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Societal Foundations of European Policy Divergence in  
Financial Governance

Stefan A. Schirm



European University Institute  
**Robert Schuman Centre for Advanced Studies**  
Global Governance Programme

## **Societal Foundations of European Policy Divergence in Financial Governance**

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## **Abstract**

EU member states frequently disagree over the management of financial crises, both regionally in the Eurozone and globally in the G20 despite decades of European integration, institution-building, and commitments to joint action. Mainstream integration theories of neofunctional institutionalism and liberal intergovernmentalism cannot sufficiently explain this puzzle of persistent European policy divergence on financial governance. I argue that the policy divergences can only be understood by analysing the societal foundations of governmental positions with the societal approach to governmental preference formation. The societal approach focusses on domestic societal ideas and material interests as explanatory variables for governmental positions. Regarding European policy divergence, I argue that both the coordination problems in the Eurozone and the European policy divergence in the G20 reflect the heterogeneity of domestic societal influences on member state governments. These arguments are empirically evidenced in case studies on the management of the Eurozone crisis and on Europe's role in the governance of the global financial crisis in the G20.

## **Keywords**

EU member states, financial governance, Eurozone crisis, G20, societal approach, domestic politics, ideas, interests, integration theory





## The puzzle<sup>1</sup>

EU member states frequently disagree over the management of financial crises, both regionally in the Eurozone and globally in the G20 despite decades of European integration, institution-building, and commitments to joint action. Regarding the management of the Eurocrisis, countries such as Germany, the Netherlands, and Finland favour fiscal restraint, seek strict conditions for financial help to crisis-ridden members and reject Eurobonds. In contrast, debtor countries such as Italy, Greece, and Portugal favour loose fiscal policies, lax conditions for financial aid as well as a communitarisation of debt through Eurobonds (see case 1). These divergences rest on structural differences in competitiveness and solvency, but also point to ideational differences regarding the role of politics in steering the economy either through deficit spending or sound fiscal policies. Regarding the G20, European member states diverge over whether to reduce or augment public debt to stimulate growth, on the governance of global imbalances as well as over financial market regulation (see case 2). These issues also seem to express both differences in material interests, such as competitiveness and solvency, as well as ideational divergences regarding governmental regulation and intervention in markets. The frequent and numerous divergences seem puzzling in light of decade-long European integration and commitments for joint action. Why is financial governance often marked by policy divergence among European countries at the regional and global levels?

Both major integration theories, neofunctionalist institutionalism and liberal intergovernmentalism, show shortcomings in explaining the controversial governmental positions of EU members towards financial governance. Neofunctionalist institutionalism can explain the creation of new institutions (such as the ESM), but encounters difficulties in explaining policy divergence among member states. This is because it focuses on functional spillovers leading to common institutions, which for their part produce convergent expectations and behavior among member states rather than persistent divergence in face of common agreements and challenges (Niemann/Ioannou 2015; Verdun 2015). Liberal intergovernmentalism offers only a partial explanation for policy divergence, since it suggests that interdependencies among nations lead interest groups to demand further integration which is then achieved in grand bargains between governments (Moravcsik 1993; Schimmelfennig 2015). Thus, both theories make important contributions to the understanding of European integration, but cannot sufficiently explain the continuous and frequent policy divergence among European states in crisis management within the Eurozone and the G20.

This paper argues that European policy divergence in financial governance can only be explained by analysing the societal foundations of governmental preference formation. For this endeavor, both domestic material interests and societal ideas matter since both lobby groups pursuing sectoral interests and value-based collective ideational expectations of voters may influence governmental positions. Resting on the assumption that governments wish to remain in office, the societal approach to governmental preference formation argues that interests and/or ideas inform governmental positions prior to the international context and to inter-state negotiations on the regional and global levels (Schirm 2014). *Thus, the core hypothesis of this paper is that European policy divergence on financial governance correlates with differences in sectoral interests and/or societal ideas in the domestic politics of EMU countries and European members in the G20.* Regarding the explanatory power of neofunctional institutionalism and liberal intergovernmentalism, the paper argues that their focus needs to be complemented by the societal approach in explaining the policy orientation of governmental preferences. In other words, the question on whether functional spillovers and common

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<sup>1</sup> Research for this paper was conducted and inspired at the European University Institute (EUI/RSCAS) in the Global Governance and Europe in the World Programmes. I am grateful for the Robert Schuman Fellowship and for the comments of the participants at the presentation of the paper's topic on Oct 23, 2014 at EUI. Special thanks go to Ulrich Krotz, Patrick Leblond, and Laura Mahrenbach for valuable comments.

institutions, on one hand, or interdependence-induced demand for cooperation and intergovernmental bargains, on the other, indeed lead to policy convergence and joint action crucially depends on the convergence or divergence of domestic ideas and/or interests in cross-country comparison. Hence, the societal approach complements major integration theories by providing a theoretical approach which considers the societal foundations and domestic politics of governmental preference formation.

