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Reinforcing Fiscal Discipline in Response to the Eurozone Crisis: Why Did the EU Insist on Strict Austerity?

MA Thesis

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Abstract

The prolonged eurozone crisis revealed the flaws of institutional design in the European Union. Indebted member states were forced to cut government spending and conduct public sector reforms that led to high levels of unemployment. The EU countries as a whole faced the threat of government debt spill-over. Creditors had lost their trust in Greek government bonds, meaning that the government was unable to bail out the banks. In turn, the banks of Greece were mainly indebted to creditors in Northern Europe and the banks of Northern Europe were "too big to fail" because it would have destabilized the financial system. Politicians and officials started to search for solutions to overcome the crisis. One of the solutions was the Fiscal Compact established by the Treaty on Stability, Coordination and Governance (TSCG) in the Economic and Monetary Union. The aim of the treaty was to reinforce existing fiscal discipline rules in a more credible manner. The thesis looks at the negotiation process leading to the agreement on the Fiscal Compact. The aim of the thesis is to test competing EU integration theories that explain the outcome of reinforcing fiscal discipline rules. To reach its objectives, the thesis elaborates on theories of liberal intergovernmentalism, supranational governance, and historical institutionalism and derives hypotheses that are tested using a process-tracing method to analyse political speeches, press releases, macroeconomic data, and existing regulatory framework. The research findings indicate convergences and contrasts between the positions of key member states and the EU institutions on the policies of fiscal discipline. The study also found that the key member states public concerns caused integration, and existing regulatory framework had an important role in formulating actors positions.

Keywords: EU integration, Fiscal Compact, liberal intergovernmentalism, supranational governance, historical institutionalism, fiscal discipline, economic and financial crisis

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List of abbreviations

DGB – German Trade Union Confederation

ECB – European Central Bank

ECJ – European Court of Justice

EFSF – European Financial Stability Facility

EMU – European Economic and Monetary Union

ESM – European Stability Mechanism

HI – Historical institutionalism

IG Metall – Industrial Union of Metal Workers of Germany

IMF – International Monetary Fund

LI – Liberal intergovernmentalism

OECD – Organisation for Economic Co-operation and Development

SGP – Stability and Growth Pact

SNG – Supranational governance

TSCG – Treaty on Stability, Coordination, and Governance in the Economic and Monetary Union

Introduction

The global financial crisis which started in 2007 revealed deficiencies of monetary integration in the EU and highlighted the central role of the member states. Shortly after the collapse of stock and real estate markets, Europeans witnessed a quick spread of the global financial crisis and the emergence of the eurozone crisis caused by the transfer of private debts to sovereign debts as a result of bailing out banks. The institutional design of eurozone contributed to financial turmoil and prevented European leaders from responding properly which in turn threatened the stability of the common currency. The sovereign debt crisis in Greece meant that the state was unable to refinance government debt and bail out banks without the assistance of third parties. Greek inability to refinance its loans increased the threat of default. The idea that one country could simply default and not serve its loans was unthinkable and unacceptable to other European leaders because of the close interdependence of member states' financial sectors. The bankruptcy of one country would have led to the defaulting of others. The so-called 'domino effect' was imminent and the credibility of the euro, in general, was at stake (Arghyrou & Tsoukalas, 2011). Some of the banks and their governments were simply "too big to fail" (Bibow, 2012). Degrading by rating agencies was a threat to all eurozone countries not only to few culprits. In other words, the global financial crisis exposed the weaknesses of close monetary and financial interdependence of the eurozone countries.

There were three main measures taken by the European community to solve the situation. First, the eurozone did not have a 'lender of last resort' type of institution which would guarantee the bondholders that there would be always money available to pay out the matured bonds. The idea was to empower the European Central Bank (ECB) to act as a 'lender of last resort' bonds (De Grauwe, 2014; Panico & Purificato, 2013). Second, a set of measures were aimed at strengthening community rules in order to ensure that member states would not neglect the rules in the future. Third, to show the wider public and financial markets that there are also substantive measures and reforms which will change the situation and limit the ability of the Greek government to continue excessive spending, the country had to follow strict austerity measures that hampered economic growth.

All three of these measures had an impact on European integration and the last one, the austerity measures, is in the spotlight because it is most controversial by nature. Many economists (eg. Alessi & Lester, 2012) suggested that it was not optimal and reasonable for Greece to carry out so many reforms in such a minimal time space. The austerity measures were simply too strict and severe. Critics did not see strict austerity measures as a tool for substantially fixing the eurozone's lop-sided architecture. Instead, austerity measures fostered economic regression and unemployment. The German government thought that it was the right time to ask for these reforms before it was too late (ibid). The idea of austerity measures was coordinated by Germany and can be characterized by putting constant pressure on Greece to conduct structural reforms and bring their finances into order (Vilpišauskas, 2013, p. 368). The Fiscal Compact, an international treaty which binds 22 member states to adopt common budgetary rules and government debt standards to domestic legislation, was a precondition for bailout programs. The enforcement of rules concerned with fiscal discipline is an example of German influence (Kreilinger, 2012). Stakes for Greece were higher than for Germany. The immediate consequences of the crisis for were more severe for Greece than for Germany who had was less threatened and held the position to solve the crisis (Schimmelfennig, 2015). Greece was forced to agree with the austerity measures and sign the Fiscal Compact to get assistance from third parties like the European Stability Mechanism (ESM) and the International Monetary Fund (IMF).

The aim of the paper is to explain why the EU insisted on strict austerity measures as the solution to solve the eurozone crisis of late 2009 to 2012. The research question is the following: Why did members of the European Union (EU) agree on strict austerity measures and structural reforms as a precondition for bailout programs for Greece? The paper asks, how did the austerity measures become the key to the plan and why did Germany so strongly back the idea of strict budgetary cuts in Greece? The IMF (2012) report argues that austerity measures only deepened the eurozone crisis and worsened peripheral countries ability to serve the loans. Traditional economists would advise implementing austerity measures only during periods of growth. Strict cuts and reforms during the crisis might have led to a prolonged recession, which destabilized the eurozone as a whole, as well as Germany. To have a better grasp of this new episode of European monetary integration it is important to understand the motives and incentives of all the key actors: ECB, European Commission, Germany, France, Italy, and Greece.

The thesis builds on European integration theories of liberal intergovernmentalism (LI), historical institutionalism (HI) and supranational governance (SNG) which offer competing answers to the research question and permit to analyse the case. European integration theories are chosen because the paper looks at austerity measures as a crisis response aimed at maintaining the level of integration that has been achieved within the EU. The political response to the crisis clearly deepened the integration of Europe. The thesis derives two rival explanations from integration theories. The theory of LI supposes that it was in the interests of member states governments to impose austerity measures and new EU institutional reforms occurred because the governments wanted to make their decisions credible. The theory suggests that austerity measures were in the interests of the German government and the government was successful because it had more relative power during the negotiations. However, the theory has little to say about how integration processes are affected by the crisis. The theory of HI supposes that austerity measures are the outcome of gradual institutional development. Instead of the member states playing a key role in pushing through austerity measures, the theory of SNG emphasizes the role of institutions and supranational organizations like the European Commission, ECB and European Court of Justice (ECJ). Finally, HI assumes that none of the member states governments had an important role in imposing the austerity measures, rather, the austerity measures was a continuation of existing institutions and the crisis created opportunity to empower and renew the institutions. Institutions like ECB and European Commission follow a certain path that is set by historical key moments called critical junctures. The paper empirically tests the validity of the propositions derived from LI, HI and SNG in the context of the eurozone crisis. It tests the proposed theoretical explanations by tracking the process which led to the agreement on the European Fiscal Compact established by Treaty on Stability, Coordination and Governance (TSCG) in the European Economic and Monetary Union (EMU). The empirical approach is process-based. The thesis will identify the positions and preferences of key actors like governments of the largest member states, supranational institutions involved in the process, including European Commission, ECB and relying on a variety of available sources including political speeches, press releases, Bank for International Settlements banking statistics, media coverage, statements by leading officials and politicians and macroeconomic statistics.

The thesis is divided into three sections. The first focuses on the theoretical framework and gives an overview of the background, origins, main tenets, and criticism of both LI and HI. Theories of LI and HI together with SNG lay the foundation of the thesis. The primary focus of LI theory is on the concept of bargaining power which defines the holders of power and thus

the direction of integration. The part for HI theory takes a closer look at the concepts of path dependency and critical junctures that guide the future of integration. HI is supplemented with SNG to give an alternative explanation to member states role in international bargaining. The aim of the first section is to spell out hypotheses which are later empirically tested. The second section explains the methodology and elaborates on data collection. The idea is to present the limitations of the research and justify case and data gathering methods. The third section starts with an overview of the Greek sovereign debt crisis and the process of reaching agreement on the European Fiscal Compact. The section continues with determining the key member states and supranational institutions positions, paving the way to subsequent theory-testing. The latter part of the third section analyses the empirical material in light of the theoretical expectations in order to answer the main research questions of the thesis.

1 Competing explanations of European integration: liberal intergovernmentalism and historical institutionalism

To study the process how member states reached an agreement on solving the eurozone crisis, the thesis builds on theories of European integration which explain how the EU has reached its present structure and which kind of role member states and supranational institutions have played in the process. Concretely, the theory of LI developed by Andrew Moravcsik in his book "The Choice for Europe: Social Purpose and State Power from Messina to Maastricht" (Moravcsik, 1998), is applied to test the explanation of the role and influence of member states in the integration process. The theory focuses on three essentials stages in the integration process: domestic national preference formation, international negotiations, and institutional choice. The LI theory is contrasted with SNG theory which is supplemented with the theory of SNG. The theory of SNG is used to clarify the role of supranational institutions like ECB and European Commission in guiding the direction of integration vis-à-vis member state governments, while the theory of HI elaborates on the causes of actors positions leading to new measures taken to solve the crisis. Differences between LI and HI explanations about EU integration arise not on the question of what happened but rather on the question of why it happened (Puchala, 1999, p. 327). The thesis seeks to answer the question of why the EU member states and supranational institutions agreed on austerity measures. Possible explanations are deduced from these theories and empirically tested to find the answer for the research question.

1.1 Liberal intergovernmentalism in European integration studies

Liberal intergovernmentalism was developed in the 1990s and it is unique among integration theories in that it is associated with a single author named Andrew Moravcsik who wrote a key book on the theory in 1998 (Hooghe & Marks, 2019, p. 1). Arguably, the theory has become a dominant 'baseline theory' that explains regional integration and works as a benchmark for comparison for new integration theories (Kleine & Pollack, 2018, p. 1494; Moravcsik & Schimmelfennig, 2019, p. 67). The predecessor of the theory is traditional intergovernmentalism, developed in the 1960s by Stanley Hoffmann who was a mentor to Moravcsik. Traditional intergovernmentalism served as an alternative to neofunctionalism, which was the dominant theory of regional integration during the time (Moravcsik & Schimmelfennig, 2019, p. 64). LI continues to clash with neofunctionalism and post-

functionalism on the question of which actors drive regional integration. On this question, traditional intergovernmentalism and LI do not differ almost at all. Both of them assume that states are the main actors which control integration processes and oppose the idea that ideational or supranational institutions have a role of their own. They are closely related and differences arise when Moravcsik answers Hoffmann's critics by building a more accurate theory that would fit for European integration (Crush, 2013, p. 3). Thus, the main differences are caused by the time when the theories emerged. There was a stagnation in EU integration as well as in the development of the theories during the 1970s and 1980s until the revival of Single Market. This meant also a revival for scholars for EU integration (Pollack, 2010, p. 19). Soon after, in 1993, Moravcsik published an article called "Preference and Power in the European Community", which he argued that integration is not driven by geopolitical interests, grand ideas, or ideology but it is driven by nation states who fully control integration process and integrate as minimally as possible to pursue their economic interests (Hooghe & Marks, 2019, p. 3; Kleine & Pollack, 2018, p. 1493; Moravcsik, 1993). Five years later, Moravcsik backed these claims with evidence and came up with a three-step grand theory in his only written book. His search for evidence made him conclude that geopolitics and ideology had an "important secondary impact" but "naked economic preferences might have led to a highly institutionalized pan-European free trade area" (Moravcsik, 1998, p. 6). His theory is one of the most cited theories in the field of EU studies.

LI theory belongs to the school of international relations and represents both realist and liberal views on regional integration processes. It takes a realist approach because it assumes that states are unitary actors in an international environment which is inherently anarchic (Moravcsik & Schimmelfennig, 2019, p. 65). Furthermore, as common to realist approaches, Moravcsik analyses only the behavior of big states and ignores the small assuming that big ones are the key to understand international politics (Moravcsik, 1993) Nevertheless, it does not deny the liberalist approach because it emphasizes the role of domestic pluralism which is inherent for liberal democracies. Furthermore, it adds the liberal theory of state preference formation and neoliberal theory of international interdependence to the 'realist approach'. (Moravcsik, 1993, 1998; Schimmelfennig, 2015, p. 178). As mentioned above, the theory distinguishes three stages that are relevant to the integration process. In short, Moravcsik theory of LI explains the 'grand bargains' which "punctuate the EU's evolution" (Peterson, 2001, p. 290). The first stage that precedes international bargaining happens on domestic levels where economic interests of powerful interests groups determine national interests which later become unitary on the international scene (Moravcsik, 1998). On the second stage, states have

to take into account the relative power of each state and bargain with one another to realize their national preferences (ibid). On the third stage, member states decide whether to delegate power and sovereignty to international institutions to make commitments credible or not (ibid). The theory has a liberalist domestic and neoliberal international interdependence view but realist state-centric view in which states seek to maximize their national preferences.

LI theory assumes that states are rational actors who seek to maximize their national preferences. According to Moravcsik: "European integration can be best be explained as series of rational choices made by national leaders" (Moravcsik, 1998, p. 18). Even the fact that states act as unitary actors on the international arena is an example of rationality. In order to maximize their national preferences, it would be disadvantageous to defend a multitude of preferences which was present at the domestic level. This shows that national preferences are not 'fixed' but governments formulate a consistent set of national preferences accompanied by national objectives which are independent of international negotiations (ibid). The theory is based on 'rational actor model' which assumes that states behave rationally and follow the most appropriate means to achieve their goals (Nugent 1999, p 509 via Cini 2016, p 97). Another example is when governments decide to delegate sovereignty to international institutions. They do so to maximize their preferences by making the achieved commitments credible. It is the rationalist framework throughout the theory which constraints and limits and limits the analysis (Moravcsik, 1998, pp. 19–20). Taking LI theory lenses, rational thought and actions are seen on every stage of development in EU integration.

1.1.1 Domestic interests

One of the assumptions of the theory is that the direction of integration is derived from dominant domestic constituents interests. Governments act as unitary and rational actors on behalf of their constituents (Moravcsik, 1998, p. 20-22). Government objectives arise from domestic competition but in order to realize these objectives governments strategize to act as unitary actors (ibid, p 22). The governments formulate set of national preference and national objectives which are followed by a strategy to realize the national objectives (ibid, p. 20). These national preferences are "set of values placed on future substantive outcomes" or desires of the government (ibid, p. 24). Government formulated positions reflect the dominant domestic economic groups preferences, which are issue-specific for each bargaining situation and international political environment (ibid, p. 20, 26). Objectives derived from dominant domestic interest groups constrain the government's ability to change positions (ibid, p. 36,

51). Therefore, interest groups can act as policy entrepreneurs and lead the government to defend a certain position, which converges with domestic interests.

To assess the power or effectiveness of governments in international negotiations we need to know the underlying objectives given by domestic interests groups. Influence cannot be analyzed if we do not know the actual intention that actors seek to realize (Moravcsik, 1998, p. 19). On this matter, the theory considers power as essentially relative (Moravcsik, 1998). Thus, power is relative because it depends on what the underlying government objectives given by domestic constituents were in the first place and how well governments reached those objectives.

Domestic interests groups compete to influence government and the winner or loser is issue-specific, depending on the characteristics of the issue. The most important interest groups that pressure politicians are producers who compete with taxpayers and consumers and third-country producers (Moravcsik, 1998, p. 36). There is systemic political bias in favor of producers, more specifically in the economic sectors of industry, agriculture, and services (ibid). However, LI theory acknowledges, that government positions are not simply dictated by lobby groups who support a certain solution. Quite often, producers demands are constrained by general demands for regulatory protection, economic efficiency and fiscal responsibility (ibid, 36-37). The LI theory concludes on this point that cooperation decisions are preceded by pressure from domestic producers but "governments promote commercial interests until confronted with an intolerable fiscal burden or conflict with strong regulatory preferences" (ibid, p 37). Moravcsik's analysis shows that producers' influence has been strongest in agriculture but less strong in regulatory policy such as monetary policy (ibid). However, producers maintain their say because the general aim for foreign cooperation for them is to open-up export markets. They simply balance autonomous preferences for regulatory protection in which richer countries have higher standards (ibid, p 38, 50). In short, producers tend to have a stronger position in the process of formulating national preferences. Depending on the characteristics of the policy topic on the agenda, producers are less influential if the topic is concerned with regulatory policies.

