context,  
169the Commission. Yet, as Principal-Agent theory suggests (Pollack 2003, Miller G. J. 2005), autonomy  
170comes with information asymmetry that can be used by the agent to pursue its own policy goals. The  
171enforcer can use its power to discriminate between the governments at the implementation stage.  
172Moreover, the collegial nature of the Commission can make its outcomes inconsistent through time  
173and unpredictable.<sup>5</sup>

174Therefore, the trade-off is clear. On the one hand, delegation to supranational institutions is necessary  
175in order to make commitments credible and allow countries to gain from cooperation. On the other, it  
176introduces uncertainty about future policy outcomes. This may not be a problem when the countries’  
177time horizon is relatively long or the national governments perceive the delegated policy as not salient.  
178However, as saliency increases and the time horizon shrinks, uncertainty becomes more and more  
179costly. Also, not all countries have the same to lose from a crisis. Therefore, it can be expected that

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365 According to Arrow’s impossibility theorem, if the preferences of the members of a voting body display a  
37modicum of diversity, then majority voting needs not generate a transitive ordering of the alternatives available  
38for choice; rather, the alternatives cycle, even though individual preferences are coherent. Indeed, incoherence  
39will often take the form of the non-existence of a collectively ‘best’ alternative, and the final outcome will  
40therefore be arbitrary (Hinich & Munger 1997: 95-9). It follows that neither the individual members of the  
41voting body nor outside observers (in this case, national governments) can know the results before the  
42occurrence of the vote.

180some Member States, which have much at stake in a given situation, will perceive as particularly acute  
181the uncertainty related to the Commission's institutional design. In this respect, the Eurozone crisis  
182may be seen as a situation in which some countries wanted to avoid as much as possible an  
183involvement of the EC *both* in the decision-making and in the implementation phase. With regard to  
184the first purpose, decentralized *informal* institutions like Merkozy reduced the uncertainty regarding  
185the negotiation outcomes; regarding the second, decentralized *formal* institutions that restricted the  
186enforcement power of the Commission as a whole, like the FC, also served to achieve the same goal.<sup>6</sup>

187

## 188      **Decentralized Bargaining in Shaping the Fiscal Compact**

189In this section, the two theoretical approaches outlined above are used to explain the emergence of  
190Merkozy in the Eurozone crisis. In order to test the plausibility of the theoretical arguments, the  
191emergence of Merkozy needs to be analysed in the context of a clear-cut event. The FC is particularly  
192suited for this exercise: compared to other eligible cases, it is relatively short, its beginning and end  
193are easily determinable, and the relevant actors can be clearly identified. Moreover, Merkozy played a  
194pivotal role in its shaping (Schild 2013: 35, 38f).

195The FC<sup>7</sup> is an intergovernmental treaty outside EU law, which was agreed upon at the European  
196Council of 8/9 December 2011. The negotiations on the details took place in the two months after, so  
197that the treaty could already be endorsed at the European Council of 30 January 2012. It was formally  
198signed on 2 March 2012 by all EU MSs except the UK and the Czech Republic. The signatories  
199commit themselves to a budget which is balanced or in surplus. In order to reach that goal they agree  
200on an automatic correction mechanism established by their national law at a constitutional or  
201equivalent level. The implementation of the provisions is to be monitored by independent national  
202institutions.

203

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456 See also Merkozy's attempt to appoint a super-commissioner in charge of the Euro (Karagiannis & Guidi  
462014).

477 Formally: 'Treaty on Stability, Coordination and Governance in the Economic and Monetary Union'.

204 *Merkozy as Recurrent Strategic Pre-negotiations*

205According to a bargaining approach as outlined above, Merkozy is an instance of a negotiation  
206strategy employed by a powerful actor. In the context of the FC, Germany used the cooperation with  
207France as a strategic tool to realize its preferences on crisis management, namely a new treaty which  
208shifts the adjustment costs of the crisis to the national level. The validity of this argument relies on the  
209premise that Germany indeed has a dominant position in the Eurozone that allows it to unilaterally  
210employ negotiation strategies to further its ends. Moreover, it needs to be shown that the FC was  
211actually a case in which Germany assumed a pro-active role and employed strategies to realize its  
212goals.