In sum, the goal of the paper is twofold: First, the empirical puzzle of persistent European policy divergence in financial governance despite common institutions, integration and commitments to joint action shall be explained. Second, the explanatory value and complementary relevance of the societal approach to governmental preference formation shall be made plausible. Given the theoretical and empirical innovation attempted here and the broad scope of the papers' empirical cases, this study is preliminary and exemplary in nature.

The paper proceeds in four steps. First, the societal approach to governmental preference formation will be presented, its variables defined, and hypotheses developed. Second, the case study on European policy divergence in the management of the Eurozone crisis examines whether the different positions of member governments correspond to domestic ideas and/or interests in cross-country comparison. Third, the case study on policy divergence in the G20 analyses whether the differing positions of European member states correlate with domestic ideas and/or interests relating to the issues debated in the G20. Both cases provide exemplary evidence for a correlation between the independent (societal ideas and interests) and the dependent (policy divergence) variables. Fourth, the conclusion compares the two case studies and aggregates the empirical as well as theoretical results of the study. Thus, the paper serves as a first approximation for the relevance of the societal approach in explaining European policy divergence in regional and global governance.

### **The societal approach to governmental preference formation**

The societal approach developed in previous works (Schirm 2009; 2011; 2013; 2014) rests on theories of domestic politics such as the liberal theory of IR (Moravcsik 1997; Katzenstein 1978; Milner 1997) and varieties of capitalism theory (Hall/Soskice 2001; Fioretos 2001). The societal approach has both partially integrated and developed these theories further and focusses on the conditions for the prevalence of either societal ideas or interests in shaping governmental positions.

The core assumption of the societal approach is that governments wish to remain in office and therefore tend to be responsive towards societal demands in democratic political systems. These societal influences on governmental preference formation can be found in societal interests and/or ideas. *Interests* are conceived here as sectoral material considerations whose cost-benefit calculations can change rapidly according to changing economic circumstances such as economic crises, competitiveness, and new global, regional as well as national economic regulations. *Ideas* are defined as value-based collective societal expectations about appropriate governmental positions and behaviour. Societal ideas and interests interact with one another and can mutually constitute each other. Their analytical separation here serves the purpose of identifying sui generis characteristics of the two variables. In its complete version, the societal approach also includes domestic institutions as an independent variable for the explanation of governmental preferences as the dependent variable (Schirm 2014). Domestic institutions, however, will not be considered in this paper, since societal ideas and interests seem better suited to explain European policy divergence in financial governance as observed at the beginning of the paper in the description of the analytical puzzle.

Ideas and interests can reinforce each other, but they can also differ and compete in shaping governmental positions. This raises the question on the conditions for the prevalence of either ideas or interests. According to the societal approach, ideas will prevail in shaping governmental positions, if the issue at stake does not directly affect specific sectoral cost-benefit calculations, but instead involves fundamental questions on the role of politics in steering the economy (Schirm 2014).

Conversely, interests will predominantly influence governmental positions, if the issue at stake directly implies cost-benefit calculations for a specific and well-organized economic sector (Schirm 2014). Furthermore, the societal approach argues that the government's ability to compromise in intergovernmental negotiations tends to be higher, if divergences are material (interest driven) in nature, than if they are shaped by contrasting value-based expectations (idea driven) (Schirm 2009: 505).

In sum, the societal theory offers an explanatory approach for the underlying reasons, that is, the societal foundations, of persistent divergence among European governmental positions towards financial governance. It complements the major integration theories of neofunctional institutionalism and liberal intergovernmentalism by suggesting domestic-level explanatory variables for the policy-contents of these divergences. A domestic politics approach to European policy divergence also seems promising because "domestic and European politics have become more tightly coupled as governments have become responsive to public pressures on European integration" (Hooghe/Marks 2008: 2). In addition, a domestic politics approach to governmental preference formation seems especially appropriate for the analysis of financial governance, because of the domestic impact of the crises and the essentially intergovernmental management attempts vis-a-vis the regional and global financial crises. Helleiner (2014: 2) underlines this point by stressing the need to examine the "enduring state-centric foundations of financial governance in contrast to analyses that focus more on the growing significance of international institutions or of transnational elites and ideologies".

*Operationalization of the societal approach.* In order to examine the relevance of the two domestic variables for governmental positions vis-à-vis the management of the Eurozone crisis and global finance, the potentially relevant ideational and interest-related indicators have to be identified. *If governmental positions correspond to these indicators on ideas and interests, and if they diverge in cross-country comparison, then a plausible domestic politics explanation of policy divergence among EU members might be offered.* In addition, the possible empirical identification of a prevalence of ideas or interests in shaping governmental positions allows for an assessment of the chances of future intergovernmental agreements. This is because a divergence in interests seems more accessible to compromise via a partition of costs than do ideational differences, which require a new consensus on societal expectations.

Regarding ideas, it seems plausible to investigate *ideas as attitudes* towards the fundamental role of politics in steering the economy. Here, ideas with possible relevance for the governmental preference formation towards Eurozone and global financial governance might be found in attitudes towards sound versus loose fiscal policy and governmental debt. These attitudes can be evidenced through public opinion data, for example, of the Eurobarometer.