1.1.2 Bargaining dynamics and power

LI attempts to explain the dynamics of bargaining processes which can be characterized by three main assumptions. First, negotiations only take place when there are gains for all the participants and the negotiations could lead to better results than unilateral action. Gains in this

context are measured in long-term and government can accept the deal even if the *status quo ante* is negative for the participant in short-term. (Moravcsik, 1998, pp. 61, 63) Second, governments work under conditions of common knowledge, which means that they know each other key bargaining positions and alternatives (ibid, p. 62). Third, the outcome of negotiations is measured by the distribution of benefits which is a reflection of the relative bargaining power and states are more willing to compromise if the very important matter is at stake (ibid, p. 62-63). On this point, Moravcsik refers to the Nash bargaining model which implies that countries that favor agreement more intensely are also more willing to make side deals on the margin to achieve the main goal. Governments that are dependent on the final deal offer the most significant compromises and "concessions on the margin are systematically biased toward outcomes preferred by governments least likely to support 'core' agreement (ibid, p 55). Therefore, countries which are more satisfied with unilateral opportunities and less dependent on the deal, benefit most from bargaining because they can pressure the opponents to make concessions and side deals. Thus, an important factor that determines the bargaining power is whether there are reasonable and credible alternatives for the country – countries with poor alternatives have weak bargaining power and must make more concessions and compromises, while governments with reasonable alternatives are more likely to demand concessions and compromises from other participants (ibid, p. 63-64). A simplified version of LI bargaining theory tells that bargaining power belongs to the country which has less at stake in case of no agreement, and bargaining power is reflected in the distribution of benefits from the final agreement. To sum up, LI bargaining theory is based on three assumptions: international bargaining requires that multilateral deal benefits everyone more than unilateral solutions or other alternatives; bargaining happens in the sphere of open knowledge where all participants know the positions of opposite side; the more dependent is the participant on the final agreement, the less amount of bargaining power owns, which is in turn reflected in the distribution of benefits of the agreement.

1.1.3 Delegating sovereignty

While the realist school of IR is usually skeptical about the formation of supranational institutions and voluntarily giving up sovereignty, then LI sets certain conditions in which states as rational actors might still choose to delegate the sovereignty. The main argument, that Moravcsik (ibid, p. 71-77) develops is that governments delegate power to supranational institutions to make commitments credible. They create supranational organizations to

guarantee the effectiveness of new commitments also in the future and also empower and authorize existing institutions in place to ensure that commitments are still plausible (ibid). Governments are uncertain about the future and do not foresee all the future emergencies when enforcing common goals, thus, they seek to free themselves from responsibility and "scapegoat" the international institutions when they foresee the political costs of unpopular policies (ibid, p. 73-74). Furthermore, governments want to delegate power if it is essential that the implementation of the agreement occurs in a neutral manner. They want the commitments to be credible which requires neutrality in case national opposition arises (ibid, p. 76). Therefore, integration is more likely to occur in policies where the level of uncertainty about future decisions is high (ibid, p. 75). Only states can act as an effective policy entrepreneur who "initiate, mediate, and mobilize domestic coalitions", while supranational institutions do not have such options (ibid, p 55). In general, delegation or pooling of sovereignty is the essence of LI because it explains how the state can remain rational while giving away powers and achieving credible commitments and neutrality of institutions.

1.1.4 Criticism

The following subsection is going to elaborate on two points of critique on LI theory and the response to the critics. First, the theory of LI finds empirical evidence by looking only at key European Council decisions about the future of integration. Neofunctionalist and supranationalist scholars criticize the theory because it does not explain how the EU works in day-to-day matters and it focuses solely on 'history-making' decisions (Cini, 2016, p. 100). Critics elaborate that though initial integration might be the consequence of agreements among governments then established international institutions take a "political life of their own" and thus bind governments collective behavior (Puchala, 1999, p. 318). The theory underestimates the role of supranational actors such as the European Commission, the ECJ, and the ECB and limits itself only with analysis of formal aspects despite the fact that informal politics shape the actual policy outcomes (Cini, 2016, pp. 99–100; Kleine & Pollack, 2018, p. 1494; Peterson, 2001, p. 296). Moravcsik answer to this kind of critique insists that only member states face real choice about the future of the Union and the European Council is the only "unconstrained source of agency in EU-decision making", thus, the European Council authority cannot be defied at any other decision-making body (Moravcsik, 1998; Peterson, 2001, p. 296). They attribute little influence on supranational agents and argue that they only monitor and implement intergovernmental agreements which are accepted by governments to assure that other states follow already made commitments (Puchala, 1999, p. 319). J. Peterson (2001, p.

297) concludes the analysis between neofunctionalism and LI on the point of whether member states or supranational institutions guide the integration that they are theories which offer overlapping rather than competing 'truths', instead, historical institutionalism truly competes with LI over this issue.

LI theory has difficulties answering the critique that governments choices for decision-making are constrained. As mentioned above, Moravcsik accredits the European Council as an agent which is unconstrained during negotiations. Institutionalists criticize LI theory on this matter because it ignores "endogenous feedback that destabilizes the equilibrium" that ultimately thrust governments to act and make new decisions (Kleine & Pollack, 2018, p. 1494). After the initial phases of integration has been passed then the "machinery constructed to cement regional cooperation constraints" future choices of the governments (Peterson, 2001, p. 299). The intergovernmentalist answer is that supranational actors can set agenda for governments only in day-to-day policymaking but not for the international negotiations and even if there is a threat that supranational influence sets governments in an unfavorable light, then governments will reassert control over the process (Kleine, 2013, p. 91; Kleine & Pollack, 2018, pp. 1499–1500) It does agree that supranational institutions have power over member state domestic agenda but the question is whether they influence government options and thus preferences in future integration decisions. Intergovernmentalism is rigid in a sense that it fails to take account that integration itself changes the nature and content of intergovernmental bargaining. Integration produces new political arenas that differ from intergovernmental politics because supranational institutions produce rules that would not have been adopted by governments which in turn set a political field that governments have to acknowledge (Sweet & Sandholtz, 1997). In short, intergovernmentalist attempt to tackle the critique that supranational institutions and their policies shape the government's preferences and positions is unconvincing and fails to grasp the essence of the critical point. Despite the criticism of LI, it remains a valuable theory that explains the general dynamics of interstate bargaining processes.

1.2 Alternative explanations: historical institutionalism and supranational governance

HI offers an alternative explanation for the case studied in this thesis. Opposing LI, the theory adopts a broader perspective and looks at integration during a longer period of time. Instead of being rigid in believing that only member state governments guide the integration,

HI emphasizes institutions, path-dependency and critical junctures, which determine the pathway of the future integration.

The theory was developed mainly in the 1960s and 1970s, although the term was coined in the 1990s (Hall & Taylor, 1996, p. 937; Steinmo, 2008, p. 118). Institutionalism itself can be traced back to ancient Greece when Plato's *Republic* attempted to explain how institutions shape political behavior (Steinmo, 2008, p. 118). The theory defines institutions as formal or informal procedures, conventions or norms associated with organizations (Hall & Taylor, 1996, p. 938). The word 'history' in the term signifies that the approach uses history as an analytical tool. The approach was truly born in the 1960s and 1970s when political scientist became disappointed with grand theories but was still seeking explanations for different outcomes seen in real-world, thus, they started to analyse the influence of institutions (Steinmo, 2008, pp. 122–123). They borrowed from group theory the assumption that conflict for scarce resources between the groups is the central question of politics (Hall & Taylor, 1996, p. 937). Scholars of HI rarely intend to push theoretical arguments, rather they wish to seek explanations for real-world empirical questions which leads them to conclude that institutions shape political strategies and preferences (Steinmo, 2008, p. 125) One of the foundational articles for institutionalism is written by P. Hall and R. Taylor (1996) which reviews three sorts of new institutionalism': sociological, rational choice and historical. The main difference which distinguishes HI from the other streams of institutionalism is that it is not seeking answers for human behavior but rather concerns "why a certain choice was made and/or why a certain outcome occurred" (Steinmo, 2008, p. 126). The scope of theory is much wider than other EU integration theories and it is widely used by the scholars of comparative politics. To conclude, the institutionalist approach has accompanied political science since the beginning of political philosophy, but systemic usage of the approach started relatively late. The institutionalist approach divides into three in which the HI seeks to find an explanation for real-world outcomes through historical development lenses.

The main point of HI is that 'history matters'. Most importantly, history matters because actors learn from experiences, meaning that the political choices made at time A have consequences for time B (Steinmo, 2008, p. 127). The theory looks at choices made about institutional design which constrain future policy-making options and calls this kind of effect 'path-dependency' (Mahoney, 2000; Pierson, 2004). Furthermore, history matters because "history is not a chain of independent events" (Steinmo, 2008, p. 128). That is why the strength of HI lays in the ability to explain continuity (Peterson, 2001, p. 297). Another aspect why HI emphasizes history is because some of the historical moments are more important then the

others. Especially if those moments change the institutions. Institutionalism sees institutions as "enduring legacies of political struggles" (Thelen, 1999, p. 388). And the political struggle, whatever the outcome, is important because it does not only decide about policies but also influences the future of decision-making. These moments are sometimes called 'critical junctures'(Capoccia, 2012; Capoccia & Kelemen, 2007; Collier & Collier, 2002; Hall & Taylor, 1996; Mahoney, 2000). More detailed insight about concepts of path-dependency and critical junctures are given in following subsections.

1.2.1 Critical Junctures

Critical junctures are relatively short phases in which agents make decisions which impact future developments and decisions. They can be described as relatively short periods of time in which actors choices influence the outcome of interests or more explicitly, they are periods of fluidity and significant change when one or another direction is taken (Capoccia & Kelemen, 2007, p. 348; Collier & Collier, 2002, p. 27). Critical junctures produce distinctive changes in different units of analysis (Collier & Collier, 2002, p. 29). These periods of change alter with periods of adaption and stability (Capoccia, 2012, p. 2). Actors choices during the critical juncture make a momentum which carries the significant impact that lasts for years (Capoccia & Kelemen, 2007, pp. 348, 350). Thus, critical juncture can lead institutions to a certain path of development, which lasts for a long period of time (Capoccia, 2012, p. 3). Sometimes critical junctures are also called crisis or turning points. Critical juncture is usually triggered by external influence, which leaves the political arena open for change. Often, critical junctures are an immediate response to external shocks and if this is the case then they occur across a number of states (Collier & Collier, 2002, p. 31). In short, critical junctures as short periods of time caused by external shocks are an essential concept for HI which assumes that decisions made about institutions set them on a path for a long and stable period of time.

All periods of hasty change should not be considered as critical junctures. Not all economic upheavals are critical junctures because they do not carry an impact on institutions (Capoccia & Kelemen, 2007, p. 349). Thus, it is important to look for the impact on the institutions themselves, no matter how colossal is the change in actual policies. Another aspect that limits the concept of critical junctures is that they are always shorter in time than its following path-dependency processes (ibid, p. 351, 348). Pierson adds that critical junctures are characterized by limited time frame when member states have to make new decisions (Pierson, 1998, p. 38). Capoccia and Kelemen (2007) say that researchers tend to

misunderstand the limitations of the concept. Between the critical junctures there might be "cumulation of causes" which eventually lead to "tipping point" meaning that there is "rapid change in the outcome", nevertheless, tipping point together with rapid change in the outcome can be the reason why the next critical juncture that would change the path is kept away (ibid, 351). Change of path is not a factor that determines the happening of a critical juncture. During the critical junctures, many possible solutions can be on the agenda but if they are rejected then it is still a critical juncture that was followed by the continuation of the path (Capoccia & Kelemen, 2007, p. 352) In other words, during a critical juncture, many options are possible. To understand when critical junctures occur with a selection of new path P. Pierson (Pierson, 2000, p. 264) encourages "to go back and look" to find the actual origins of the path. To sum up, not the change in actual policies determine whether critical juncture occurred but rather the impact on institutions themselves. In case critical juncture occurs, it does not inevitably lead to a change of path but can lead to a continuation of the path.

1.2.2 Path-dependency

The concept of path-dependency comes together with critical junctures. It describes the follow-up period in which institutions start to live a life of their own. During that period, they gain information and insight about possible unintended consequences which conceal clues for possible new policies.

Theory of HI emphasizes the concept of 'path dependency' to understand why something has occurred in a way it has. Sewell (1990) is one of the first to define the path-dependence by saying: "that what has happened at an earlier point in time will affect the possible outcomes of a sequence of events occurring at a later point of time" (Mahoney, 2000, p. 510). Later developments of the concept add that earlier parts of the sequence matter more than the later (Mahoney, 2000, pp. 510–511). Earlier developments matter because they give input which is later inherited and mixed with new contextual features (Hall & Taylor, 1996, p. 941). Furthermore, after the historical momentums take place, they are followed with inertia meaning that there is inherent logic in which one event "naturally" leads to another event (Mahoney, 2000, p. 532). Preferences of decision makers change faster than institutions which creates a tendency for continuity and inertia (Peterson, 2001, p. 297). The legacy of critical juncture takes time to establish itself and is usually accompanied by shaping intervening steps until the legacy crystallizes gradually (Collier & Collier, 2002, pp. 31–32, 37). Mahoney (2000) typology distinguishes reactive sequences and self-reinforcing sequences in which the latter

can be described as long-term reproduction of certain institutional pattern. Thus, the concept of path dependency supposes that outcome new developments is the legacy of decisions made at an earlier point which gradually crystallize.

The theory of HI argues that at the grand intergovernmental bargains, the direction of integration is guided by institutions because the institutions themselves give impetus for new institutions. Even if governments try to foresee long-term effects of treaty amendments, there are still unintended consequences which grow over time and policy becomes one with 'high issue density' (Pierson, 1998, p. 39). Existing institutions may generate inefficiencies, which lead to unintended consequences (Hall & Taylor, 1996, p. 942). The necessity to delegate complex matters to experts reduces the member-states control over the process (Pierson, 1998, pp. 39–40). Eventually, the involvement of experts leads to accumulation of information to experts which gives them the upper hand to influence the outcome. The "asymmetrical access to information…provides a foundation for influence" (Moe 1984, via Pierson, 1998, p. 40). Ultimately, the new institutions are built on old institutions and new structures are inspired by structures that had been created before (Verdun, 2015, p. 231) The system does not look for brand new solutions because the 'price of exit' from previous institutions is too high and therefore governments are 'locked-in' and alternatives are unthinkable (Pierson, 1998, pp. 45–47). It's a process in which "self-perpetuating interests, embedded in sunk costs, can crystallize around prevailing patterns of union organizations…" (Collier & Collier, 2002, p. 37). Hence, institutions themselves produce new knowledge which is the foundation of influence in the debates of reform. Governments are following the guidance of institutions while reasonable alternatives are excluded because the costs of changing the path are too high. In other words, government choices are constrained by the given information which makes only a few choices look reasonable and ultimately leads to the crystallization of the same policy patterns.

To keep it clear, HI theory divides the sequence of events into two – critical junctures are followed by a period of stability. During stability, institutions gain knowledge and try to manage unintended consequences until the institutions are once again reformed. Unintended consequences became unmanageable within given institutional setup and thus another moment of decision-making occurs. Institutions tend to self-reinforce themselves and the new solution are built on the previous set of rules. Hall & Taylor (1996, p. 942) calls the flow of historical events as "periods of continuity punctuated by critical junctures". During the critical junctures, actors have a choice to change the path but they choose not to do so because of the high costs it would entail. The outcome of the process is the crystallization of the legacy of the first choices.

1.2.3 Supranational governance

The following paragraph is outlining contextual information concerning the theory of supranational governance. The theory became prominent in the 1990s as the main theory that challenges LI. The theory has influences from both neofunctionalism by sharing the assumption that supranational organizations like the European Commission and ECJ become the agents which drive the integration further through spillover effect (eg. Haas, 1964) and transactionalism by taking forward the assumption that integration is a response to societal demand caused by the community feeling within European societies (eg. Deutsch, 1957). The theory supposes that, after World War II, Europe entered into unique political space which is not anymore characterized only by classical neo-liberal intergovernmental negotiations but also by autonomous 'Brussels complex' which has profoundly institutionalized over time (Fligstein, Sweet, & Sandholtz, 2001, pp. 1–2). Theory of supranational governance does not neglect the importance of intergovernmental politics and national executives, rather it tries to assess the impact and relevance of member states influence and supranational organizations influence across policy domains (Fligstein et al., 2001; Sweet & Sandholtz, 1997). In general, it postulates that in some policy domains, where the societal demand for cross-border regulation is higher, the competence to govern is given to supranational organizations while in others, where the transactional demand is lower or absent, national institutions are still in control over policy-making (Sweet & Sandholtz, 1997, pp. 298–299). The theory is taking forward the ideas of transactionalism and neofunctionalism and serves the role to oppose purely intergovernmental explanation of European integration by emphasizing the development of supranational institutions and their autonomy.