213As outlined above, power resources can be distinguished into material, institutional, and ideational  
214resources. Germany's power in the Eurozone relies primarily on its economic resources. The most  
215important indicator for material resources in the context of the crisis is the aggregate GDP because it  
216determines the capacity to contribute to financial stability in the Eurozone. However, also a MS's  
217refinancing options (government bond yields), its savings potential (current account balance), and its  
218long-term solvency (gross public debt) are relevant. Table 2 shows Germany's superiority in terms of  
219economic power resources at a glance. In 2011, it had the largest GDP in the Eurozone, the lowest  
220interest rates for its debt (decreasing trend), and the biggest current account surplus in absolute terms.  
221Although the debt level of 77.9% was much less impressive, it was still lower than the Eurozone  
222average of 86.0%.

223Table 2: *Germany's Economic Power Resources (2011)*

	GDP		GOVERNMENT BOND YIELDS (10 YEARS) %	CURRENT ACCOUNT BALANCE		GROSS PUBLIC DEBT % of GDP
	Million EUR	% of EU-17		Million EUR	% 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	1.638.857	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	36.868	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	6.903	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>

224 Reference: Eurostat (own illustration)

225 These superior economic resources have an amplifying effect on Germany's institutional and  
226 ideational resources. As regards institutional power, Germany's formal resources in the European  
227 Council do not exceed those of other MSs because decisions are taken by consensus. Although  
228 Germany's formal voting weight in the Eurogroup and ECOFIN Council exceeded those of most other  
229 MSs, also in these fora "there is a strong sense to come to joint, common solutions" (Interview 15).  
230 This de facto unanimity rule in combination with its economic resources vests Germany with huge  
231 institutional power: As a high-level official in Brussels put it: "Germany practically has a veto on  
232 whatever is happening at present. And if they don't like it, they don't take it. So you need to rewrite,  
233 and rewrite, and rewrite, until the Germans are in agreement" (Interview 13; also Interviews 10, 11).

234As regards ideational resources, Germany has roughly the same information and expertise as other  
235MSs. Its credibility, instead, is higher than that of the other MSs because of two different sources.  
236First, the high credibility Germany enjoys in the capital markets is essential to the stability of the  
237common currency.<sup>8</sup> Second, the strong roles of the German Parliament and the Constitutional Court  
238function as a credible commitment at the European level (Interviews 3, 15, 25). Also as regards  
239legitimacy, Germany was perceived to have the biggest claim to a hearing among the MSs because of  
240its economic weight (Interview 2; Spiegel & Schäuble 2011). In sum, on all three types of resources,  
241Germany scores the same or higher than the other MSs.

242With regard to Germany's use of strategies, the FC largely reflects German priorities and would not  
243even have been on the agenda without Germany strongly pushing for it (Ludlow 2012a: 29). Since this  
244article focuses particularly on strategic pre-negotiations, only some of Germany's most important  
245strategic moves are highlighted in the following.

246Most notably, the German government made use of arena-shifting. By bringing the issue directly to the  
247level of the heads of state and government, the Commission and the European Parliament were  
248circumvented and the signal effect of the legal provisions was considerably strengthened (Ludlow  
2492012b: 3). Moreover, when it turned out that the UK would veto a Treaty change, Merkel shifted the  
250arena again by pushing for an international treaty outside EU law (Beach 2013: 118f; Crossland 2011).  
251As regards agenda-managing, Germany made the financial assistance of the ESM conditional on the  
252ratification of the FC and included the French demand for formal 'Euro summits'. It thus managed to  
253ensure the signature of those MSs which were sceptical with regard to further budgetary restrictions  
254(Interviews 10, 11; Beach 2013: 117-9, 126). Furthermore, the German government provided common  
255knowledge: Already in August 2011, Germany and France proposed the incorporation of a 'debt brake'

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548 The relatively sound public finances in Germany are often traced back to the role of ordoliberalism as guiding  
55principle of German economic policy. However, a closer look reveals that the concepts of ordoliberalism and  
56stability culture do not necessarily determine the German policy as such, but are rather used rhetorically in a  
57strategic manner to legitimize a certain policy whenever this appears to be useful (Howarth & Rommerskirchen  
582013). When it is detrimental, instead, Germany itself has often not followed ordoliberal principles: in 2003 it  
59not only violate the Stability and Growth Pact (SGP), but also halted the application of the Excessive Deficit  
60Procedure; in 2005 it succeeded in relaxing the same rules it had promoted eight years earlier; and in 2008 and  
612009 it reacted to its economic crisis at home by adopting two voluminous stimulus packages instead of  
62implementing austerity measures. At present, Germany's debt level of more than 70% considerably exceeds the  
63limits of the SGP and its huge current account surplus even fosters instability in the Eurozone. Nevertheless,  
64ordoliberalism remains a strategic resource if it comes to the legitimization of German preferences in the  
65Eurozone (Bulmer 2014).