Regarding interests, evidence with possible relevance for governmental positions might be found in statements of business associations on their expectations vis-à-vis the rules and management of the Eurozone crisis and global finance. In addition, data on economic competitiveness can indicate structural interests as well.

Two disclaimers apply to the following case study analysis of societal ideas and interests. First, given the length restrictions for this paper, the evidence in the following sections can only be exemplary in nature. A comprehensive test of the argument of this paper is not intended and will need further research. Second, the focus on societal ideas and interests does not imply that other variables might not have influenced the divergence of governmental positions on the Euro area rules and on global financial governance in the G20. Rather, the argument brought forward here is that governmental positions and policy divergence cannot be understood without analysing the relevance of societal influences.

## Case study selection

The analysis of cases on both regional integration and global governance in comparative case studies is unconventional, since the European and the global policy levels are usually examined individually. Analysing the two levels together, however, seems promising since it overcomes the reductionist exclusively regional perspective which treats European integration as if it were singular in terms of intergovernmental cooperation in finance. In addition, comparing the positions of EU members on the regional and the global levels can exemplify the bearing of the societal variables with more plausibility, if the same variables matter on both levels. Furthermore, it can be shown that governmental preferences originate primarily in domestic politics and not primarily from the respective international, regional, or intergovernmental context. Thus, analysing regional and global finance in conjunction is a test for the societal approach because, if domestic politics really matters prior to the intergovernmental context, than similar ideas and/or interests must be detected at both policy levels.

Regarding Eurozone country selection, the paper focusses on three crisis-ridden debtor countries (Spain, Italy, and Greece), a solvent major donor country (Germany), and a donor country with severe competitiveness problems (France). These countries serve as exemplary cases for policy divergence and (possibly) diverging societal ideas and interests. Regarding the G20, all four European member countries, namely, France, Germany, Italy, and the United Kingdom (UK), will be analysed.

Regarding the two independent variables, the selected cases lead to the expectation that ideas and interests might matter to different degrees in shaping governmental positions. In the Eurozone case, both ideas and interests are expected to matter since it involves fundamental questions on the role of politics in steering the economy (ideas) as well as material cost-benefit considerations of economic sectors (interests). In the G20 cases, the debate on public debt focusses on the role of politics in steering the economy (ideas), while the controversies over global imbalances directly imply cost-benefit considerations for the export sector or for firms threatened by imports (interests). Thus, the case selection offers variation regarding the possible bearing of ideas and/or interests on governmental positions.

### Case 1: Societal foundations of policy divergence in the Eurozone crisis

The sovereign debt crisis in the Euro area erupted in early 2010 with the near default of Greece and has dominated policy making in the EU ever since. As of today, huge rescue packages, numerous intergovernmental negotiations, new institutions such as the European Stability Mechanism (ESM), new rules of conduct such as the revised Stability and Growth Pact, the sovereign bond buying programs by the European Central Bank (ECB) as well as reforms in the heavily indebted countries have all not solved the crisis.

The governance of the Eurozone crisis has been markedly controversial from the outset and remains so today. While the Southern crisis-countries (Greece, Spain, Portugal, Italy) continue to need external help in order to manage their sovereign debt, solvency, bank rescue and lack of competitiveness, Northern countries (Germany, Netherlands, Austria, Finland) demonstrate lower debt levels, fiscal restraint, no solvency problems, higher competitiveness and a successful export performance. While the latter want their huge financial transfers to the South to be linked to strict conditions on economic policy, the Southern recipients favour lax conditions for transfers and a communitarisation of the debt burden through Eurobonds and a banking union. The two major drivers for European integration positioned themselves on differing sides with France advocating a policy discretionary approach and Germany a rule based approach to fiscal policy (Schild 2013: 36). Why has crisis management been harshly controversial in the last years? Specifically, why have policy harmonisation and common rules - which are perceived as necessary for a successful monetary union - been so difficult to achieve?

Research on the Eurozone sovereign debt crisis has focussed largely on four topics: First, intergovernmental bargains have been examined juxtaposing the different negotiating positions. Northern countries insisted on offering guarantees and transfers to the South only under strict conditions for reforms in crisis countries, for example, regarding the large rescue packages for Greece totalling 246 billion Euro (The Economist 10.8.2013: 53). Furthermore, the Northern Euro members led by Germany favoured fiscal restraint as a recipe for growth, national responsibility for economic policy, and a complete economic union as a precondition for Eurobonds which would communitarise credit-worthiness (The Economist Special Report on Germany 15.6.2013: 10). In contrast, many Southern Euro members favoured debt-fuelled demand, national autonomy regarding reforms, lax conditionality for aid, and the immediate creation of Eurobonds.