There are two general postulates that compose the theory. First, the theory argues that supranational governance works for the interests of those who are deprived by national rules and advantaged by European rules. There is an assumption that cross-border transactions and communications are the reason which drives the integration because they make a social demand for rules and regulation which is satisfied through supranational organizations (Sweet & Sandholtz, 1997) Supranational organizations responds to the demands of transnational society, non-governmental actors influence directly or indirectly policy-making process (ibid. p. 304). The level of engagement by supranational institutions is determined by the level of pressure by non-state actors whose influence is across national borders (ibid, p. 306). Non-state actors can pressure their own governments but when they are ignorant, then they also have access to

influence supranational institutions like the European Commission (ibid). Supranational institutions start to engage if cross-border transactions are rising in the policy domain because it means that there is also increasing demand for European level rules (ibid, p. 308). In short, supranational organizations serve the demands of transnational society especially in the policy domains where the level of cross-border transactions is high.

Second, once the supranational organizations and rules in place, they start to govern themselves. The theory of SNG does not agree with the neofunctionalist theory that supranational institutions replace nation states gradually, neither LI assumptions that member states remain in full control of integration (Sweet & Sandholtz, 1997). Instead, in many domains where transnational societal demand is high, supranational institutions like Commission or ECJ respond by a broad interpretation of Treaties to fulfill the initial purpose of the agreements (ibid, p. 299). After the rules and institutions are in place, they create "self-sustaining dynamic that leads to the gradual deepening of integration" which limits the member states role in the process (ibid, pp. 299-300). Supranational organizations, owning substantial autonomy, become the policy entrepreneurs and became the source of policy innovation (ibid, pp. 304-305). It is a process in which governments can attempt to slow the integration because they have their own self-interests but fundamentally they are reactive and adjusting to the integration (ibid, p 306). Supranational organizations interpret and apply the rules through modifying them to guarantee their effective meaning - it is a "rule-centered logic" which leads to institutionalization of rules and forbids governments to reverse the supranational governance by making the rules "sticky" (ibid, p. 310-312). To conclude the point, supranational organizations tend to interpret agreements and Treaties in a light that allows innovating new policies which over time become institutionalized and thus constrain government options to back from common rules.

1.2.4 Criticism

The following paragraph outlines the general similarities and differences between HI and LI. Pierson (1998) opposes the theory with intergovernmentalist theories of integration because the latter only provides "snapshot" of events while HI provides a whole "film" which explains the integration processes, especially the gaps when member state governments do not control the situation. To a certain extent, LI and HI are not controversial as it may seem. While LI emphasizes that bargaining power determines winners and losers then HI theory admits that institutions give some groups disproportionate access to the decision-making process and also

emphasize that some groups win and lose (Hall & Taylor, 1996, p. 941). Pierson (1998, p. 30) also admits that member states may have a strong initial position and seek to maximize their interests as like intergovernmentalists, but HI does not have a part in classical rational and non-rational choice work because the theory inhibits both characteristics and thus emphasizes the 'temporal' processes and institutional evolution (ibid, p 34). HI inhibits key aspects of neofunctionalism but offers more to argue against member state control over integration (Pierson, 1998, p. 48).

Theories of LI and HI together with SNG clash on the question of who is control in the integration processes. The debate is caused by the differences in the assumptions about the roles of member states and supranational organizations. They have common assumptions that member states and supranational institutions are rational actors who seek to maximize their role. LI limits the HI conditions in which supranational actors set the agenda for member states (Pollack, n.d via Kleine p. 1499). On the one hand, Moravcsik argues that governments have themselves expertise and are not dependent on information provided by the supranational institution. Nation-states are stakeholders because they manage negotiations intelligently, have enormous financial and bureaucratic resources and own considerable EU experience (Moravcsik, 2005, p. 362). On the other hand, HI assumes that member states influence is limited because their choices on the agenda are pre-set by the institutions. While Moravcsik argues that instead member states set the agenda for supranational institutions then SNG approach emphasizes the independence of created organizations. Studies show that especially ECB is remarkably independent (McNamara, 1998). It is a classical principal-agent debate between the theories of LI and supranationalism in which the former tends to underestimate the delegation of powers and latter tends to overstate the power of European Commission (Kassim & Menon, 2003). In sum, both can be used to explain the EU integration processes but the nature and focus of the theories may produce different explanations because of the differentiation in assumptions on the role of actors.

1.3 Hypotheses

This subsection will outline five hypotheses for the case analysed in this thesis. They are the causal mechanisms that one should be able to recognize in case the theory serves well to explain the case. They guide the research in testing the validity of the theories. The following graphic visualizes the hypothesis and theoretical framework attempts to explain the integration outcomes.

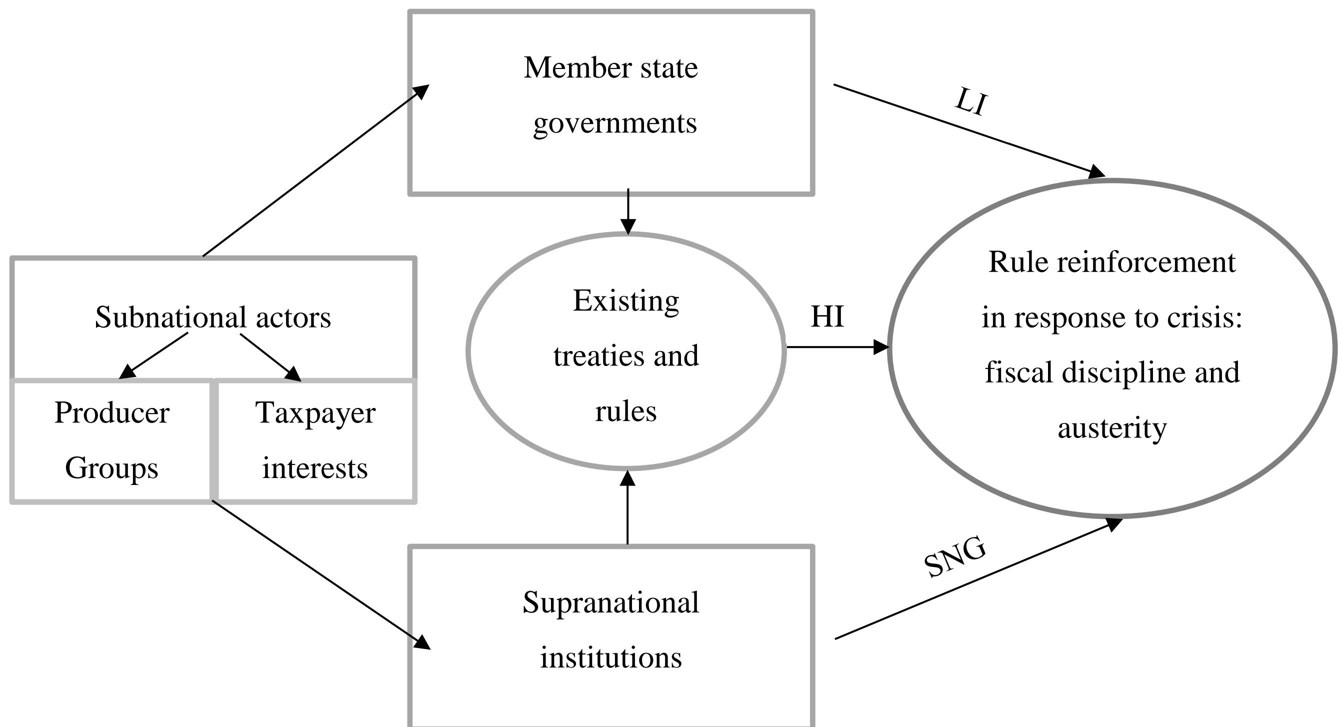

Figure 1. Explaining integration outcomes in the context of crisis

Figure 1 shows three lines of explanations for the euro crisis outcomes. The upper part of the figure shows the LI explanation of processes leading to reinforcement of fiscal discipline and austerity measures. It assumes that subnational interests, more specifically producer groups and taxpayers, influence member state government positions which in turn agree on the reinforcement of fiscal discipline. The lower part shows how SNG theory gives a competing answer for the causes of the outcome by assuming that the same subnational actors across borders gave the impetus for supranational institutions to influence the outcome in the direction of fiscal discipline. The theory of HI stands in the middle of the two and explains how both member state governments and supranational institutions had a role in formulating preceding regulations which in turn cause a tendency for continuity and reinforcement of rules.

The theory of LI implies that governments seek to empower supranational institutions, which are autonomous to make neutral decisions in the future. According to the theory, it is in the interests of governments to ensure the credibility of commitments by delegating the sovereignty to supranational institutions. As previously noted, there is a tendency in which giving away responsibility, governments free themselves from uncomfortable decisions that would not be in accordance with public opinion. Big states government anticipated uncomfortable decisions that had to be made in the future to put the new treaty into practice and therefore agreed to delegate the right to intervene to the European Commission and the ECB and they applied the policies in a neutral manner. Furthermore, the big states governments delegated sovereignty to avoid being accused of intervening in Greece sovereign issues and can 'scapegoat' supranational institutions for doing that. Therefore, the first hypothesis is the following:

H1: *Integration outcome reflect the interests of the large member state governments*

Second, taking account the idea of 'asymmetrical independence' embedded in the theory of LI, there are two types of countries concerning the necessity of the agreement. For some countries (A), reaching an agreement is essential because any of the unilateral solutions would be even worse. For other countries (B), the agreement is not so vital. Therefore, a set of A countries hold more bargaining power and are able to secure compromises and side-deals at the expense of B preferences. Both A and B types of member states are interested in agreement because it brings rational-economic benefits. Moravcsik assumes that bigger member states are less dependent on the integration but also gain more from integration than the smaller member states. Thus, the big ones have more leverage power and political will to guide the direction of integration. Initial research confirms that big states, especially Germany, had a special role in supporting austerity measures. Concretely, there was more at stake for Greece than for Germany. Austerity measures, more specifically signing the TSCG which includes the Fiscal Compact was a precondition to ESM, which ultimately solved the euro crisis. Therefore, the thesis analyses fiscal compact, in the light of the second hypothesis, as a side-deal and the ESM as the core of the agreement. Furthermore, the theory of LI emphasizes, bargaining power is reflected in the distribution of agreement benefits. Therefore, the set of A countries get more from the agreement than the B countries. The second hypothesis is the following:

H2: *When the preferences of member states governments conflict, bargaining power belongs to the one who has less at stake, which is reflected in the distribution of agreement benefits*

Third, LI assumes that the member states preferences are guided by the interests of dominant interest groups, such as producers, and public interests. Both constituents set the 'bargaining space' for governments. In policies concerning regulations and fiscal responsibility, such as monetary and fiscal policies, producers demands are under major constraints by general demands. In other words, producer groups like industrialists vis-à-vis taxpayers are in domestic competition to influence the official government positions which limit the preferences of the government. Thus, the third hypothesis is the following:

H3: *Government positions are shaped by subnational interest groups, and in case of regulatory policy, public interests prevail over producer interests*

The theory of SNG assumes that instead of focusing only on single country domestic interest groups, subnational interest groups share common goals across borders, and insist supranational organizations to take integration forward by establishing common rules. Theory of SNG assumes that the Treaties and regulatory framework became the source for supranational organizations who tend to do wide interpretations while innovating new policies to guarantee the general aim of Treaties and previous regulations.

H4: *Outcomes of* integration *reflects the preferences of supranational actors*

The theory of HI says that after a certain path has been taken, unintended consequences occur. Therefore, after the creation of eurozone, the EU institutions acknowledged the problems but were powerless to engage to solve the situation. Involvement of experts who were aware of the weaknesses of the current state of the EMU started to look for solutions to reinforce regulations which would fix these deficiencies and maintain the system in general. According to theory, it was the idea of supranational organizations, who were guided by the existing regulatory framework, to impose austerity measures on the countries who had behaved irresponsibly with state financial issues. These supranational organizations gave lead to treaty amendments because the experts knew how to reinforce the current system and make the EMU work properly again. Thus, HI does not emphasize the role of member states in the new outcomes. Instead, the theory encourages to look at the history of institutions and regulations

to find the causes of the outcome. It assumes the existence of critical junctures in the EU integration process which are followed by stable periods. So, the thesis considers the creation of EMU as the first critical juncture where a certain path was taken. If this was so, then the Maastricht Treaty includes clues for the responsible handling of state finances like common rules regarding state loans, budget deficits, and spending. In this perspective, at the moment of next critical juncture, the governments have limited options on agenda and they basically confirm the new proposals of supranational organizations because there are no reasonable alternative solutions on the agenda because the alternative solutions bear high 'sunk costs'. In other words, a certain path of development 'locks in'. This a key moment in which HI and LI contrast the most because the latter would assume that member states are in total control over the treaty, while HI assumes that member states are not in control anymore because they face limited options and institutions shape their choices. Therefore, the fifth hypothesis is the following:

H5: *Integration outcomes are, to a significant extent, shaped by path dependency – continuity of existing treaties and regulatory frameworks.*

2 Research Design

The following section will elaborate on the research design and justify the case, method, and data collecting methods. The section starts with justifications for case selection, following with elaboration on methods and data used to answer the research question.

First, it is necessary to detect which kind of forces gave impetus for austerity measures. On the one hand, the theory of LI would assume that bigger member states are less dependent on the integration but also have more to gain from integration than the smaller member states. Thus, the big ones have more leverage power and political will to guide the direction of integration. Initial research confirms that big states, especially Germany, had a special role in supporting the austerity measures.

2.1 Case selection

The research is a single case study with an aim to explain why the EU agreed to impose austerity on Greece as one of the measures to solve the crisis. The focus is on the relations between Germany and Greece. The decision to choose these two countries out of 28 member states is based on the initial insight from the empirical material concerning the euro crisis and theoretical framework. Euro crisis was one of the most troublesome crises that tested the credibility of eurozone integration. The central topic of the crisis was the question of how to deal with the countries who were on the verge of default. The key debate was over austerity measures – while Germany was the strongest supporter of austerity measures then Greece was a persistent opponent. Case of Greece was especially important because it was the first country in the eurozone that could not survive without the assistance of third parties. Thus, it paved the way for other member states whose outlook on budget deficits and sovereign debts was also worrisome. Another reason why the research limits itself only with the case of the Greek debt crisis is that it enables to come to conclusions about the case. The causes of crisis and countermeasures have considerable variation between the states who needed third-party financial aid. Thus, it is reasonable to limit the research with only one important case. Studies of the EU often explore cases of successful integration and are often outcome-centric, which makes them select cases on the dependent variable (Schimmelfennig, 2013, p. 3). As the dependent variable is a reinforcement of fiscal discipline, Greece is the strongest case among other countries who also had to implement austerity measures.

Governments positions on the issue of solving the euro crisis are divided into two – the ones contribute to the ESM as net contributors and those who gain as net beneficiaries. The net contributors – Austria, Finland, and the Netherlands were led by Germany and form a coalition, which supports austerity measures (Schimmelfennig, 2014). The other set of countries is composed of Southern-European countries and Ireland. Germany and Greece represent the most vivid example of relations between these set of countries. While Germany exemplifies set of countries who are net contributors to ESM, then Greece is one of five among other PIGS (Portugal, Ireland, Greece, and Spain) countries to whom ESM is essential to maintain the flow of money in the financial sector.

The measures aimed to solve the crisis was many-fold but the thesis focuses on the TSCG, more specifically chapter III of the treaty which established Fiscal Compact, which was key political agreement that established the direction of integration in long-term. There were many measures and regulations preceding the TSCG. Namely, the so-called "six pack" which were six legal acts aimed to improve the coordination of the economic policies within EU, supplemented by "two-pack" furthering the budgetary surveillance, both packages proposed by European Commission, and supplemented by political agreements of "Euro plus pact" and the TSCG. In legal perspective, political intergovernmental agreements, Euro plus pact and TSCG have high importance for constitutional point of view because they have a far-reaching impact on economic governance of the EU and lead to a higher level of political integration (Merino, 2012, p. 1614). Aim of Euro plus pact was to improve the competitiveness of each country, which leaves us to conclude that the TSCG, as a treaty of fiscal governance including political response, was a key political response to the crisis and formalized the austerity measures. However, it would be a mistake to solely focus on the TSCG, as the only measure that solved the crisis and brought the austerity measure. The measures concerning the economic governance and financial assistance are like "two rails of the train of EMU that run parallel" (ibid). Thus, the focus of the thesis remains on the TSCG as the political agreement which formalized austerity measures but takes account the parallel and preceding agreements that influenced the outcome of austerity measures. Another justification for focusing on the TSCG is that it is possible to see the crystallization of austerity policies while the immediate responses were meant to be short-term solutions and did not soothe the credit markets.