256into national constitutions (Bundesregierung 2011b). In the months after, Germany used all its  
257diplomatic weight to promote the idea: German ambassadors approached the respective governments  
258in the MSs, bilateral meetings took place at all levels, all possible fora were used to promote the idea  
259of a debt brake (including the IMF and the G7), and the chancellor herself met her colleagues to  
260promote the FC (Interviews 15, 26; Rinke 2011). In sum, Germany has a dominant position in the  
261Eurozone and used strategies to shape the FC. Thus, the empirical premises for analysing Merkozy as  
262an instance of strategic pre-negotiations are given.

263Especially within the institutional setting of the EU, pre-negotiations play a crucial role (Janning 2005:  
264826). With regard to the Franco-German case, it has been pointed out that pre-negotiated deals are  
265particularly effective when the two MSs do *not* share preferences: In this case they have to  
266compromise, whereby the resulting deal covers a larger range of the other MSs' preferences and is  
267therefore more likely to result in a final agreement (Webber 1999: 182f). In the remainder of this  
268section, it is shown that Merkozy was indeed an instance of this strategy.

269The idea of a Fiscal Pact provided ideal conditions for the use of strategic pre-negotiations with  
270France. Although "there was a collective recognition" (Interview 15) that such a signal was needed to  
271calm the markets and stabilize the Eurozone, France was very sceptical at the beginning. Instead of  
272stricter budgetary rules, it would have preferred a rather discretionary '*gouvernement économique*' and  
273the mutualisation of risk as firewalls against the markets (Interviews 1, 5, 7, 8, 25, 27; Beach 2013:  
274116f; Schild 2013: 28-30). Hence, Germany and France had divergent preferences, which is why a pre-  
275negotiated deal was an effective means for Germany to push through the desired treaty without getting  
276stuck in the negotiations.

277Already the first step was made together with France by writing a joint letter to Van Rompuy in  
278August 2011 (see above). For supporting the idea of a 'debt brake', France was compensated by  
279including the codification of 'Euro summits' into the treaty (Schild 2013: 28, 38).<sup>9</sup> The Euro summit

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689 By most MSs, the Fiscal Compact was perceived as the counter-price for Germany joining the ESM  
69(Interviews 8, 25). However, Germany and France agreed on a permanent rescue fund (ESM) already at their  
70Deauville deal in October 2010 (Schild 2013: 31). The Fiscal Compact, in contrast, was put on the agenda by  
71Germany only later. France was initially very sceptical and gave its support only in August 2011 (Schild 2013:  
7238) after Germany accepted to formalize regular Euro summits in the same treaty.

statement of October 26, 2011, where the Eurozone leaders formalised their summits and agreed on the adoption of ‘debt-brakes’ in national legislations, was based on this Franco-German compromise (European Council 2011a; Beach 2013: 116f).

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 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 (Wittrock 2011; EurActiv 2011; Ludlow 2012a: 7-9). 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 two days before the summit started, Germany and France replied within only one day by releasing a joint letter, rejecting Van Rompuy’s ideas and outlining their own position (Bundesregierung 2011a; Ludlow 2012a: 10f). In sum, 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.

307Table 3: Impact of Franco-German letter on Euro Area Statement and First Draft of Fiscal Compact

Franco-German letter of 7 Dec 2011	Euro Area Statement of 9 Dec 2011	First Draft of Fiscal Compact of 16 Dec 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"
"The <b>European Court of Justice [...]</b> should have the possibility to <b>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> "
"Regular <b>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 economic and fiscal <b>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"	"The <b>euro area Heads of State or 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"

308 Reference: Own illustration

309Especially the last element listed in table 3 reveals Germany's impact on the negotiation outcomes  
310through the use of Merkozy. The Fiscal Compact as primary law was an exclusively German



311preference which originally was neither shared by France nor by other MSs (Beach 2013: 118; Schild  
3122013: 37). Although Van Rompuy, who had the mandate to prepare a basis for negotiation, proposed to  
313realize all changes through secondary law, Merkozy suggested not only treaty change, but in  
314anticipation of a British veto also an international treaty among the Eurozone MSs. The fact that even  
315with regard to this issue, Merkozy's "proposal to our European partners" (Bundesregierung 2011a: 4)  
316prevailed over Van Rompuy's proposal which was backed by the supranational institutions and most  
317other MSs, corroborates the theoretical expectation that pre-negotiated deals can function like already  
318evolved agendas.