The second strand of research has examined whether crisis management was able to appease 'the markets' (Schmidt 2013) which were heavily speculating on the default of crisis-ridden member countries, thus bringing their market interest rates to pre-Euro levels now seen as unsustainable. This strand of research pointed at the perceived primary need to calm financial markets and lower interest rates for Southern countries and criticised German hesitation and the long negotiations over the conditions for transfers. Bond-buying activities of the ECB were seen as stabilising the Euro area. Questions on the need to pressure crisis countries to undertake reforms, on democratic accountability and effects for the real economy were not in the focus of the 'appease financial markets'-literature.

The third group of researchers focussed on the 'national' interests of the Euro member countries and especially on Germany's interests, as Germany was held to be the key player in solving the crisis due to its economic strength (comprising around 27% of Eurozone GDP). This strand of research often also debated whether Northern or Southern countries were the main beneficiaries of the Euro through trade and capital flows until 2010 (Bibow 2013; Young/Semmler 2011). While some authors attribute Germany's high export performance to imports from Southern Eurozone countries, others point to the trade data showing that German exports mainly go to Northern EU countries plus France and especially grew vis-à-vis emerging markets and the US. Southern Euro countries would mainly have benefitted by importing Northern credit-worthiness through the Euro, which allowed them to borrow for interest rates of 2-5 percent instead of 8-12 percent as they had before joining the Eurozone in the 1990s. With these much lower interest rates, Southern countries enjoyed unsustainable consumption (Greece, Italy) and a real estate boom (Spain), causing solvency problems and ultimately leading to the crisis (Busch 2010; Lane 2012: 53). Banks from the US, the UK, France and Germany lend heavily to Southern Euro members and are now the main beneficiaries from the rescue packages (Hall 2012: 364). The involvement of US banks explains the forceful demands of the US government for rescue payments and Eurobonds.

The fourth area of research concentrates on the design faults of the European Monetary Union (EMU) from its inception in the Maastricht Treaty 1992 to the current crisis management (De Grauwe 2013; Lane 2012). Deficiencies are detected in the creation of a common currency without a political union, including common economic, fiscal and financial policy making, and without a lender of last resort. The parallel authority of sovereign nation states for their economic and fiscal policies, on the one hand, and the unified monetary policy under the ECB's control, on the other hand, would be unfeasible.

While these four strands of research on the Euro crisis clarify many issues, they fail to properly address the causes of the divergence of national economic policies, which decisively contributed to the crisis itself and to its controversial management since 2010. Specifically, with few exceptions (such as Hall 2012 and Höpner/Schäfer 2012 on domestic institutions; Olender 2012) research has widely ignored the domestic foundations of economic policy making and of governmental preference formation vis-à-vis intergovernmental negotiations. Differences in domestic ideas and interests, however, present an obstacle to any legitimate and efficient European regulation, since regulations must be accepted and implemented in all member states if the EMU is to achieve a sustainable

common basis. This gap in research will be addressed in the following case studies by using the societal approach to governmental preference formation.

***Ideas in the political economy of the Eurozone crisis***

Following the societal approach, if policy divergence on the Euro rules and crisis management are influenced by societal ideas, these have to refer to the fundamental role of politics in steering the economy, especially in the fields of fiscal and monetary policies. Policy divergence on the Euro level focussed primarily on fiscal restraint versus debt-financed policies. Therefore, potentially relevant societal expectations about appropriate governmental positions can plausibly be found in public attitudes towards more/less government debt and monetary stability (inflation). The following exemplary numbers from the Eurobarometer (2013) serve as preliminary evidence for societal ideas as attitudes:

Public attitudes towards public debt and inflation in Europe		
	Government debt as important issue facing your country	Inflation as important issue facing your country
Germany	23 %	25 %
Greece	15 %	7 %
France	13 %	15 %
Italy	11 %	22 %
Spain	7 %	9 %

EU Commission 2013: Public Opinion in the European Union, Standard Eurobarometer 80, Autumn 2013, Brussels, p. 12.

These numbers evidence societal attitudes corresponding to the respective governmental positions vis-a-vis financial governance in the Eurozone crisis. Even though Germany did not have any problems with its solvency and government debt, Germans were considerably more preoccupied with governmental debt than the voters in the other countries, whose governments showed much higher levels of debt and severe problems in serving their debt burden. Thus, the insistence of the German government in the Eurozone negotiations on reducing public debt and the laxer positions assumed by the governments of the other countries vis-a-vis public debt reflect more domestic societal attitudes than the actual debt levels and the ability of a country to service its debt. Similarly, German insistence on monetary stability (low inflation) and the more relaxed positions of the other countries' governments on this issue also correspond to the considerably higher importance Germans attribute to this challenge compared to the attitudes in the other countries under scrutiny here.

The following exemplary quotes underline the positions of the respective governments:

*Germany:* Chancellor Merkel was quoted in the Financial Times defending the Eurozone's fiscal rules prioritizing low governmental debt and monetary stability, stressing that 'All member states must accept in full the strengthened rules' (Wagstyl/Politi 2014). The Economist's Special Report on Germany (p. 10) concludes 'Mrs Merkel has no truck with Keynesian deficit spending, and her government stands firm against Eurobonds'.