The choice of theories is based on Frank Schimmelfennig studies of integration in crisis. He argues that intergovernmentalism only partly explains the integration processes during the crisis and concludes that LI is not dynamic theory and has to be supplemented through synthesis with neofunctionalist or post-functionalist theories because they take account of "endogenous

preferences that may result from path dependence (Schimmelfennig, 2018b). Another of his studies (2018a) acknowledges that LI remains the backbone of integration studies but adds neofunctionalists path dependence to the theoretical mix and finds that level of supranational capacity and interdependence determine whether integration continues after the crisis. Thus, the thesis attempts to check the scope of explanation of both LI theory and HI, SNG theories as representatives of post-functionalism.

2.2 Process-tracing

The thesis relies on the method of process-tracing to evaluate the explanatory power of the theories. The term "process-tracing" comes from the scholars of cognitive psychology since 1960s and was later adapted to political science by Alexander L. George to make inferences about historical explanations (Bennett & Checkel, 2015, p. 5) It is a tool used for qualitative analysis which is often used to analyze data within-case (Bennett & Checkel, 2015; Collier, 2011, p. 823). There are no special methodological challenges when using process-tracing in the study of EU integration and the method has taken "pride of place" in the domain of EU integration studies (Schimmelfennig, 2013, p. 2) By definition, it is "systematic examination of diagnostic evidence selected and analyzed in light of research questions and hypotheses posed by the investigator" (Collier, 2011, p. 823). In other words, it is a tool for making the "causal inferences from diagnostic pieces of evidence" (ibid). Process-tracing is used for theory-testing through examining how actor preferences are produced and in which order they have an impact on the outcomes (Schimmelfennig, 2013) Because the process-tracing method focuses on casual inference it focuses on events that unfold over-time (Collier, 2011, p. 824). The method requires a rigid and careful description of events that identify a series of specific moments (ibid). In order to use the tool, the investigator needs to identify these moments beforehand and specify hypotheses to make an analysis of change and sequence which requires background knowledge (ibid, pp. 824-825). Quite often, the method implies both qualitative and quantitative data because the method focuses on "single nuggets of information" (Collier, 2011, p. 825) It is a "key technique for capturing casual mechanisms in action" (Bennett & Checkel, 2015, p. 9). Process-tracing often follows inductive and deductive logic meaning that once the initial theory is set, it switches to deduction and develops case-specific hypotheses (Bennett & Checkel, 2015, p. 18). In sum, process-tracing is a useful tool for especially in the studies of EU integration as it allows to draw the empirical material from a variety of sources to explain the causal mechanisms that unfold over time.

However, process-tracing has also some short-comings. The problems concerning the process-tracing method are that they require a huge amount of information because the sequence of causal processes become long or even infinite (Schimmelfennig, 2013, p. 5). Process-tracing can become storytelling because the researcher can present the material appears plausible because humans tend to tell coherent stories (ibid, p. 6). Meta-theoretically there is a problem with process-tracing is equifinality meaning that there is a possibility that multiple pathways lead to the same outcome (Bennett & Checkel, 2015, p. 4) To avoid the mistake of storytelling, the research should contain "ex-ante specification of the causal mechanism" (ibid, p 8.), meaning that theory testing should be based on forecasts rather than actual results. Furthermore, another safeguard against storytelling and also against "infinite regress" is competitive theory testing which enables to select data that matters and focus on cases which are worth "digging deep" (ibid, p. 7, 9) For this reason, the research is conducted in vigorously and hypothesis are proposed as forecasts and not based on actual results.

2.3 Data gathering

The following section is giving an overview of the data that is necessary to collect to test the validity of the theoretical assumptions and justify the choices of data gathering. First, the research needs to determine the positions of actors. More specifically, positions of key governments like Germany and supranational organizations like the European Commission, the ECB, and the IMF. The German government position is shown by analyzing Merkel 3 speeches half year before signing the TSCG. The positions of The Chancellor of German Federal Public represents well the positions of Germany in the process because she, as the highest level political leader, participated in the final round of negotiations on behalf of Germany. The first speech analyzed is in the front of the German lower House of Parliament and represents a decent source to analyze government positions as the chancellor openly speaks about German preferences, causes of crisis and solutions for solving the crisis. The second is a few days before European Council meetings in which Merkel laid down the objectives and guidelines before the meeting. The third is after the European Council meeting in which the heads of governments, essentially but not technically, decided about the Fiscal Compact 2011. In the speech, Merkel makes clear statements about German positions after the European Council meeting. After the analysis of German positions, the thesis analyses key speeches of other big member states, namely French and Italy government leaders positions about the situation concerning the euro crisis and compares them with German position. Empirical data

is drawn from the leaders of the government because the crisis was highly salient taking the track of high-politics and ultimately leading to negotiations on the leaders of the governments level. The scope of the thesis does not allow throughout analysis of French and Italian positions and there is no point in doing so because the initial insights tell that both of them opposed strict austerity measures and thus they did not have such input for the outcome of austerity measures. In order to analyze the sources of German government position, the thesis relies on an analysis of key producer groups and taxpayers interests influencing the government position. Therefore, main interests groups press releases are analyzed to understand their influence on bargaining space for the German government. Specifically, the paper is looking into press releases of the two biggest trade union in Germany. Industrial Union of Metal Workers in Germany (IG Metall) as the largest industrial union within Europe, and umbrella German Trade Union Confederation (DGB). The press releases are analyzed by looking at their statements about austerity measures. As the biggest representatives of the lobby groups, they tried to influence government positions. The analysis of taxpayers influence on government relies on macroeconomic data, more specifically German government net-position concerning the ESM.

The supranational organization's positions are determined by looking at the information given to the public by press conferences and statements. The position of the European Commission is based on press releases by the Commission. Inquiry of press releases is conducted in the time frame of 2011 September to March 2012 when the TSCG was agreed. The inquiry is limited with press releases only from the EU Economic and Monetary Affairs and the statements which are concerned with austerity measures, Greece debt situation, rules concerning economic governance, and the TSCG. The position of ECB is determined based on statements to the press conference with questions and answers. Data-set includes 7 regular briefings given by Presidents (Jean-Claude Trichet replaced by Mario Draghi during the period) of the ECB during the same time period of September 2011 to March 2012. The justification for time-frame is based on the fact that the temporary European Financial Stability Facility (EFSF) was replaced with the permanent ESM in September and the political response to substantially fix the eurozone architecture was agreed half year later in March when heads of governments agreed on Fiscal Compact. The press releases are analyzed in the light of looking for the ECB stance on reinforcing fiscal discipline, the TSCG, and rules concerning economic governance.

Furthermore, to elaborate on the Commission positions, the analysis takes into account relevant Treaties and regulations that precede the TSCG and influence the Commission position. Specifically, Maastricht Treaty economic convergence criteria, Treaty on the

Functioning of EU article 126, two council regulations before the adoption of euro, which established Stability and Growth Pact (SGP), Memorandum of Understanding between Hellenic Republic and Commission.

As a complementary source to explore Greece and Germany different positions regarding the solutions, general overview of the Greek debt crisis, and process of leading to Fiscal Compact, the analysis includes on spot reliable mainstream newspaper media, time period of 2009 - 2012, that mediate valuable information gained from anonymous diplomats and policy advisors. The political response to the crisis and negotiations were conducted behind the closed doors. Official press conferences about the actual negotiations remain superficial and say little about which roles the participants had in the negotiating process. On spot newspaper, media and journalists have close ties with diplomats and experts who have insight about what happened during the negotiations and who represented a certain point of view. Empirical inquiry through media investigation is especially important for testing out LI theory because it requires to distinguish positions of different Member State governments which officially remain in secrecy.

Allusions of German government position during international negotiations is tested by looking at macroeconomic data. Macroeconomic data concerning the state net-position in ESM. Furthermore, analysis of state positions during negotiations is based on data from Bank for International Settlements consolidated statistics of state claims (1998 – 2009 and 2009 - 2012). Greece position is defined by looking at Eurobarometer statistics of support for euro in Greece in the years of 2008, 2009 and 2013. Comparison between Greece and Germany positions is based on the Organisation for Co-operation and Development (OECD) statistics of debt to Gross Domestic Product (GDP). Furthermore, the OECD statistics of debt to GDP is used to show the positions regarding the fiscal rules by looking at debt-to GDP levels from 2008 to 2012 in Germany and 1998 to 2009 in Greece. Eurobarometer data on support for euro is used to assess the Greece dependence on the euro. World Bank information about currency reserves and exports levels is used to show how Greece was more dependent on the agreement.

To find out how did the austerity measures become the key for the reforms the paper needs to answer why the German government had more power in the bargaining process than Greek adversaries. For that reason, the paper takes a look at macroeconomic data to assess which of the states had more at stake in the final agreement because this information determines the bargaining power. Bank for International Settlement provides valuable data sets on the consolidated claims within the banking sector between the states. Data is taken from 1998 to 2009 to show the rise and dynamics of interdependence between the banking sectors of Greece,

Germany, and France. According to this kind of data, it is possible to see the debt and creditor relationships within the EU member states. In other words, the paper collects comparative macroeconomic quantitative data about the economic gains and losses which are connected with the crisis countermeasures. Furthermore, if the theoretical assumptions are true, there should be data that confirm that Greece obtained more from the deal than Germany but had to accept side-deals and compromises insisted by Germany. For this reason, the thesis analyses the institutional relationship between two treaties: ESM and Fiscal compact. LI tells that the benefits of the agreement to reflect the bargaining power, thus, the paper is going to assess whether Germany or Greece benefits more from the final deal. This is tested by a dummy variable that checks whether defaulting of member states costs are in general higher than the benefits from the survival of euro, taking account the analysis from academic literature that estimates the gains from the existence of euro for Germany.

3 Austerity measures in the context of the euro crisis

The following chapter lays down the empirical part of the study following the method of process tracing. The structure of the chapter is divided into three. First, it presents a general overview of the euro crisis on the example of the Greek debt crisis. The first part also includes an overview and timeline of the key measures aimed to resolve the crisis, more specifically the role of Fiscal Compact in the crisis. In the second part, the paper presents the positions of different actors in the integration process which in ultimately led to a reinforcement of fiscal discipline rules and austerity measures. The third part analyses the positions of actors in the light of theories explaining the integration. The aim of the third part is to analyze which kind of aspects influenced the positions of different actors. In short, the chapter gives an overview of the chain of events, it then goes into a more detailed description of positions of actors involved in the process, followed by analysis with a goal to show which factors, if at all, had a role.

3.1 Greece debt crisis in 2009 – 2012

The following subsection gives an overview of the euro crisis and its countermeasures on the example of the Greek debt crisis which was ground paving case for the outcome of austerity measures.

The phases of the Greek debt crisis can be divided into three. The first phase occurred when the Greece government decided to reveal a lie, which the previous governments had hidden from the public, that undermined the credibility of the eurozone in general. The crisis for Greece began in 2009 when the new socialist prime minister of Greece George Papandreou revealed that Greece had deliberately misreported and lied about its financial data. According to new estimates made in October 2009 by Greeks, the state had a 12.5% deficit of GDP which was far above 3.7% that was reported a few months ago (Financial Times, 2010). Soon after, rating agencies like Moody and the Fitch started to lower the ratings of Greek long-term debts and warned the other countries like UK who had structural public deficit running above 10% that their AAA rating is not anymore taken for granted (TheGuardian, 2009). Rating agencies like Standard & Poor ignored the EU sided promises on the support package and calls on rating agencies to be cautious and responsible in a sensitive period and labeled Greece government bonds as a junk (TheGuardian, 2010c). To sum the phase, the new Greece government confession about the mismanagement of state finances jeopardized the credibility of the eurozone and showed light on the loopholes of the system.

The second phase consisted of political conflict over the solutions and can be described as a political crisis. While on the verge of defaulting, Greece started to seek financial aid from the IMF and the EU. Already before the first bailout, Germany and Merkel showed stiff attitude towards bail-out programs. Unity between France and Germany was only formal because the former favored financial aid while the latter did not. Berlin started to bring out arguments: under the terms of Maastricht Treaty, Germany cannot aid the single country in trouble; instead of bailing out Athens, Greece should start with rigorous austerity guided by Troika (a term that refers to ECB, Commission, and IMF) (TheGuardian, 2010a). "Germany cannot justify its taxpayers having to finance costly lives of the Greeks," said a senior diplomat to describe the rationale behind Merkel position (ibid). Degrading by rating agencies like S&P and Moody's, who named Greek debt as junk, meant that borrowing costs for Greece rose to unsustainable levels (TheGuardian, 2012b). The second phase included searching for the culprit that was responsible for the outcome and victim blaming which in turn resulted in a political crisis and did not help in solving the situation but made it only worse because rating agencies continued to lower ratings of Greek government bonds and thus raised the Greek borrowing costs.

The third phase can be characterized as seeking for solutions that would make the eurozone survive. Despite German government reluctance to bail out Greece, Angela Merkel, under pressure, finally agreed to "last resort" package in 26 of March 2010 (TheGuardian, 2012b). It was a joint financial assistance program by euro area countries and the IMF to safeguard the stability of the euro area as a whole. Statement by the Eurogroup (2010) emphasizes that "the program is supported by strong conditionality" meaning that the Greek government has to "resolutely address the fiscal imbalances". The total sum of the financial package, made available for Greece, was 110 billion euros. Germany and especially the finance minister Schäuble are believed to have the most pivotal role in shaping bailout programs together with tough conditionality while using the idea of toughness to soothe the public opinion in Germany (TheGuardian, 2010b). The IMF foresaw the future and predicted that because of the austerity measures the money which was planned until 2013 will run out before and Greece would be on the verge of bankruptcy once again (TheGuardian, 2010d). In April 2011, after the Greek Parliament had passed the pension reform, the EC reports that Greek budget deficit is even worse than before, rising to 13.6% and a few months later S&P downgrades Greece credit rating even further to CCC, which is the lowest level in the world (TheGuardian, 2012b). Thus, the initial solutions to make eurozone survive in the third phase made the stability of the eurozone even worse.

The fourth phase can be described as a period of follow-up of bailout programs in which strict austerity measures was maintained but accompanied by complex procedures to ease the situation for Greece. Considering the sluggish growth, rising deficit levels and continuation of indebtedness together with austerity measures, it was obvious that second bailout program was inevitable but this time Germany managed to defend even more strongly its taxpayer's concerns. In the start of 2011 July, Eurogroup Finance Ministers met and postponed the decision about the second bailout package. The second deal became hard to achieve because of the demands of German government who wanted to see the involvement of the private sector but were struggling to convince the German parliament on the matter (Veron, 2011). Some other net-contributor countries like the Netherlands did not have such issues and were more assured in the need of private-sector investors involvement. Insiders tell that Angela Merkel and President of France Nicholas Sarkozy found a last-minute compromise after a telephone dispute that was not a for the taste of the ECB president Jean-Claude Trichet (TheGuardian, 2011). Merkel (ibid) commented few days before the meeting that "I know there's a great longing for a big decision, proposals for Eurobonds, a big restructuring (of Greek debt), for a transfer union, and much besides….I will not give in to this. The government will not give in to this". The new deal reached by Merkel and Sarkozy included private creditors involvement, the idea that Greece private creditors shall take some responsibility (ibid). Germany resisted to rewrite the EFSF (which later became the ESM) rules and on 22th of July of 2011 Eurogroup Heads of States and the EU institutions come up with a statement on a second bailout package to Greece. The statement includes a new and complex method to restructure Greek debt by extending the EFSF loans maturity period from 7 to 15 years and allowing Greek banks to make liquidity operations by voluntarily buying back its own bonds and contributing this way 37 billion euros. With the contribution of the IMF, the private sector and the ESFS, new money was made potentially available to keep Greece on track. Strict austerity measures remained in place and paragraph 11 of the Eurogroup statements demands to "adhere strictly to the agreed fiscal targets" (Council of the EU, 2011). Some economists are critical about the plan to continue with harsh austerity measures and call it unconvincing, eg Paul Krugman (2011) who asks: "So demand will be depressed in both crisis and non-crisis economies; this will lead to a vigorous recovery through … what?". The finalized version of the second bailout package emerges in February 2012 and Eurogroup together with the ECB and the IMF agrees on giving out the second round of loans mediated by the EFSF. The second bailout consisted of 130 billion euros made available for Greece and a debt write-down of 107 billion euros (BBC, 2012) by restructuring the debt and lowering the yields of privet sector creditors to 3.5 % which

lost the value of these bonds over 50 % (TheGuardian, 2012a). Furthermore, member state central banks contribute to easing the situation for Greece by giving back the profits made through the holdings of Greek government bonds until 2020 (Eurogroup, 2012). However, while the Greek situation gets some alleviation by debt restructuring and member states contribution, the member states demand also more control and monitoring over Greek domestic financial operations. On behalf of member states, Commission created a Task Force composed with the experts provided by member states, which represents Commission permanently on the ground in Greece and monitors the measures taken by Greek government (Eurogroup, 2012). While the second bailout program was agreed in February 2012, then the Fiscal Compact, which reinforced the fiscal discipline by making assistance from the ESM conditional, and by demanding to adopt fiscal rules to national legislation. To sum up the fourth phase, strict austerity measures continued to accompany the bailout package while the situation for Greece was eased by debt restructuring together with the Commission on-ground monitoring institutions.