319Finally, while the details of the treaty content were negotiated in January 2012 at the level of high-  
320ranking diplomats and Finance Ministers, Merkel and Sarkozy met several times to discuss the content  
321in parallel to the negotiations (Ludlow 2012b: 7).

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### 323 *Reducing uncertainty: Merkozy and the Fiscal Compact*

324As illustrated above, Merkozy and the FC can be seen as instances of decentralization, in terms of both  
325decision-making (as they reduce the role of the Commission and of the other EU supranational  
326institutions vis-à-vis Member States) and policy implementation (as they reduce the enforcement  
327powers of the Commission and excluding automatic competences of the Court of Justice of the EU).  
328On the one hand, the article argues that Merkozy was 'set up' by its two members to reduce the  
329uncertainty of EU policy-making, especially in terms of agenda-setting. On the other, the FC can be  
330interpreted as a means to side-line the Commission (but also the European Parliament) when imposing  
331tougher limits on national budgets. Why did this happen? Following incomplete contracts theory, it is  
332argued that this was due to the nature of EU institutions, and to the particular time constraints that the  
333relevant actors faced in 2011-12.

334The financial crisis of 2008-09 had turned into a sovereign debt crisis in Europe, with countries like  
335Greece, Ireland and Portugal that needed to be bailed out between 2010 and 2011, while the situation  
336of much bigger economies like Italy and Spain (whose failure would have most likely meant the end

337of the Euro as such) was more and more uncertain. EU MSs needed to act quickly in order to restore  
338credibility. It was clear that credibility alone was not sufficient to solve the crisis – indeed, Draghi’s  
339“whatever it takes” of July 2012 was probably more effective than all the legislative and institutional  
340changes of the previous months.<sup>10</sup> However, it must be stressed that without a clear commitment to  
341fiscal discipline from all the MSs, the ECB would have probably been unable to announce the  
342‘Outright Monetary Transactions’. The perception that the EU was doing “too late and too little”  
343(Fabbrini 2013: 1018) boosted financial speculation and appeared to make a recovery more  
344troublesome.

345In line with the theoretical argument presented above, Germany and other countries indeed perceived  
346EU institutions more as an obstacle than as a useful tool for bargaining a way out of the crisis. As is  
347evident from the interviews conducted by the authors, the EU institutions were perceived as  
348ambivalent and too prone to the interests of ‘Euro-losers’ (see below). For Germany and France, the  
349decentralized institutions, and Merkozy in particular, were a way to ‘neutralize’ extreme positions and  
350to make it impossible for the centralized, collegial institutions to exert excessive influence on the  
351result of the negotiation – which might have been discriminatory for them. Merkozy was therefore  
352employed in order to restrict the number of possible outcomes.

353The fact that already in June 2010 the European Council delegated the task of drafting proposals for  
354reinforcing the governance of the Eurozone not only to the Commission, but also to a ‘Task force’  
355composed by the ECOFIN members and the President of the European Council, corroborates this  
356interpretation. As Chang (2013) argues, this was a way to monitor the EC and avoid shirking.  
357Although the ‘Sixpack’ measures were formally decided under the Community method, the influence  
358of decentralized institutions on its development and drafting is not comparable with what normally  
359happens under the ordinary legislative procedure (see Bressanelli and Chelotti 2015). From the  
360underlying theoretical point of view, the ‘Task force’ was a first attempt to create an informal,  
361decentralized institution in charge of steering the reform process. However, its heterogeneity largely

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8110 In a speech given at a conference in London on 25 July 2012, Draghi stated: “Within our mandate, the ECB is  
82ready to do whatever it takes to preserve the euro. And believe me, it will be enough.”