*France:* President Francois Hollande 'demanded that Brussels allow them more budget flexibility' (quoted from the FT, in: Wagstyl/Politi 2014). The Irish Times comments: 'Germany and France in

austerity vs stimulus stand-off: The French-led camp were as heartened as the German camp was frustrated with the ECB president Mario Draghi's apparent call in the US for EU leaders to boost growth by emphasizing fiscal stimulus over austerity' (Scully 2014).

*Italy:* Prime Minister Matteo Renzi 'proposes big tax cuts' (meaning raising debt) (BBC 2014) and says EU stability pact is 'stupid': 'Renzi (...) made clear that he would like to be able to ignore the three percent ceiling and spend his way out of the long and severe recession Italy has only just edged out of' (The Local 2014). In addition, Renzi declared that 'Europe needs to be capable of an economic response that invests in growth and not just rigour and austerity' (quoted from the FT, in: Wagstyl/Politi 2014)

*Spain:* Like the Italian and the Greek governments, the Spanish government was caught in between the conditions of the EU/Troika, including budgetary restraint and reforms, for obtaining financial help on the one hand, and the opposition of many voters to these conditions on the other. The Spanish government followed the conditions more than the Greek and Italian governments did, but could also not refrain from increasing debt through new stimulus: 'Spain's Rajoy adds some stimulus to austerity' (Morris/Ortiz 2013). The Economist (2.3.2012) comments 'Rajoy loosens his belt (...) Spain's Mariano Rajoy has rebelled against this year's European Union-agreed objective'.

*Greece:* The several Greek governments in power since the first bail-out rescue programme for their country in 2010 undertook reforms and budget consolidation to a lesser degree than Spain and largely focussed on cuts in social systems. However, they did not enact privatisations and taxes for the rich. Positions oscillated between blaming the Troika conditions for the country's problems and appeasing the Troika to continue receiving financial help (The Economist 11.12.2014). Ultimately, many Greek voters were unsatisfied with the modest reforms and budget cuts of previous governments and voted for Syriza in 2015, a party which rejects the Troika conditions for transfer payments (The Economist 2015).

Summing up, the evidence shows that the dependent variable, governmental positions in the Euro crisis, corresponds to the independent variable, societal ideas as attitudes. The insistence of the German government on fiscal restraint in crisis countries and the much lesser priority on this issue in the other countries are both consistent with the different priority attributed to government debt and to inflation by the respective societies in cross-country comparison.

### ***Interests in the political economy of the Eurozone crisis***

If policy divergence on the Euro regulations and the management of the Euro debt crisis is informed by domestic interests, then material cost-benefit calculations of specific interest groups must be found that demand corresponding positions from their national governments. In the following, statements by national industry federations and chambers of commerce in the countries under scrutiny will be presented as exemplary evidence for well-organised and politically relevant lobby groups. Other interest groups may, of course, also have influenced governmental preference formation. Industry associations and chambers of commerce, however, can be considered as the most important regarding diverging demands to national governments since their members' cost-benefit calculations are directly affected in different ways by Euro regulations and because their members represent a large segment of private economic interests. The financial industry, represented by banking associations, is also an important player in the Euro crisis. However, its interest in making the public pay for bail-outs and in the appeasement of financial markets, can be held as constant in all the countries and can therefore not explain policy divergence.

*German interest groups.* The presidents of the Deutscher Industrie- und Handelskammertag (DIHK), Hans Heinrich Driftmann and of the Zentralverband des Deutschen Handwerks (ZDH), Otto Kentzler, issued a joint statement on their organisations' demands regarding the management of the Eurozone crisis in 2011, stressing that neither an 'exit of members' nor 'unrestricted solidarity' should

be seen as viable. Rather, the following points should be considered as core requirements for a ‘new start of the Monetary Union’: Solidarity with crisis countries must be accompanied by strict conditions and control for financial aid; sound budgetary policies must lead to growth through savings; Eurobonds are not an option given the lack of integration in economic and financial policies; the credibility of solid national fiscal policies has to be anchored by debt-brakes in national constitutions; the ECB should only buy national debt in times of emergency; rules-based insolvency of EMU countries should be made possible in order to increase early pressures for consolidation of public debt (Driftmann/Kentzler 2011). With these demands, two of the most important representatives of German industry formulated what can be observed as the German government’s policy positions vis-à-vis the Euro crisis: the reasons for the crisis are seen in unsustainable debt in crisis countries; financial aid will only be provided if accompanied by strict conditions for sound budgetary policies; and Eurobonds are not considered an option as long as national fiscal policies are not integrated.