The third bailout package given to Greece is out of scope for this thesis. In short, the loans and liquidity given to Greece were still not enough and in 2015 the third bailout program was released. The content of the bailout was generally same – strict austerity measures and reforms vis-à-vis new loans made available for Greece. Some researchers believe that the first part of the crisis (2010-2012) can be described as "fast burning phase" in which "coercive and ideational powers", like the Member States of Northern Europe, played a key role in solving the crisis while in the second part the supranational organizations like the ECB and the European Commission followed the pattern after the first part (Carstensen & Schmidt, 2018). The following analysis in this paper is focusing on the first part, especially the time frame of September 2011 until March 2012, which was the moment in which most of the key measures were formalized to long-term policies.

The Greek debt crisis was one of the causes of the eurozone crisis in which some of the states did not manage to repay the government debt without foreign assistance. Choices for these countries was limited and goals hard to achieve. The incapability to cope with government debt increased the interest rates of government bonds. There were mainly two solutions for indebted countries to solve the problem. One was to come to an agreement on a collective level and create the 'lender of the last resort' on EMU level which was the actual solution (the ECB became the lender of the last resort) (ECB, 2016). The idea was to provide liquidity to the banking system (ibid, p. 2) because the main problem for the troublesome countries was a liquidity crisis in which governments did not have enough liquid assets to meet

its short-term obligations. The second alternative was to ignore the loans and accept the downgrading of the euro currency by the rating agency. Third, countries in excessive debt could have stepped out from the EMU. The latter would have been fatal for the EMU because the domino effect could have brought down also countries whose situation was also worrisome (Arghyrou & Tsoukalas, 2011, p. 22). Thus, the choice to take forward the ECB mandate was the only reasonable option to save the credibility of the euro.

One of the many causes of the eurozone crisis, as well as to the Greek debt crisis, was political. The crisis did not simply result of global financial crisis or an internal prolonged recession, it was the result of accumulating tensions within EMU for more than a decade (Copelovitch, Frieden, & Walter, 2016, p. 813). The decision to upgrade and empower the ECB was burdensome. It was a relatively long journey in which governments had to act quickly but failed to do so. The euro crisis was not only about economics but also a serious political crisis in the history of the EU which threatened the progress and future of European integration (ibid, p. 812). Under political constraints, economists focused on fixing the crisis through politically feasible solutions which ensured the survival of eurozone but did not develop more viable long-term solutions (ibid, p. 813). However, the political crisis turned when the ECB mandate to engage was empowered and Mario Draghi, the president of the ECB announced that "within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough". Lingering and hard negotiating processes and indecisiveness only worsened the anxiousness of financial markets and hindered the troubled countries outlook to get new loans from the market. The turning point was in 2012 when the ECB finally able to take resolute action.

3.2 European Fiscal Compact

The following subsection aims to give context to the Fiscal Compact, which formalized and crystallized the policies of fiscal discipline, which in turn forced member states in need of foreign assistance to make cuts in government spending. It is going to elaborate on the general information regarding the European Fiscal Compact.

Technically, European Fiscal Compact is the chapter 3 of The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) that was agreed by member states on 2 March 2012 and entered into force on 1 January 2013. The first two bailout programs for Greece was made available through two documents, Memorandum of Understandings signed by the Commission acting on behalf of member states and the EFSF.

Few months after the second bailout, the same policies were constituted in the TSCG which was more official form and laid the groundwork for other indebted countries. The core of the Treaty is the European Fiscal Compact, which consists of a requirement to have balanced budget rules in domestic fiscal policies. The Commission preferred to see the treaty laid down on the EU legal framework but in the end, the treaty became intergovernmental treaty established outside of the decision-making procedures (European Commission, 2017, p. 3). This was caused because of the crisis situation, as an intergovernmental approach became the "emergency stopgap" (ibid). However, the content of the treaty binds member states, called "Contracting Parties", with the EU institutions and legal framework. (art 2, TSCG, 2012) The TSCG is applied coherently with EU Treaties and it includes a clause which incorporates the treaty into Union law by 1 January 2018 (ibid). The treaty was signed by 22 European states, including 19 states who use euro as the currency in 2012 and later three states joined the treaty. As the treaty was intergovernmental, signatories had to ratify the treaty in national parliaments.

The Fiscal Compact includes rules that establish the base-line for principles of fiscal responsibility and austerity measures. These rules are: budget position of the general government must be balanced or surplus, signatories should aim for structural deficit of 0,5 % and a general government deficit of 3 % of the gross domestic product (GDP) at market prices, the parties of the treaty can only temporarily deviate from the adjustments in case of exceptional circumstances like financial crisis, in case government debt to GDP is significantly below 60 % then the government can allow a structural deficit of 1%, in case of deviations, happen during the adjustments, a correction mechanism triggers automatically and parties shall implement measures to correct the deviations (art. 3, TSCG, 2012). Nevertheless, European Council has to decide, whether a member state breaches the excessive deficit criteria because TSCG binds on the Treaty of the functioning of the EU (art. 4, ibid) which postulates that the European Council decides whether an excessive deficit exists or not (art. 126, TFEU, 2008). Article 5 (TSCG, 2012) authorizes the Commission to monitor and conduct surveillance procedures over the deficit and debt criteria under the Stability and Growth Pact (SGP). In case breach has been noted, the state has to commit the proposals and recommendations given by Commission (art 7, ibid). If the member states still fail to meet the deficit criteria, another member state independent of Commission assessment or the Commission itself can bring the case to the ECJ which can impose financial penalties paid to the ESM (art 7, ibid). After all, the 60 % debt rule together with fiscal deficit rule is indirectly guiding the governments for fiscal responsibility. In case states are exceeding the 60 % debt level but aiming to achieve it

without breaching the fiscal deficit rule then the only way to accomplish the goal is by cutting government spending or collecting more taxes.

The Fiscal Compact can be used as a focal point to analyze the political outcome in which one can see the crystallization of austerity policies. After all, there is not much essentially innovative in the rules established by Fiscal Compact. Maastricht convergence criteria already establish that general government budget cannot exceed the 3 % limit and set the Government debt-to-GDP ratio on 60 % (Maastricht Treaty: Protocol on the Excessive Deficit Procedure, 1991, p. 183). What was new concerning the Fiscal Compact is that it became the pre-condition to receiving new loans from ESM. It was mainly Paul de Grauwe (2014) who had examined the possibilities for the ECB to act as 'lender of last resort' and insisted that ECB should buy unlimited amounts of government bonds of member states to break the vicious circle. The ECB started to govern the ESM. It is important to note, that Treaty establishing ESM was another intergovernmental treaty agreed outside of the EU decision-making procedures. The ECB and Commission were empowered by the mandate to start supervisory processes over national budgets. Namely, to control whether national budgets follow the rules concerning the deficit standards. Two treaties, the TSCG and the ESM became "complementary in fostering fiscal responsibility and solidarity within the economic and monetary union" (Treaty Establishing the European Stability Mechanism, 2012, p. 4). Hence, the countries who had desperate need of financial aid from ESM had no other choice than sign the TSCG, including Fiscal Compact, and be financially responsible.

3.3 Contrasting and converging positions of the key member states

The following subsection is going to elaborate on the positions of actors involved in the process of reaching agreement on the TSCG. It is going to have a closer look at three biggest member states: Germany, France and Italy, and three institutions: European Commission, ECB, and IMF.

To analyze the German government position during the negotiations, it is important to understand what they believed to be the causes of the crisis. Defining causes inherently points out the aspects that need to be fixed to solve the crisis. German government believed that the causes of the crisis was irresponsible loaning and ignoring the SGP rules by politicians. Merkel (2011c) pointed out that only one single country, Greece which contributes only 2% of entire GDP of the EU, can jeopardize the system and it is possible because the current regulatory framework does not have any implementing mechanism of economic governance. She adds

that politicians failed to meet the SGP standards and calls for an agreement that would stop this kind of actions (Merkel, 2011b). Later, when the initial agreement was reached, she emphasized that everybody agreed that ignoring the rules was the root cause of the crisis (Merkel, 2011a). The aim of the German government during the negotiations was to erase the root cause.

The German government was eager to push their solutions forward and implement the same policies that they had done on a domestic level to international level because they saw that Germany had been successful in overcoming the crisis and should now have the central role in solving the eurozone crisis. Merkel (2011b) quite explicitly says that: "Our task is to push Germany forward". The goal was to "exert pressure" to achieve common European directives and the German government had a very clear idea about the substance of the directive (ibid). Merkel was eager to take political credit for overcoming the financial turmoil domestically and that gave German government confidence to take 'German solutions', which included lowering the excessive deficit and reducing debt to GDP ratio, on the international scale (ibid). She praised Germany for fast recovery from the crisis and emphasized that this was so because of the effective domestic policies that work as "guide posts". However, the German government admitted that they had not been successful yet to take their preferences on an international scale. Merkel notes that "What we succeeded in terms of the real economy (in Germany), we have not succeeded in terms of international economy" referencing that internationally Europe has not reached these "guideposts" (ibid). Self-perception on the role of uniting Europe was strong as Merkel said that "We as the German Federal Republic are a central component of European Union" (Merkel, 2011c). The government of Germany believed that they had overcome the crisis domestically because of successful policies, which in turn justified their central role to take the same policies to the international scale.

The aim of German centrality and pushing forward their ideas was to safeguard German success. Merkel (2011c) illustrates the point by saying: "if euro fails, Europe will fail" and adding that "Germany cannot be successful in the long term if Europe does not well". The idea that German solutions should be followed on an international scale was important for Germany to make the people of Germany prosper (Merkel, 2011b). To sum up, German government believed that they had managed to overcome the financial crisis in Germany because of policies, which took a step closer to SGP rules, and now, as an example of a successful case, they had the opportunity to take their preferences on an international scale to preserve the prosperity of German people.

The German government did not want to see any debt mutualization because they believed that it would not substantially resolve the crisis. Merkel (2011c) completely dismissed 'Eurobonds' (an idea first proposed by the Commission including the idea that investors issue new loans to the eurozone altogether) by reasoning that Germany does not have influence over other member states national budgets while the interests rates for the whole euro zone would become common. She called the idea about Eurobonds as "sweeping everything under the carpet" while not reaching any stability within the union (ibid). Merkel emphasizes that the union should not be debt union but stability union meaning that joint liability for the debts of other euro-zone countries was unthinkable for the German government (Merkel, 2011c, 2011b). Furthermore, the position of the government was that the structural reforms concerning growth should not be financed by credit (Merkel, 2011b). To conclude, the German government strongly opposed the alternative ideas about sharing the debt burden which would mutualize the credit interests.

Instead of debt mutualization or burden sharing, German government insisted that member states in need of foreign assistance, which are the sources of root causes, should take responsibility before the others help them as minimal as possible. Merkel clearly had the idea that other member states had to change the way of governing state finances. "Its time to put some order into things" was the opening sentence of her speech (Merkel, 2011c), meaning that the new agreement should involve establishing new rules in the national legislation of the member states, and if possible, even on the constitutional level (Merkel, 2011a). The justification for this demand was that solidarity and responsibility should accompany each other and Germany should not show solidarity for those who do not show responsibility (Merkel, 2011c). The German government did not believe that making new funds available was going to solve the crisis. She added that "there are people who are saying that you have to do even more, but I believe that we can only be successful if we tackle the problem at the root causes of the crisis" (Merkel, 2011a). She emphasized, on the matter of fiscal responsibility, that the six-pack was an important step forward but did not solve the issue because it was not binding enough and thus not effective (ibid). After the initial agreement, she concluded that Germany managed to reach a satisfying deal (ibid). To sum up, the German government aim was to reach an agreement which would force governments in debt to change their policies through conditionality of financial aid.

Another aspect of the German position, which Merkel hid between the lines, was that Germany had to take some risks to find the stability for the union. Merkel (2011c) presented the idea to Bundestag by coming up with a parallel of founding fathers of the EU who also had

to take risks to unite the union. The German government saw the permanent bailout fund as a solution which brings stability (Merkel, 2011c) but only because the ESM is linked up with the new treaty (TSCG) (Merkel, 2011a). Merkel was glad that after 20 years of the Maastricht Treaty, the EU has finally addressed the weaknesses of the system by taking forward the political union (ibid). The German government was ready to take some minimal risks for uniting the EU and deepening the integration of political union.

The German government wanted to see new 'fiscal union' in which supranational institutions, such as the ECB, the European Commission, and the ECJ, and not Germany, would have an important role in implementing the new rules. First of all, Merkel pleaded Bundestag that if in the future they are going to send the budget to Brussels, then they should also listen to Commission's proposals (Merkel, 2011c). The German government wanted to see a new fiscal union in which the credibility and independence of the ECB and ECJ must be protected (Merkel, 2011b). This kind of position was justified by turning attention to the fact that in the case of ignoring the rules the states cannot be submitted to the ECJ (ibid). Merkel states that: "Failure of complying with the common rules must have repercussions and institutions must play an important part" (ibid). Furthermore, she called that "every step need to be monitored" by European institutions (Merkel, 2011c). The German government was eager to strengthen the authority of the EU which included the "right to take offenders to European Court" (Merkel, 2011b). The aim of the positions was to exclude the possibility that Germany would dominate Europe (ibid). After the initial agreement, Merkel also emphasized the importance of preventive measures, like excessive deficit procedure in which countries which have done mistakes have to commit themselves to proposals, made by European Commissions, about reforming and restructuring finances (Merkel, 2011a). According to the German government, the new financial Union meant that indebted countries have followed the guidance of the European Commission and the ECB and in case they fail to do so, there must be an opportunity to take them to the ECJ.

While the German government position was stiff about the following of the common fiscal rules and called for fiscal responsibility, then the position of France government also called for common European solution but in a way that would not demolish perspectives of economic growth. First of all, President Sarkozy said that the solution should be not to implement austerity or to lower wages and pensions but to "respond to the crisis through work…and preserve living standards", in order to not make the crisis worse, and if there was something that can be done about budget deficits then it should be cutting and reducing "expenditure that is useless" (Sarkozy, 2011). The French President emphasized that that

France is integrated with global economy and thus there is "no difference between domestic policy and foreign policy, between national policy and European policy", calling for European solution, out of necessity, to help the banks, which he justified through the argument that peoples savings are threatened (ibid). The government of France called for restoring the credibility through total solidarity, which means that countries in need for foreign assistance should be helped (ibid). The government of France position was to unite Europe and refinance the banks without strict cuts in government spending on growth and wages.

France, German and Italian government positions essentially converged on the issue that the Maastricht Treaty had to be taken forward to fix the imperfections of fiscal irresponsibility but the rhetoric on the issue was different. Sarkozy (2011) mentions that solidarity comes together with discipline but rhetorically the focus is a lot more on the solidarity than discipline, compared to German counterpart. However, the French government also emphasized that "Maastricht Treaty turned out to be imperfect" and the ECB had to became enough independent in case Europe faces risks that threaten whole Europe (ibid). A discursive analysis of the two leaders shows that while Merkel became the 'Iron Lady' who wanted to impose hardship on Greece to please the domestic taxpayers then Sarkozy was the 'White Knight' who was willing to rescue Greece through common European solution (Crespy & Schmidt, 2012). Italian prime minister Monti saw that fiscal responsibility has to be implemented because France and Germany started with the deviations from the SGP rules and emphasized that fixing Single Market and convergence of the wages was more important than the issues of austerity measures (Monti, 2012). Thus, the strict austerity measures and reforms were more important for German government than for France or the Italian government.