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 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

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<sup>85</sup>11 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  
<sup>86</sup>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>;  
<sup>87</sup>Reuters, "Sarkozy and Merkel's letter to Van Rompuy", 07 December 2011, <http://www.reuters.com/article/2011/12/07/us-eurozone-france-letter-idUSTRE7B612Y20111207>.  
<sup>88</sup>12 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>89</sup>13 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>90</sup>14 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>.  
<sup>91</sup>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-gagnant-du-sommet.php>.  
<sup>92</sup>

380FT might have been passed through the Community method (see Kocharov 2012, Miller V. 2012). The  
381choice of adopting an international treaty, rather than EU secondary legislation, was strongly contested  
382by the Commission and by the members of the European Parliament.<sup>15</sup> While it can be questioned  
383whether this makes enforcement more effective, it is evident that the FC was mainly a matter of form  
384rather than substance: the negotiations for the FC and the ‘Twopack’ proceeded in parallel, and it  
385would have been very simple to adopt most FC provisions as EU secondary law (Interview 33). It was  
386Germany that strongly insisted for having a separate treaty (Interview 11). This interpretation is  
387corroborated by the fact that the Commission, conversely, did not oppose the substance of the FC but  
388only the legal means used (Interview 12).

389The FC itself is a *formal* institution whose aim is similar to that of Merkozy and other decentralized  
390institutions (like the ‘Task force’ headed by Van Rompuy or the ‘Frankfurt group’<sup>16</sup>), i.e. limiting the  
391discretion of the Commission. The FC, in particular, limits the Commission’s discretion in budgetary  
392supervision, in that it anchors fiscal discipline in *national* law (Interview 6). A general distrust of a  
393group of countries towards the EC in this instance appears as the most relevant explanatory factor.  
394Several interviewees (Interview 6, 10, 27) pointed out that enforcement at the European level was not  
395considered to work necessarily better than national enforcement, as the former “depends ultimately on  
396the Commission’s courage and rigour” (Interview 10). The EC’s attitude during the crisis, in particular,  
397had been judged too hesitant and lenient by Germany and other countries (Interview 27).

398This lack of trust is evident if one analyses articles from 6 to 8 of the FC, where the Commission is  
399delegated some powers, but with all kinds of limitations and checks. See for instance Article 7, which  
400gives the Commission the power to submit recommendations “where it considers that a Member State  
401of the European Union whose currency is the euro is in breach of the deficit criterion in the framework  
402of an excessive deficit procedure”. While the parties commit to implement these recommendations, a  
403qualified majority of them can make the recommendation not binding. Similarly, the EC and the Court  
404of Justice’s powers in sanctioning countries for not complying with the treaty obligations are subject to

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10615 See Euractive Press Release, “Verhofstadt on EU summit: “Eurozone needs action not words””, 31 January  
1072012, <http://pr.euractiv.com/pr/verhofstadt-eu-summit-eurozone-needs-action-not-words-91988>.

10816 See for instance: “A crisis? Call the F-team”, The Economist, 4 November 2011,  
109<http://www.economist.com/blogs/charlemagne/2011/11/euros-frankfurt-group>

405a sort of “authorization” of at least one national government: only “one or more Contracting Parties”,  
406and not the Commission, can bring the matter to the Court of Justice (Article 8.1).

407As argued above, the ‘instability of outcomes’ caused by the collegial nature of the EC is, in most  
408cases, beneficial to the MSs, because it guarantees cyclical outcomes and it ensures that no country is  
409permanently discriminated in the long run. This is why a relevant delegation of powers to the EC in  
410almost all the EU policy fields (for instance, the Common Agricultural Policy, Competition Policy,  
411Environmental Policy, and so forth) is perfectly rational according to this logic. These are policies  
412whose decision-making procedure and enforcement is carried out through a sufficiently long period of  
413time. What was different in the sovereign debt crisis was the time constraint: the perception that little  
414time was available and that the solution had to be *immediately* effective. This ‘urgency’ made those  
415negotiations look like a one-shot game (not a repeated one, as is usually the case in EU politics).  
416Having just one shot available, Germany and France needed to be sure that it hit the target.

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## Conclusions

419According to an approach based on negotiation theory, Merkozy emerged because it was an instance  
420of a particular strategy employed by Germany to further its ends in crisis management: strategic pre-  
421negotiations. By striking a deal with one or a few crucial actors ahead of the negotiations, a powerful  
422actor can reduce transaction costs, accelerate the decision-making process, and increase its leverage in  
423the central bargaining. According to an incomplete contracts theory of EU institutions, in contrast,  
424Merkozy was a decentralized institutions aimed at reducing the unpredictability of outcomes related to  
425the collegial nature of the EC.

426Thus, the two approaches elaborated and applied in this article agree that Merkozy served to avoid  
427undesired consequences of central institutions to the advantage of one or a few powerful actors. At a  
428theoretical level, this implies that both informal strategies of policy-making (‘subterfuge’) and ad hoc  
429institutions 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: 40-66).<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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