*French interest groups.* The president of the French Mouvement des Entreprises de France (MEDEF), Pierre Gattaz, demanded from the French government that state expenditure be drastically cut and conditions for competitiveness improved vis-a-vis its neighbours (Gattaz 2014). Furthermore, in a joint declaration with the Federation of German Industry (BDI), MEDEF underlines the need to fully implement EMU’s growth and stability pact, to reduce public debt, to secure budgetary discipline, and to reform national economies. Both organisations stress the need for ‘maintaining a consistent balance between member states’ own consolidation and reform efforts and, in direct association with them, joint solidarity mechanisms which are clearly defined in terms of scope and duration’ (BDI/MEDEF 2013). Thus, the major French and German business associations agree on ‘clearly defined’ (that is, strict) conditionality for transfer payments, which must be linked to national reforms and to a substantial reduction of public debt in order to strengthen the EMU.

*Spanish interest groups.* The president of the most important Spanish industry federation, the Confederacion Espanola de Organizaciones Empresariales (CEOE), Juan Rosell, wrote in a contribution to the daily El Pais that Spain must engage in structural reforms of the labour market similar to those undertaken in Germany under Chancellor Schröder (Agenda 2010) in order to ‘strengthen the mobility of labour’ and ‘reduce competitive disequilibrium’. Additionally, he demands a ‘fiscal and banking union’ in the EMU (Rosell 2012). In another article by El Pais, Rosell is quoted asking for more time to be given to Spain for its economic adjustment and reforms (Gonzales 2012). Thus, the requests of the president of Spain’s major business association correspond to the strategy of the country’s government in pushing through structural reforms in order to increase competitiveness and balance the budget on one side and demand more time for reforms and a fiscal and banking union in the EMU on the other. The latter would imply a communitarisation of debt and risk in the EMU and is therefore opposed by solvent countries and their interests groups, including Germany, Austria, and the Netherlands.

*Italian interest groups.* The president of Italy’s most important industrialist association CONFINDUSTRIA, Emma Marcegaglia, stated in her report to the association’s assembly in 2010 on the Euro crisis that ‘Greece’s public debt crisis has contaminated the entire Eurozone (...) For years, Greece has been living beyond its means and hiding the real state of its public accounts. (...) It was a good thing that the autonomy and independence of the ECB, in the way it acquires government bonds, were preserved. (...) it has now become clear, we need to strengthen our collective means for ensuring budget discipline. National budget policies and structural reforms must really become more like shared issues: to fight discrepancies in productivity and create a truly integrated economic area’ (Marcegaglia 2010). Thus, in 2010, the president of CONFINDUSTRIA had already stressed public debt and low competitiveness as major sources for the Euro crisis and demanded reforms from their own and other governments, for example, reforming the labour market and implementing sound budgetary policies, to address these issues. These reforms were enacted most decisively by the Monti government in 2011-13. In line with her Spanish counterpart, but in opposition to Germany’s industry representatives,



Marcegaglia asked the ECB to continue to buy bonds from crisis-ridden countries in order to prevent market-driven interest rates for Italy.

*Greek interest groups.* The chairman of the Hellenic Federation of Enterprises (SEV), Dimitris Daskalopoulos, stressed in his speech before the SEV assembly in 2013 that Greece would have ‘two millstones round its neck: the anti-growth memorandums and the anachronistic state’. Besides criticising the inefficient and ‘clientele’-dominated character of the Greek state, the SEV-President complained about the conditions (‘memorandums’) which the Troika of the EU, ECB, and the IMF demanded in return for the vast bail-out loans and guarantees necessary to help Greece stay solvent. While praising the ‘great and successful efforts the current government and prime minister, personally, is making’, Daskalopoulos demanded changes in the conditions (budgetary restraint, higher taxes etc.) for financial aid, which would then allow for a ‘National Development Program’ consisting of alleviations for banks, lower taxes and energy costs, and an industrial policy. Thus, one of the most important representatives of Greek business demanded an easing of conditions for external help (‘relaxed fiscal stance’) and an introduction of state-led growth strategies, such as industrial policy. The latter would imply rising public expenditures and new problems in competitiveness and debt-repayment. These positions correspond to the Greek government’s resistance to and only partial fulfilment of the conditions for its financial rescue. Greece did not comply, for example, with the condition to privatise parts of its large, state-controlled economic sector, to liberalize corporatist regulations and to raise taxes on the wealthy.

In comparison, the domestic interest group associations in the five countries expressed different demands vis-à-vis their governments, all of which reflected their respective competitive position and cost-benefit calculations. The German DIHK and ZDH Presidents were the most explicit in their organisation’s positions towards the conditions- and self-responsibility-driven management of the Eurozone crisis. The French MEDEF emphasised the need to restrict budget deficits, to enhance competitive conditions for French business, and to link transfer payments for crisis-ridden countries to reforms in these countries. The Spanish CEOE President focussed in its statements on the need for domestic structural reforms (specially of the labour market) and asked for largely unconditional transfers to Spain through a fiscal and banking union. The Italian President of CONFINDUSTRIA emphasised the need for sound fiscal policies in the Euro area and for national reforms in Italy, but also demanded transfers from other Euro countries through ECB bond buying programmes and the creation of a fiscal and banking union. Finally, the Greek President of SEV criticised both the inefficient Greek state and the Troika-conditions for external financial aid to his country, demanding a change towards lax fiscal policies and state intervention e.g. through industrial policy. Thus, while the first four countries’ business representatives approved of sound fiscal policies, but differed on unconditional transfers and a fiscal/banking union (which would cost Germany and France, while benefitting Spain and Italy), the Greek business representative’s preferences diverged on most points from those of his counterparts.