The Italian government position is a bit more complicated because there were two prime ministers before reaching the agreement accompanied by the collapse of government caused by internal fraction within the Berlusconi government on the issue of structural reforms. According to leaked files of Timothy Geithner (Financial Times, 2014), who was US treasury secretary during the time and involved in the negotiations, there was a plot against Berlusconi to force him to step down from the position of Prime Minister. While Berlusconi was accused of completely ignoring the new ideas of the fiscal union of Germany, then Sarkozy was trying to find the middle ground between the two (ibid). Geithner points out that Obama refused the offer to join with the plan to get Berlusconi out of the way through ultimatum of canceling the IMF funds (ibid), and later Berlusconi accused the EU officials of having the plot to force him to resign (Reuters, 2014). Italy was in a position in which the government was divided because the Euroskeptic factions in the Berlusconi government never took the ECB demands on

structural changes seriously (The New York Times, 2011). Berlusconi government was replaced with technocrat Mario Monti, who was a former EU commissioner, with a hope to regain investors confidence in Italy (Voss, 2011). This chain of actions prevented new Italian government to formulate a strong and unique position because Monti had to step in the middle of the process when most of the key policies about the austerity measures were already in place. Monti reflects his sadness that the UK stepped out of the process because it would have been helpful to formulate a stronger position against the Franco-German axis (Monti, 2012). In short, domestic political struggles in Italy hampered the Italian government to find a strong position.

Nevertheless, the government of Italy had mainly two positions regarding the TSCG. Monti as the new prime minister had to find explanations for agreeing on the Treaty and this shows the government position. First, he pointed out that it was never the euro itself that was in the crisis, but rather the design of EMU which had to be completed. He called the Maastricht treaty as a "cherry on the cake" without the cake itself and blamed France and Germany for the starting with the irresponsible economic governance during 2003 when they started to violate the standards of the SGP, while Italy was not (Monti, 2012). Taking this into account, the Italian government saw the Fiscal Compact as a solution to bring back fiscal responsibility for all the member states not only for the countries on the verge of defaulting. According to Monti (ibid), the problems of EMU are caused by large continental countries, who are not compliant with Single Market principles and that is why Italian government looks forward in meetings with governments of France and Germany to "play with them in order to provide impulsions of EU processes". Second, and most importantly, the Italian government was forced to agree with the austerity measures for political reasons. As Monti (ibid) says: "We decided to stick with the commitments, although macroeconomists would contend that it was not the optimal course, but I think from a political point of view we would have lost any authority and ability to influence developments if we had presented ourselves with a demand of more leniency". Meaning that Italian government wanted to see more mercy on the issue of austerity measures but they acknowledged that it was not politically beneficial because it would abolish their bargaining power for the future negotiations concerning real economic convergence in the EU. Thus, the Italian government agreed with the Fiscal Compact because they agreed that a lot of member states, not only the Southern ones, have been irresponsible and this was the issue that needed to be fixed and because it would keep Italy politically on the scene.

To sum up the key member states positions, one can see that the German government took the lead on Fiscal Compact and enforcing fiscal discipline through supranational organizations while dismissing the Eurobonds. French government essentially agreed about the

necessity of the rules but emphasized that the cuts should be not be done at the expense of wages and growth and called for common EU solution including a high level of solidarity. The dynamics of the two worked out well as Merkel (2011a) confirms that "Franco-German cooperation has been very valuable indeed". The Italian government, as in need of foreign assistance, had to accept the Fiscal Compact to preserve the political power in the future. The German government had leadership in demanding fiscal responsibility, thus, the analysis part coming later in this paper focuses on the analysis of German position only.

3.4 Positions of the ECB and the European Commission

The position of the European Commission was to go on with strict fiscal rules to regain the trust and confidence of the financial markets. In mid-2011, the European Commission was already busy monitoring Greece economic perspectives and deficit levels to meet the conditionalities for the financial assistance given by the EU and the IMF. The problem was that Greece was not meeting the demands and deficit reduction was not proceeding as expected. The Commission reaction to this kind of development was clear: "The slowdown is no excuse to stop putting our fiscal houses in order. That is necessary to restore confidence" (Rehn, 2011a). Also, the task force was already in place in Greece but without any authority to intervene in Greece domestic decisions but simply give policy recommendations and monitor the progress (Barroso, 2011). The Commission also admitted that Greece could not exit from the eurozone because of the serious damages that it would bring to Europe and thus also influencing the world economy (Rehn, 2011a). To the critiques of austerity policies, Commissioner for Economic and Monetary Affairs Oliver Rehn answered that there is no room for maneuver because the indebted countries like Greece cannot access "to market financing meaning it is becoming prohibitively expensive" for the sources of financial aid (ibid). The most critical issue according to Commission was the lack of trust and confidence in the sovereign debt market (Rehn, 2012) Similar to the German government, the Commission saw the solution in strict fiscal rules that had to be reinforced. The reasoning for fiscal discipline was that there was no other alternative in regaining the trust of financial markets and the restoration of normal lending was a top priority.

However, contrasting to German government views about financial aid, Rehn constantly emphasized the need for common Eurobonds accompanied with strict fiscal surveillance. The idea was to introduce Eurobonds with "reinforced fiscal surveillance and policy coordination as an essential counterpart, as to avoid moral hazard" (Rehn, 2011b). The

Commissioner called them a more realistic type of solution and an “expression of Europe’s evolutionary road” that would step forward in economic policy integration (Rehn, 2011a). The Commissioner also tried to convince German Bundestag about the idea and noted that it is a matter of fiscal sovereignty that is up to member states to decide (Rehn, 2011e). On the visit to Germany, he called to stop the populist voices and instead achieve a new level in European integration while being on “the current critical juncture” (Rehn, 2011c). As a solution, the Commission saw a need for Treaty change which would include strict discipline and stronger governance that would prevent a future crisis by creating a real stability union (Rehn, 2011d). To sum up, the European Commission position was that the new Treaty should continue with strict fiscal rules accompanied by Eurobonds which come with stronger EU economic governance.

The role of ECB was rather technical than political meaning that they had a key role in assessing the big picture and providing liquidity for the financial system, but it was hard to push forward any positions concerning the development of new rules because they were bound by existing rules. The President of the ECB Jean-Claude Trichet under the pressure of journalists questions about political negotiations and state-of-art points out that ECB has never engaged or will not engage in the political negotiations (Trichet, 2011a, 2011b). “We comply with laws; we don’t discuss laws. We do not push; we comply with legislation; we do not discuss legislation” (Draghi, 2011b). The ECB had to find other means to express their opinion about the rules. Thus, the ECB managed to show through constant monitoring that something had to be changed. The ECB had the responsibility to monitor and to pass messages to all the governments which were “not easy, but our duty” (Trichet, 2011a, 2011b). They pointed out that the ECB is not like other central banks because they have Treaty which constrains their abilities to act (Draghi, 2011b, 2011a), and Trichet (2011b, 2011a) had to point out many times that they are not in the positions of governments to implement the SGP rules. However, over time, the ECB had become the “preacher in desert” as the only one who had called for member states to follow the rules since the creation of euro (Trichet, 2011b). As a relatively independent institution, it had to fight to preserve the SGP pact in 2004 when key states of the euro wanted to relax the rules (ibid). When the political crisis started, they were in a position of ‘we told you’ but you did not listen and that the organization does not have the mandate to solve the crisis.

There were slightly more explicit positions, regarding the new treaty, when the Presidency of Trichet was replaced with Draghi. The new President welcomed the progress on the TSCG and insisted that governments should sign the treaty sooner (Draghi, 2012a).

According to Draghi (2012c), the fiscal compact was tested to release some sovereignty, and the first step to the fiscal union which should be step-by-step progress that can lead to fiscal transfer union in the future. He believed that it was an efficient treaty because it was necessary that policy-maker correct their excessive deficits and move to more balanced budgets which will support public confidence (Draghi, 2011b). On the question about whether ECB should be able to channel the money from third parties to indebted countries, Draghi emphasized the "spirit of the Treaty should always be in our minds", meaning that their powers to channel money was constrained by the existing Treaty (Draghi, 2011b). On the question of Greek indebtedness, the ECB was on the position that indebted countries should "not count on external help that could alleviate the temporary market pressures, instead, the real answer is actually to count on the countries' capacity to reform themselves" (Draghi, 2011a). The ECB also showed a strong belief in Fiscal Compact after it had been signed. After the signing of the TSCG Draghi (2012b) said that: "Monetary union needs from all the countries the willingness to be subject to a discipline that cannot be changed by any government whatsoever – a discipline that is rooted in their primary legislation or their constitutions". Therefore, the ECB was in support of the Fiscal Compact and believed that it would help in solving the crisis.

3.5 Bargaining outcomes

The following subchapter outlines key bargaining outcomes of the TSCG and elaborates on the insights during the negotiations.

Drafting of the TSCG started on 16 December 2011. The first draft was named "International agreement on reinforced economic union" and the final version was ready by 30 January 2012 (Kreilinger, 2012, p. 1). One of the key outcomes of the final Fiscal Compact was that rules have to be implemented in national legislation and if possible then on a constitutional level. The exact wording of this was that "The rules set out…shall take effect in the national law of the Contracting Parties…through provisions of binding force and permanent character, preferably constitutional…" (TSCG, 2012, p. art 3.2). A second key outcome was that the ECJ could start to impose penalties for those who do not follow the Fiscal Compact rules. The Treaty consists following wording: "Contracting Party has failed to comply with Article 3(2), the matter will be brought to Court of Justice of European Union by one or more Contracting Parties". (ibid, p. art 8.1) Third, there was nothing new at the at surveillance and monitoring procedures as the article 5.1 (ibid) put that "monitoring will take place within the context of the existing surveillance procedures under the Stability and Growth Pact". Fourth,

the outcome was innovative in a way that the treaty became conditional for getting aid from the ESM (ibid, p. 7). To sum up, the Treaty reinforced fiscal rules and monitoring procedures, demanded new legislation on the national level, and enhanced ECJ mandate to act in case of deviations.

The insights tell, that Germany that the ECB had a special role during the negotiations and strict approach concerning the chapter about Fiscal Compact. They were pushing more precise and “hard-line” rules (Kreilinger, 2012, p. 3). The ECB blamed others during the negotiations for not following the “general agreement on an ambitious fiscal compact” and blamed for “watering-down” the tough deficit levels which allows easy “circumvention” of the rules by governments in need of financial assistance (Financial Times, 2012). Therefore, the ECB was still engaging in the negotiations, while they said earlier that it is not their job. Furthermore, Germany was not only successful in pushing forward more precise rules but also the idea of conditionality was put in place. The new provisions on fiscal discipline “fulfilled the demands of Germany” and the media called Germany victorious (Kreilinger, 2012, p. 6). Germany was successful proposing the idea that the new treaty became bound to solidarity mechanisms (Kreilinger, 2012, p. 4) as the conditionality part of the treaty was made as a compromise to Germany (Laffan & Schlosser, 2015, p. 7). Thus, Germany and the ECB had both a role in the outcomes of the treaty.

As the deal on Eurobonds was not achieved, then the treaty was not for the taste of the Commission. Rehn pointed out that the negotiations are not going to take “decisive action” and called for more powerful rescue fund during the negotiations (Financial Times, 2012). However, this was not achieved with the TSCG.

3.6 Analysis of austerity measures in light of liberal intergovernmentalism

The following two subchapters are going to analyze the causes of the actor's positions and assess which kind of positions were reflected in the outcome of integration. It does so by testing the theoretical assumptions about the causes of the integration and influencers of key actors.

LI theory emphasizes the role of member state governments in the EU integration and helps to explain how and why the crisis was solved through the impact of governments. The theory helps to understand the role of governments in the integration processes. The aim of LI theory in the thesis is to show how big states, like Germany, had a special role in the process of solving the crisis. German government positions are not explicit and accessible to the public.

However, looking at the German government leaders speeches, domestic group's interests and state macroeconomic standing related to the agreement it is possible to derive the position and interests of the German government. In other words, it is an attempt to empathize with German policy experts and find out what could have been the concerns, interests and advise that they gave to the political leaders of the country and how it affected the negotiation process. The following subsection tests LI assumptions of German producer groups interests, relative low importance of the agreement for Germany, a reflection of agreement benefitting Germany, and the assumption that supranational organizations work as an extension of a German government office.

Positions of the German government are well reflected in the integration outcome, namely, in the TSCG that reinforces the fiscal rules in a new manner. Even some wording of the TSCG reflects German Chancellor Merkel positions. She said in front of Bundestag that the fiscal rules should be established in national legislation, and if possible on the constitutional level then this reflected in the treaty by a wording of: “Contracting Parties’ obligation to transpose the balanced budget rule into their national legal systems, through binding, permanent and preferably constitutional provisions” (TSCG, 2012, art 3). Furthermore, Merkel called that the supranational institutions like the ECJ to have role if member states fail to comply with the common rules, which is reflected in the TSCG (2012, p. 5) with an exact wording of: “Contracting Parties’…should be subject of the Court of Justice of the European Union”. These are two key points that took a step forward in European integration and was not explicitly included in the SGP. Thus, the German government was successful in achieving their preferences during the negotiations.

Strength of LI in explaining the case lays in the bargaining dynamics model which tells us why Germany was successful in defending their national interests. The theory assumes that agreement happens only if both parties gain from the agreement and relative power over the agreement belongs to the one who is less dependent on the agreement. Net-contributors to the ESM like Germany, are also export-oriented countries. Export-oriented countries benefit the most from the existence of the euro and the deal was made to make the euro survive. German had to find some kind of agreement because they benefit from the euro by reducing the costs of international trade (Böhmer, Petersen, & Stein, 2013, p. 1). According to some estimates, Germany benefits solely from the existence of euro since 2013 until 2025 around 1.2 trillion euros, and even if Germany writes off all the loans of the indebted states in Southern-Europe, then the benefits still overweight the losses in overall terms (ibid). Therefore, the ‘no agreement’ is not an option for Germany because they benefit a lot from agreement and

continuation of the euro. And the exit of Greece would have been worrisome for Germany because of the economic spill-over effect from country to country would have damaged the euro. However, they were relatively less dependent on the agreement than Greece. The Germanys' position was bipolar in a sense that saving the euro was not achievable without appropriate burden-sharing and rising the taxpayer's concerns, while Greece position was unipolar because they had no other solution than to go along. Simply said, Greece preference was to stay in the eurozone because there are almost no other reasonable alternatives to choose from. The alternative, to leave the eurozone, would result in Greek defaulting. The price of Grexit in absolute terms is hard to assess because it is a hypothetical case and none of the countries have ever left the eurozone. This scenario would worsen even more the Greek government bond interest rates. Greece government had only 5.5 billion in foreign currency reserves in 2009 (World Bank, 2009b) and its exports were only 19% of national income compared to Germany 38 % (World Bank, 2009a). Low foreign currency reserves and incomes from export would have meant that Greece runs out of vital imported goods like food, medicine or raw materials because suppliers would not take new currency seriously and credible. Thus, Greeks were not interested in stepping out of the eurozone because it would have had fatal consequences on the state responsibilities to safeguard its people. According to public polls, the euro gained popularity in Greece. Euro found a strong 71% support by Greece population according to domestic public opinion polls (Phantis, 2015). Eurobarometer (2010, pp. 220–221) sources tell that everybody had an opinion about single currency because 58 % supported the euro and 42 % was against the single currency leaving 0 % who were neutral about the euro. Even after the start of the crisis, support for euro increased within the year of 2008 over 7% (ibid) and rose to 62% in 2013 (Eurobarometer, 2013, p. 24). Leaving the eurozone would mean that the "rich people would buy still everything with euros" (Tsipras, 2012) and thus the Greeks knew that Grexit would be worse than any other solution. Stepping out of the eurozone was not considered as a realistic alternative for the Greek government because it would leave the state without possibility to influence monetary policies while most of the important transactions are still made in euro. Therefore, positive agreement over the burden sharing was essential for the Greek government and there was not much they could do to counter the demands and side-deals what did not converge with Greek preferences. The only way to keep Greece banks on track was to provide financial liquidity through the EFSF and the ESM. Hence, the ESM became the core of the agreement, while Fiscal Compact was the side-deal that Greece was forced to accept. Schimmelfennig (2015) points out that preference constellation resulted in "chicken game" characterized by "strong joint preference to avert a

breakdown of the euro". His study concludes that Germany had a special role during the Greek crisis and international bargaining because Germany managed to shift the costs of adaption as much as possible to other states while the international bargaining was characterized by brinkmanship and 'chicken game' situation while "flirting with disaster". The process of international bargaining become the chicken game because for both participants the agreement was critical. To sum up the point, for German government the agreement was important because they wanted to preserve the stability of the euro to maintain their prosperity of export, but for Greece, the deal was more important because of no deal would have damaged key functions of the state. This dynamic in turn gave an opportunity for the German government to ask for side deals, namely Fiscal Compact.

The theory of LI suggests that bargaining power belongs to the one who is less dependent on the agreement. In this case, both participants were dependent on the agreement. This kind of reasoning brings us to the conclusion that the German government had more bargaining power than the Greece government. Regardless of the German government high degree of bargaining power, Greece also had some bargaining power because Germany was also subordinated to reach the final deal. Hence, Greece was not powerless in the negotiating processes. The concessions and compromises also reflect the differences in bargaining power – Germany only had to write off some minor debts while Greece had to conform to a variety of austerity measures. However, the surplus gained by Germany, through the existence of euro, means less than the meltdown of the Greek economy and this gave the German government upper hand in international bargaining.

The assumption that Germany had more bargaining power can be tested by looking at the benefits of the agreement. According to LI theory, bargaining power reflects in the distribution of benefits of the agreement. Put differently, inequality in the distribution of agreement benefits proves that there was an imbalance in bargaining powers. There are four main reasons why Germany benefitted from the agreement. First, Germany benefitted from the agreement because the agreement provided a continuation of money flows which prevented defaulting of German banks. It is important to take into account the German financial sector interests in the EFSF and the ESM. Something that Merkel does not want to mention is that bailout programs worked also as a bailout for German banks. According to Rocholl and Stahmer (2016) only 5% of the bailout money given to Greece during the first and second bailout program actually reached the national budget to decrease the budgetary deficit, while most of the money (64%) was aimed to service the existing banks and 17% of the money was used to recapitalize the Greek banks while most of the money was redirected to banks located

in Germany and France. Bortz (2015) who uses reports of the European Commission comes to a similar conclusion with Rocholl and Stahmer who utilize IMF data for analysis. He concludes that 74,9% of the payout was given to creditors to repay the debt (Bortz, 2015, pp. 32–33, 2016) but as noted, most of the creditors were the banks located in France and Germany. In the debate about the numbers, Colasanti (2016, p. 72) takes a more moderate view and believes that half of the money was used for interventions to serve the debt while the other half was used for Greek expenditures that the country could not finance on their own. More specifically, statistics of consolidated positions from the Bank for International Settlements confirm that France and German banks were the main creditors for Greek loans before the crisis began. In the start of the Greek crisis, at the beginning of 2009, the total number of claims on an immediate counterparty basis held by French banks was 69532 and for German banks was 38308 which is relatively high compared to the UK banks that is far beyond and comes in third with 12510 (Bank for International Settlements, 2009b). The same number about total amount of claims rose to 75172 for France and 45003 for Germany by the end of the year (Bank for International Settlements, 2009c) but fell to only 2739 for French banks and to 25332 for German banks, making UK banks taking the second place (7526) and German banks taking first place for having claims in Greece by the end of 2012. (Bank for International Settlements, 2012). In short, the ESM mediated disbursement given to Greece, benefitted Germany indirectly, especially their banks. Second, the benefits from the goal to save the euro for Germany, overweight the concessions to write off some loans, as shown before. Third, since Germany is the biggest contributor to the ESM they also maintain their power over the control of money flows and that fits well with German government preferences. ESM and Fiscal Compact were established outside of Community framework and thus remain intergovernmental by character. In 2019, the ESM has not become the European Monetary Fund and thus, has not been officially incorporated to the EU legal framework (European Parliament, 2019). Germany maintains its power because as long as the ESM is intergovernmental, they have the veto power over the decisions, as the only member states whose contributions exceed a quarter of the total contributions. Neither has the Fiscal Compact formally incorporated to Community framework, although Commission has proposed to do it in 2018 (ibid). Fourth, as Moravcsik (2012) points out in his interstate relations analysis, Germany managed to shift the 'adjustment costs' on indebted countries through austerity measures. He blames Germany for creating a macroeconomic gap between Southern and Northern States in the years since the creation of euro through domestic taxation policies at the expense of German workers and adds that Germany shifted the responsibility to reform on

other countries, while the actual root cause of the crisis remains intact. Looking at Southern-European countries as the sole culprits is misleading. Since the creation of euro, Germany has created the macroeconomic imbalances by dampening the inflation rate to less than the ECB standards (2%), and reducing the costs of labor per unit to less than one percent per year with sluggish wage growth, weak domestic consumption, labour-market reforms and cuts in government spending (ibid, pp. 58-59). These policies created the competitiveness gap with some of the EU areas around 25% and benefitted the German export sector at the expense of German workers whose wages did not keep up with the inflation rate. (ibid). In other words, it was Germany who created the competitiveness gap within the EU and the austerity measures do not aim to solve the issue which was the root cause of the crisis. Austerity measures for Greek might prohibit excessive spending and calm the German taxpayer concerns in regards to whether Southern-European countries are trustable after burden-sharing but they do not address the root cause of the euro crisis and the macroeconomic imbalances remain between the member states. Fifth, probably unintentionally but still, German government saved around 94 billion during the period of 2008 to 2014 because they became the "safe-haven" of government bonds and creditors reduced the interest rates for German bonds (Bundestag, 2015, p. 9493). Modest estimates say that German saved 23-29 billion euros because of creditors "flight to quality" (Boeing-Reicher & Boysen-Hogrefe, 2017, p. 1). These numbers exceed Germany contributions to the ESM. Germany contribution to the ESM was about to be 21.5 billion euros in total, paid by 4 billion every year (Reuters, 2011). However, German government contributed only 527 million in 2013 and 387 million in 2014, adding that they also gained directly 2.9 billion between the years of 2010 to 2017 from the interests rates made possible by Security Markets Programme (Euractiv, 2018). The cause of the crisis was internal – the monetary union has been built lopsidedly and the austerity measures came on the expense of people while they actually do not address the structural imbalances (Lindo et al., 2010). Greece irresponsible lending was not the sole cause of the crisis, however, after the international bargaining and agreements, the responsibility to reform and fix the situation has been put on Southern countries. This, in turn, refers to the unequal distribution of agreement benefits which proves that LI theory can successfully be applied to understand the Greek-German relationship during the negotiation. To sum up, the benefits of the agreement are not only financially lop-sided in favor of Germany, but also politically, because Greece became the one who had to reform.

LI does not so well in giving a coherent explanation for the sources of German government interests. The theory assumes that main producer groups like industrialist are the

force behind furthering integration and in regulatory policies, the force is more limited by taxpayers or regulatory concerns. However, in the case of Germany, some of the very key important producer groups and trade associations were against austerity measures. Representatives of most powerful industrial trade union IG Metall said that they are not supporting austerity measures because it is against the will of people (IG Metall, 2010). Furthermore, he called the austerity measures hypocritical and called for new negotiations between Merkel and Greece. "The contracts between Greece and the Troika have turned out to hinder true reform policies and choke government! New negotiations about the contracts are required!" and "The Greek people's democratic vote must be respected! This includes being respected by the EU institutions and also by Merkel, Schäuble, and Co.!" (IG Metall, 2015). The critical stance against austerity measures for Greece is also shared by Germany's Federation of Trade Unions president Michael Sommer who said: "We want the right measures against the crisis, that means investing against the crisis and not making savings at all costs" (DGB, 2012). The critical position of producer groups was because the austerity measures inherently reduce foreign demand for German exports, the measures aimed to bring down fiscal deficits damage the grass-root level people buying power. Instead, for the explanation of the German government position its reasonable to take a look at domestic taxpayer's concerns that arose when Germany engaged in the talks of collective burden-sharing. The fact that Germany was one of the main contributors to ESM (27% compared to Greek 2.8%), made the German taxpayers very cautious about the burden-sharing because they had to contribute the most to the ESM. Merkel was very well aware, that most Germans believed that the Greek crisis was caused by over-spending and that German taxpayer should not pay the bill (Kickert, 2012, p. 302). It is reasonable to say that public opinion snared the government option to freely go on with burden-sharing. German domestic concerns are well reflected by political leaders who soothe the public by saying: "Eurobonds are absolutely wrong…collectivizing debts would not solve the problem…", "…in order to bring about common interest rates, you need similar competitiveness levels, similar budget situations. You don't get them by collectivizing debts" (Merkel, 2011d). This kind of rhetoric is an example of how Merkel responds to the taxpayer's concerns and her popularity was high during the crisis leading to re-election. The theory of LI would assume that on domestic producers groups drive the integration and taxpayers constrain their drive but on the matter of austerity measures, it was the opposite because the producer groups of Germany did not support the deepening of integration on fiscal regulation at all.

The theory of LI has both some errors and success in explaining the delegation of sovereignty to supranational organizations. The Fiscal Compact has clearly the characteristics

of being a policy that needs supranational intervention to be credible. Many of the Northern ESM net-contributor states, including Germany, had their own problems with debt-to-GDP ratio and did not follow the common rules reinforced by Fiscal Compact. German government debt-to-GDP rose from 75.5 % in 2009 to 88.1 % in 2012 (OECD, 2012), being over the 60 % rule all the time. In fact, it would have been severe hypocrisy when the German government, who did not follow the debt-to-GDP rule by themselves, had started to ask Greece for fiscal discipline, austerity measures, and following of the common rules. Furthermore, Article 3 (2) (TSCG, 2012) sets out that the mandate for Commission to create the Single Supervisory Mechanism (SSM). This is a task that none of the governments could do on their own because of the perspective bias, thus it needs a neutral supranational approach. However, taking account that ESM and Fiscal Compact has not yet officially incorporated to the EU framework, they are still intergovernmental by character and delegation of sovereignty has not officially happened. The Council remains in power in deciding whether fiscal deficit exists or not, and member state Central Bank representatives decide how is money on behalf of the ESM distributed. It is the constellation of new institutional setup in which we can see German government centrality. Germany contributes 27% to the ESM, which is an intergovernmental organization, and thus has more to say on the topic. LI assumes that integration occurs in case of low distributional costs. On the one hand, the ESM does not inhibit the characteristics of low distributional costs but neither can we see a full delegation of sovereignty. The ESM was created as an independent international organization and thus the voting mechanism remains anonymous instead of EU style quality majority monitoring. On the other hand, new institutions like the Single Supervisory Mechanism and Task Force are effectively delegated to the European Commission and the ECB which refers to the delegation of sovereignty. Delegation of sovereignty in these issues is not only technically more neutral but also enables "scapegoating" to the institutions to remind Greece or Italy that they are not holding on to the international commitment.

3.7 Analysis of austerity measures in light of historical institutionalism and supranational governance

Theory of SNG assumes that the outcome of integration reflects the positions of supranational institutions. On the matter of taking the fiscal rules, it was reflected as Commissioner Rehn called for new reinforcement of fiscal surveillance and policy coordination to avoid moral hazard. The same points are reflected in TSCG (2012, p. 3) by the

wording of “welcoming the legislative proposals made by the European Commission…on the strengthening of economic and budgetary surveillance of Member States experiencing or threatened with serious difficulties…”. However, these provisions were already in place with the SGP. Nevertheless, as shown before, both the ECB and the Commission also demanded strict fiscal discipline rules, which were later reinforced with the TSCG. Thus, the integration outcomes reflect also the interests of supranational institutions, which leads the analysis to principal-agency debate.

In contrast to LI, which helps to understand what and why exactly happens during intergovernmental bargaining, HI helps to explain the impact of the interim period between negotiations on the political outcome. HI helps to comprehend the case of the euro crisis and its solutions from a wider perspective. The following analyses creation of EMU as first critical juncture and euro crisis as second critical juncture and tests the assumption that in the interim period ‘unintended consequences’ led the actors to certain path of development which was hard to change because of the sunk costs for the governments made them to ‘lock in’ and support austerity measures.

In the case of the eurozone crisis, HI makes a strong attempt explaining the outcome with the assumption of unintended consequences leading to reinforcement of former policies in new forms. As shown before, the Maastricht Treaty and convergence criteria included the excessive budgetary deficit limits. The 60% debt-to-GDP standard was adopted later in 1997 (entered into force 1 July 1998) with a regulation called “on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies”, in other words, called “preventive arm”. The regulation states that: “For Member States faced with a debt level exceeding 60 % of GDP or with pronounced risks of overall debt sustainability, the Council and the Commission shall examine…”, “The Council and the Commission shall take into account whether a higher adjustment effort is made in economic good times, whereas the effort might be more limited in economic bad times. In particular, revenue “windfalls and shortfalls shall be taken into account” (European Council, 1997a, p. 7), leaving a lot of room for interpretation of economic “good and bad times”. In reality, governments ignored the 60 % standard. Greek general government debt to GDP rose from 94 % in 1998 to 117% in 2008 and accelerated to 135% in 2009 (OECD, 2009). The theory of HI would call the process ‘unintended consequences’ because it was never meant that the member states can enjoy the benefits of the euro while ignoring the common rules

Theory of HI also explains the integration by assuming that during the next critical juncture it is possible to reinforce the path is taken, in case of the euro crisis, it was the high

level of interdependency within the banking sector which led to a reinforcement of the ‘path’. Schimmelfennig (2018a) argues that level of interdependence determines whether the crisis leads to more or less integration, meaning that the more interdependent states become the more likely it is that integration occurs to solve the crisis. Looking at general government debt does not give precise information about the interdependence between member states banks. The general trend was that countries on the verge of default, like Greece, had taken their loans from the Northern states, which shows the rise of interdependence. In 1998 second quarter, German banks claims on Greece were 7.1 USD billions and rose to in 38.1 USD billions at the start of 2009 (Bank for International Settlements, 2009a) which is an increase of 436 %. Taking account that the USD currency inflation during the given time range was 32 %, it is still a remarkable increase of German banks claims on Greece. Hence, the rise of interdependence between Northern and indebted countries member states constitute the high ‘sunk costs’ which constrained the actors to go backward and instead forced to go on with the integration. The previous analysis shows how the interdependence before the crisis arose because of the rise of credit-debtor relationships between the states. To sum up, integration occurred because there was a rise of interdependency between the member states banking sectors and actors were locked in to reinforce the same rules as the only option to regain the trust of creditors.

The logic of path-dependency, that unintended consequences lead to reinforcement of policies, serves well to explain policy outcomes, namely the austerity measures. The Fiscal Compact was a continuation of the SGP policies complemented with small but crucial changes that realized the austerity measures. As showed before, the fiscal deficit criteria were established by the Maastricht Treaty and rule that government general debt should not exceed 60% of GDP was established just before the creation of the euro in 1999. At that time, the European Council created the basis for the SGP. The Pact consisted of “preventive arm” meaning that government debt to GDP ratio shall be lower than 60 % ratio and government fiscal deficit should not exceed 3 % mark (European Council, 1997a). The preventive arm was accompanied with “dissuasive arm” established by “excessive deficit procedure” to sanction states which could not correct the excessive deficit within 10 months (European Council, 1997b). The Commission monitored the implementation of these policies and in 2005 there was a reform in which the policy gained some flexibility. The Commission started to assess country-specific or “differentiated mid-term objectives”, adjustment path towards the goals started to be measured by “cyclically adjusted terms”, and the amendment defined the list of “special circumstances” in which excessive deficit is prohibited (European Central Bank, 2005). Responsibility to implement these policies was on the governments themselves.

However, the governments ignored the rules. In 2009, Greek new Prime Minister Papandreou had revealed a lie about Greek government deficit by making public the fact that government deficit was 12.7 %, which was more than double than the previous government had stated (Reuters, 2009). Next month, the Commission engaged with its own statistics and Eurostat estimated Greek government budget deficit to be 15.4% (The New York Times, 2010). In 2009, the European Council took forward the excessive deficit procedure by defining Eurostat, as Commission statistical authority, that "execute its tasks in accordance with principles of impartiality, reliability, relevance, cost-effectiveness, statistical confidentiality and transparency (European Council, 2009). This shows that the Commission and governments did not take other governments as trustable sources in presenting their fiscal deficits. As the crisis persisted, it became certain that the EU fiscal framework, more specifically the SGP rules, should be taken on a national level with domestic legislation. This was the aim of the TSCG, and because European Council failed to agree on such amendment in December 2011, it was agreed on an intergovernmental level with those who wanted to proceed with the integration (European Commission, 2017, p. 2). For those countries that were in desperate need of foreign aid, the Fiscal Compact became inevitable because the agreement on the TSCG was prerequisite to get aid from the ESM. Thus, the crisis provided an opportunity to make the SGP policies finally work. The first bailout programs together with promises for austerity measures were technically reached through the Memorandum of Understanding between Greece and the European Commission/IMF/ECB. The Commission created special Task Force for Greece "at the request of the Greek authorities" with an aim to help Greeks with the reforms brought by the 'economic adjustment programme' (European Commission, 2018, p. 8). However, Greece was not doing well in aiming the new fiscal aims, therefore the actors had to reinforce once again the fiscal rules, this time demanding the adoption of the rules into national legislation. Therefore, the TSCG takes together all former policies before the crisis and the emergency agreements, like the first Memorandum of Understanding, and consolidates the austerity measures. Studies which have used historical institutionalist lenses to explain the crisis and its aftermath also find that many of the new institutions are a continuation of old structures and institutions. Verdun (2015) writes that the euro crisis was a critical juncture for the integration in which governments had few years to establish a new institution like the ESM or the Fiscal Compact that was built on previous institutions. To sum up, the fiscal rules were put in place long before the crisis but the crisis and non-doings by Greece provided the opportunity to change the flaws of institutional design and overcome the unintended consequences.