In cross-country comparison, the different interests articulated by industry associations on budgetary policies corresponded fully with their respective governments’ positions in the case of Germany and, for the most part in Italy, Spain and Greece as well. The latter three governments, however, were forced formally (Spain, Greece) and informally (Italy) to cut budgetary deficits in order to receive external help from solvent Eurozone members, the ESM, the IMF, and the ECB, but demanded laxer conditions on this issue and more external help through Eurobonds. It is interesting to note that while the industry associations’ differing positions on budget deficits were roughly in line with their respective governments’ positions in Germany, Spain, Italy, and Greece, the French MEDEF was the only association whose position was critical towards its government on this crucial issue. A plausible explanation for this variation can be found in the relatively smaller relevance of French industry for its economy in cross-country comparison. French industry’s contribution to total GNP (12.5%) is only half of the German industry’s contribution (25.8%), with the contributions of Italian and Spanish industry falling in between (Eurostat numbers in: Statistisches Bundesamt 2013).

Thus, the relative importance of an interest group for the respective economy seems to contribute to its influence on governmental positions.

## **Case 2: Societal foundations of European policy divergence in the G20**

For European policy divergence in the G20 to be shaped by societal influences and thus explainable with the societal approach, governmental positions in the G20 must correspond to ideas and/or interests prevalent in the domestic politics of countries. Therefore, this section of the paper will delineate the positions of the European G20 members on core issues of G20 debates and investigate possibly relevant societal foundations for these positions. The four European G20 members are France, Germany, Italy and the UK. The issues to be examined here are (1) the debate on public debt and economic stimulus packages, and (2) the controversies over global imbalances. These two economic policy topics were at the core of G20 debates since 2010 and triggered strong controversies among G20 members. Hence, they seem especially interesting as case studies for the analysis of the policy divergence of European member countries. Did European member countries pursue a neofunctionalist-institutional logic in following the mutual commitments in the European Council to coordinate their positions in an ‘agreed language’ (Hodson 2011: 9; Wouters et.al 2010: 15) in the G20? Or did differing societal preferences correlate with governmental positions in the G20 negotiations?

### ***Domestic ideas in the G20 debate on public debt and economic stimulus***

Prompted by the eruption of the global financial crisis, the G20 first gathered on the leaders’ level in 2008 and agreed to cushion the crisis-induced recessions with national economic stimulus programmes. These stimulus packages are largely held to have successfully prevented a further deterioration of the economic downturn and beggar-thy-neighbour policies in many countries (Schirm 2013: 695). Since the fading of the crisis in 2010, however, some G20 members, such as Germany, increasingly advocated ending stimulus programmes financed by deficit spending while other members, including the US and France, demanded deficit spending to be continued and expanded. While countries favouring fiscal restraint argue that deficit spending would be structurally unsustainable and could trigger inflationary pressures, G20 members favouring a continuation and expansion of deficit spending argue that fiscal restraint would endanger the prospects for recovery and growth.

European G20 members have largely positioned themselves on differing sides of the debate. While Germany led the camp advocating an ‘exit’ to deficit spending, France, Italy, and the UK were in most instances in favour of continuing stimulus programmes.

*Germany:* For example, Chancellor Merkel demanded before the G20 Seoul summit in 2010 that members ‘talk more in the G20 framework about the exit strategy from our various crisis programmes. We must switch to a phase of budget consolidation, as we are doing in Germany’ (Merkel 2010). Already in 2009, the German Finance Minister Steinbrück (2009) had urged G20 members to seek an ‘exit-strategy’ from debt-fuelled big spending.

*Italy:* Prime Minister Renzi made clear that job creation and growth, rather than austerity will be the focus of his government (BBC 2014). In 2011, Prime Minister Berlusconi ‘had been expected to come to the G20 summit in Cannes with a specific austerity package (...). But divisions within his cabinet meant he arrived empty-handed, frustrating other EU leaders concerned that the euro edifice could collapse’ (Wintour/Elliott 2011).

*France:* Opposing Germany at G20 summit in St. Petersburg 2013, Presidents Hollande and Obama stressed that ‘budgetary orthodoxy must not destroy growth’ (Faujas/Le Monde 2014). Before

the G20 summit in Los Cabos in 2012 Hollande pushed to do more to stimulate growth and not just focus on reducing deficits, while other G20 members such as Germany and Canada opposed this position. Canada’s Prime Minister Stephen Harper argued ‘that tight budgets and healthy economic growth are both possible’ (Palmer/Reuters 2012). At the G20 finance ministers meeting in 2014 in Cairns, the policy divergence between European members continued: ‘France and Italy are pushing for fiscal stimulus while Germany is an advocate of budgetary restraint’ (Smyth 2014).