The logic of HI explains why supranational institutions positioned themselves in support of reinforcing the fiscal discipline. As they were responsible within the existing legal framework for resolving the euro crisis but were "handcuffed" because of they could not intervene in Greek domestic policies themselves, they had to convince governments to reinforce the fiscal rules. As previously shown, the ECB pointed out that they can only work within the limits of the Treaty when the media started to ask them why the crisis was not solved.

3.8 Summary of findings

On the question of whether integration outcomes reflected the preferences of big member states governments or supranational institutions, the LI gave a stronger explanation than the theory of SNG. As the paper has shown, especially German government preferences was well reflected in the TSCG, namely reinforcement of fiscal discipline rules to the domestic legislation of all the signatories and binding the fiscal discipline with the financial aid given to countries on the verge of defaulting. The supranational actor's positions are not so well reflected because they wanted more than they got. Although it was not the aim of the treaty, the Commission calls for Eurobonds was never reached. The ECB promised to not to engage in the negotiations but they still did and blamed member states for "watering-down" strict rules. The mandate for the supranational institutions to engage remained intact, as the TSCG only recalled the Commission role of monitoring the processes. Furthermore, the member states agreed on as minimal as possible on the treaty that technically did not become supranational at all but was intergovernmental. The characteristics of the policies given to the EU level, monitoring and giving recommendations, also enabled governments to "scapegoat" the EU institutions and avoid the blame of intervention when the Troika became the one who started to demand stricter austerity. To sum up, LI gives a better explanation because the position of the supranational institutions to "do more" did not go through the international bargaining.

However, the explanation for the convergence in the positions of big member states positions and supranational institutions positions regarding fiscal discipline lays in the explanation of HI. In general, both big member states and supranational institutions were in favor of fiscal discipline. HI lays down the logic of path dependency which is fruitful in the analysis as the critical junctures, unintended consequences, sunk costs, and lock-ins are distinguishable in the evolution of the EMU. As the paper has shown, the first critical juncture was the Maastricht Treaty which laid down the principles of the rules that were reinforced with the SGP and the TSCG, followed by unintended consequence as the period when the member

state ignored the 60% debt to GDP rule. The crisis constituted another critical juncture but because of the high level of interdependency achieved in the banking sector the ‘sunk costs’ caused the governments to ‘lock in’ in the path and reinforced the path with an agreement on the TSCG. To conclude, HI provides a good explanation of why the actors, including the supranational institutions who worked in the “spirit of the Treaty”, were supporting austerity measures.

The LI hypothesis that bargaining power belongs to the one who is less dependent on the agreement which is reflected in the agreement of benefits was useful in understanding why Greece agreed on the Fiscal Compact. The Fiscal Compact became the side-deal and core of the deal was the bailout. Greece had to accept the side-deal because the core of the agreement was for them vital, while Germany also was dependent on the core agreement because the banks of Germany wanted to get their loans back and the export markets were looking to preserve the stability of euro. This, in turn, was reflected in the agreement of benefits because Germany preserved the euro, safeguarded their banks from bankruptcy, maintained their strong position in new treaties as they were intergovernmental and thus gave them veto rights, and because they shifted the responsibility to reform on Greece.

The LI theory had two minor problems of giving a coherent explanation. First, because the nature of the TSCG was intergovernmental, it is possible to argue that the delegation of sovereignty did not occur at all. Second, the hypothesis that government positions are shaped by subnational interest, and in case of regulatory policies public concerns prevail was the case in general, but the author of the theory Moravcsik emphasizes that producer interest competes with the public concerns. In this case, the analysis did not determine the producer's interests that need to be constrained, but rather solely the public concerns, more specifically German taxpayers shaped the government position towards demanding fiscal discipline. Thus, leading to the conclusion that theories of politicization have to be taken into account in future research.

Conclusion

The objective of the thesis was to find out why the EU member states and supranational institutions imposed austerity measures on Greece in times of economic crisis. To answer the question, it derived two kinds of potential explanation for the question from the theories of liberal intergovernmentalism, historical institutionalism, and supranational governance and subsequently tested these explanations in the context of the negotiations of the Fiscal Compact. The method to find explanations from empirical material was process-tracing, leading to the analysis of key moments, that explain causal mechanisms of integration. The case that the thesis was trying to explain was the reaching of an agreement on the Fiscal Compact. The Fiscal Compact was part of the wider treaty, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, which reinforced fiscal discipline rules on the national legislation and thus pushed European integration forward. To determine the positions of the key actors involved in the process of reaching an agreement and analyse the reasons for these positions, the paper analysed political speeches, press releases, Bank for International Settlements banking statistics, media coverage, statements by leading officials and politicians and macroeconomic statistics, secondary academic literature and journalistic insights of the negotiations. After the positions of key actors regarding the Fiscal Compact were determined, the thesis used macroeconomic data provided by the Bank for International Settlements, the World Bank, and the Organisations for Co-operation and Development to explain the relations between the member states. Especially the Bank of International Settlements information was a valuable data source to show the banking sector interdependency which in turn influenced the actor's positions and political outcome. Following the method of process-tracing, the formation of the German government’s preferences in the negotiations was analyzed. To explain the formation of the German government position, the thesis used information about the interests and demands of domestic producer groups. Lastly, the thesis also analyzed the existing legal framework to explain the positions of supranational institutions.

The first hypothesis, which stated that integration outcomes reflect the interests of the large member state governments, was confirmed. Both French and German governments supported the adoption of the European Union Stability and Growth pact fiscal discipline rules to domestic legislation. Especially the German government positions were well reflected in the integration outcomes as the government demanded strict austerity for Greece and potential sanctions by the European Court of Justice in case of failure to comply with a new order. French

government emphasized the need for solidarity and the Italian government supported the deal to save their political credibility in the future.

The second hypothesis, which assumed that when the preferences of member states conflict, bargaining power belongs to the one who has less at stake, which is reflected in the distribution of agreement benefits, was also confirmed. The conflict of preferences occurred between the Franco-German axis and the Greek government. The treaty was conditional because it was bound to the bailout funds. Greece government was highly dependent on the bailout funds, for them it was vital to avoid defaulting of the state which in turn would have damaged the fundamental state responsibilities. The French and German governments were less dependent on the deal. For them, as export-oriented countries, the deal was important to guarantee the stability and credibility of the euro and to avoid defaulting of French and German banks. In other words, for the governments of France and Germany, the deal was important to maintain prosperity, while for the government of Greece the deal was important to avoid catastrophe. Therefore, French and German governments held the bargaining power meaning that they had the opportunity to ask for side-deals. In this perspective, the Fiscal Compact was the side-deal and the treaty establishing the European Stability Mechanism which distributes bailout funds was the core of the agreement. However, as governments of France and Germany had a lot on stake also, the Greek government had the opportunity to ask for debt restructurings. Meaning that the Greek government also had some of the bargaining power which enabled them to secure the side deal and write-off some debts. Nevertheless, it remains a trifle for Germany in absolute gains. There is strong and many-fold evidence which shows that asymmetrical bargaining power was reflected in the agreement of benefits. Economically, the large member states managed to avoid the collapse of the eurozone, and as export-oriented countries, they benefit the most from the stability of the euro. Financially, most of the bailout money given to the Greek government did go indirectly to French and German banks avoiding the collapse of the banks that were “too big to fail”. Politically, the governments of France and Germany managed to put the responsibility to reform on Greece while the root cause of the crisis, macroeconomic imbalance and inequalities within the Single Market, remain intact. Technically, the agreements became intergovernmental treaties meaning that usual European Union voting procedures do not apply, thus, giving the German government as the biggest contributor to the European Stability Mechanism a veto power in the decision-making. As the main contributors to the European Stability Mechanism, they had an interest in remaining in charge of the decisions. Lastly, the governments of France and Germany benefitted from the prolonged crisis and long negotiation process indirectly because it caused creditors “flight to

safe-haven" government bonds, meaning that the German government saved money because creditors lowered the interests for German government bonds, however, it is doubtful that they did it intentionally.

The third hypothesis, which stated that governments positions are shaped by subnational interest groups, and in case of regulatory policy, public interests prevail over producer interests was confirmed. However, Moravcsik's theoretical assumptions had some flaws on the matter of explaining the main force behind integration. In general, public interest prevailed in the formation of the German government positions as the taxpayers were disturbed by the idea of paying for the mistakes of the Greek government through bailout funds. Moravcsik assumes that producer groups interests are the root force behind the integration. The research did not find evidence of producer groups that would demand taking forward the integration. In this case, the producer groups interest was against the reinforcement of fiscal discipline. This leads the analysis to conclude that public concerns, not the interests of producers, were the root force behind integration.

The fourth hypothesis, which assumed that outcomes of integration reflect the preferences of supranational actors, was partially confirmed. On the one hand, evidence shows that supranational institutions supported the reinforcement of fiscal discipline rules in domestic legislation. The European Central Bank and the European Commission both wanted to overcome the institutional shortcomings of the institutional design in the European Monetary and Economic Union. On the other hand, they wanted to do more about the issue. The European Commission desire of Eurobonds was not the actual outcome of the integration. The European Central Bank blamed member states for diluting the initial agreement about fiscal rules during the negotiations. Thus, the supranational institution's positions were not fully reflected in the outcome of the integration.

The fifth hypothesis, which stated that integration outcomes are, to a significant extent, shaped by path dependency – continuity of existing Treaties and regulatory framework, was confirmed. Maastricht Treaty constitutes the critical juncture when the path of fiscal discipline was taken because it inhibits convergence criteria, namely standards for government budget deficit and government debt to GDP ratio. These standards were further developed by Stability and Growth Pact. The unintended consequences started to occur when large continental member states started to ignore the rules. The government debt to GDP levels rose significantly over 60%, especially in Greece but also among other member states. The European Central Bank monitored the process whole time but was powerless to engage in member states domestic affairs and legislation. Level of interdependence between member states also rose,

namely German banks claims on Greek banks increased by 436 % over the time period of 1998 to 2009. Thus, the ‘sunk’ costs, namely the possibility that Greece would exit the eurozone and default, became unbearable. In order to regain the trust of financial markets, the actors started requesting the reinforcement of the path – reinforcing the fiscal discipline rules and providing temporary liquidity to banks to keep them afloat.

Liberal intergovernmentalism offers a stronger explanation for integration outcomes than the theory of supranational governance. The analysis on the question of whether integration outcomes reflect member states or supranational institutions positions concluded that member states, especially the German government, had a key role in taking a step forward in European integration. This was so because Germany managed to defend its positions against supranational institutions, who wanted to do even more. The German government positions were influenced by domestic public concerns. These concerns arose because the country was the biggest contributor to financial aid mechanisms. It was mainly German government who demanded to bind the European Stability Mechanism with the Fiscal Compact. The German government had to find a solution to save their banks from bankruptcy while soothing the domestic public concerns. They also had to find a mechanism to force the Greek government to reform and cut government spending in a neutral manner. Thus, they delegated the sovereignty to the EU level so that all the member states had to adopt fiscal discipline rules in domestic legislation and abide with the European Court of Justice decisions in case of deviations occur. Supranational institutions wanted to have Eurobonds but it was against German public concerns. Finally, the agreement was an intergovernmental treaty and not abiding with European Union decision-making procedures giving Germany veto power in future decisions. Thus, liberal intergovernmentalism has a stronger explanatory power than the theory of supranational governance.

In the case of eurozone crisis integration outcomes, liberal intergovernmentalism remains limited because it only explains why governments of France and Germany supported reinforcing the fiscal discipline. There was a convergence of positions between the key member states and supranational institutions concerning fiscal discipline that forced Greece to implement austerity measures. On this matter, historical institutionalism gives throughout answer and explains the positions of all the actors involved in the negotiation process from a different perspective. Thus, liberal intergovernmentalism and historical institutionalism complement each other. The assumptions of historical institutionalism were fruitful in explaining why the idea of fiscal discipline became dominant. Actors worked under the mandate of existing treaties, and when the crisis broke out, it became eminent that existing

treaties have flaws that had to be fixed. Thus, leading us to the conclusion that liberal intergovernmentalism and historical institutionalism are not conflicting theories but explain different aspects of the same case. In the case analyzed, liberal intergovernmentalism served as a baseline theory to explain the concrete moment in the integration process, while historical institutionalism explains integration outcomes in the perspective of integration evolution.

To answer the research question shortly: The agreement on Fiscal Compact reinforced fiscal discipline through the adoption of rules to the Greek domestic legislation, which made the Greek government to implement austerity to meet the fiscal standards. Greece was forced to sign the agreement because the agreement was bound to the bailout funds that were essential for the Greek government. Key member states, namely Germany, was especially looking forward to the reinforcement of the rules because they wanted to soothe German taxpayer's concerns about German contribution in the bailout funds. The crisis brought to light the shortcomings of existing treaties and regulatory framework. The alternative solutions to regain the creditor's trust was excluded because of the high level of interdependency in the banking sector. Supranational institutions like the European Central Banks and the Commission supported plan because they saw the shortcomings of the existing treaties.

The thesis contributes to a growing literature seeking to explain the Europe Union’s response to the euro- and financial crisis and adds evidence-based arguments to the debate on which actors – member states governments, supranational actors – played a decisive role in determining the outcome. It also reinforces the view that European integration is characterized by significant path dependencies – legal, institutional, and normative – which means that the default crisis response is to strengthen mechanisms for ensuring compliance with existing rules.

The author of the thesis in line with Moravcsik’s critique that the root causes of the crisis remain intact. The completion of the European Monetary Union has to be done when the crisis is over and political saliency is reduced. The key lays in overcoming the macroeconomic imbalances between the member states within the Single Market which causes the unequal debt-creditor relations which accompanied with high levels of interdependency leads to unequal distribution of bargaining power.

The thesis has four implications for future research. First, one could argue that the delegation of sovereignty has not happened because the treaties remain intergovernmental. The crisis situation caused the governments to proceed with the agreement on the intergovernmental level and classical European Union decision-making procedures were put on the side. Nevertheless, by substance, the intergovernmental Treaty on Stability, Coordination, and Governance in the Economic and Monetary Union were bound on the European Union legal

framework. The juridical relationships between the European Stability Mechanism, Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, and the European Union's legal framework remain hazy. Therefore, further juridical research could be done to explain the relationship between intergovernmental treaty and the EU legal framework. Second, as the thesis has shown, French and German government positions converged to some extent. Further research could be done to analyze the exact extent and causes of the convergence by analyzing German and French public discourse during the period. Third, it was the highly salient public concerns that forced the German government to ask for fiscal discipline. Thus, further research should be done on the effects politicization on integration outcomes in crisis situations. Fourth, some of the existing knowledge about the negotiations process of the Maastricht Treaty points out that Germany gave up their monetary sovereignty and was on the side of "losers" in the bargaining process. The thesis puts these conclusions in a different light because it was the Maastricht Treaty that installed the roots of fiscal discipline rules. Thus, the further research about the negotiations on the Maastricht Treaty has to take account that convergence rules of Maastricht Treaty were beneficial for German government twenty years later, which turns around the "winners and losers" debate. Therefore, research concerning bargaining processes of Maastricht Treaty should be conducted by taking account the wider perspective of the evolution of the European Monetary Union to come on more accurate conclusions about beneficiaries of the Treaty. Fifth, the benefits of the agreement favored Germany. The aftermath of the crisis shows that Germany saved huge amounts of money because of the creditors "flight to safe-haven bonds", meaning that for Germany the prolonged crisis was beneficial. However, it is doubtful that they did it intentionally. Further research could analyze the German Ministry of Financial Affairs non-papers, which are not available to the public. Testing the assumptions of "strategical planning" that lead to "victim blaming", to gain better appearance in credit markets, would strengthen the meta-theoretical assumption that liberal intergovernmentalism is rooted in rationalism, as governments seek to maximize gains.

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