*United Kingdom:* Prime Minister Gordon Brown stressed the need to keep economic stimulus in November 2009, saying ‘choking off recovery by turning off the life support prematurely would be fatal to world growth ... (will) continue with our plans to support our economy until the private sector recovery is established’ (Brown 2009). Brown reaffirmed his position stating that ‘it would be suicidal to abandon economic stimulus’ (Hennessy 2009). Prime Minister David Cameron started his tenure refusing new fiscal stimulus for the UK, but eased his stance on this issue later on, for example, by enacting a stimulus programme for Northern Ireland, a new 140 bn Pound stimulus plan in 2012, and by tax cuts (The Guardian 2014). Within the G20, Cameron favoured continued stimulus: ‘Cameron calls on G20 leadership to spearhead economic growth stimulus’ (Chu 2011).

These governmental positions towards the exit or prolongation of debt-fuelled stimulus programmes correspond to differences in ideational societal expectations in cross-country comparison:

Public attitudes towards public debt and inflation in Europe		
	Government debt as important issue facing your country	Inflation as important issue facing your country
Germany	23 %	25 %
UK	14 %	18 %
France	13 %	15 %
Italy	11 %	22 %

EU Commission 2013: Public Opinion in the European Union, Standard Eurobarometer 80, Autumn 2013, Brussels.

These numbers on ideas as attitudes regarding appropriate policies offer preliminary evidence for different degrees of acceptance for public debt, and thus for stimulus programmes financed by deficit spending in European G20 member states. Regarding sectoral interests, the analysis maintains that material economic interests cannot explain the divergences of governmental positions. This is because economic actors in all countries would benefit from stimulus programmes. Furthermore, no single sector is specifically affected since stimulus programmes are distributed mainly in a diffuse way and not sectorally. Thus, variation in the dependent variable (governmental positions) cannot be explained by interests since this independent variable (material interests) does not offer variation.

Overall, the case of public debt and stimulus apparently supports the societal approach’s hypothesis that ideas prevail in shaping governmental positions when fundamental questions of the role of politics in steering the economy are concerned and sectoral interests are affected in a diffuse manner. The heterogeneity of policies and positions was plausibly informed by the heterogeneity of domestic ideas. The Eurozone crisis and the G20 cases differ regarding their policy contents. While the G20 debate was about general public debt/stimulus, the negotiations on the Eurozone crisis involved budget

deficits, inflation, communitarisation of debt (Eurobonds), transfer payments to crisis-ridden countries and their conditions. Thus, while the Eurozone crisis affected interest groups directly, the G20 debates only diffusely. As a result, ideational divergences dominated the controversies in the G20 and no agreement was reached. As such, this finding additionally supports the societal approach's hypothesis that intergovernmental compromise is more difficult to achieve in cases of ideational differences than in cases of diverging material interests.

### ***Domestic interests and the G20 controversy on global imbalances***

Global imbalances became a core issue in the G20 debates in 2010 when US treasury secretary Timothy Geithner demanded a cap on trade surpluses and deficits which exceed 4 percent of GDP. With this initiative, Geithner was targeting the large export surpluses in China, Germany, Japan and Brazil in hopes of reducing the competitive pressure facing US industry. Geithner's proposal was rejected by the surplus countries in the G20.

The four European G20 members differed regarding global imbalances: while the German government strictly opposed caps for imbalances and identified the competitive problems of trade deficit countries as the main problem (see quotes), the French, the British, and the Italian governments supported the US proposal in stressing the need to reduce global imbalances via multilateral rules.

*Germany:* German finance minister Wolfgang Schäuble emphasised that 'the German export successes are not the result of some sort of currency manipulation, but of the increased competitiveness of companies. It is the American growth model, on the other hand, which is in a deep crisis' (Schäuble 2010). Chancellor Merkel defended the German export sector in the G20 debates by stating: 'we have clearly paid attention that export surpluses as expression of good competitiveness must never be banned' (Merkel 2011).

*France:* President Sarkozy emphasised that 'the International Monetary Fund's mandate should be expanded to measure, monitor and enforce new rules on global economic imbalances' (Sarkozy 2011). In 2014 President Hollande and the US Secretary of Finance Jack Lew stated that G20 must give full priority again this year to growth, employment and reducing global imbalances (Embassy of France 2014).

*Italy:* Giulio Tremonti, Minister of the Economy and Finance stated: 'The steady increase in global imbalances threatens the sustainability of the global recovery and risks to exacerbate financial volatility' (Tremonti 2011). Prime Minister Mario Monti was quoted in The Guardian in 2012: 'In a sign of the tensions, the Italian prime minister, Mario Monti, said no one thought the EU was 'the only source of the problem'. The crisis 'had its origins in imbalances in other countries (...)' (Wintour 2012).

*UK:* Prime Minister Brown demanded that the Group of 20 major economies should come up with a strategy to tackle global imbalances in trade (Reuters 2009). UK Chancellor of the Exchequer George Osborne urged 'all countries to play their part in redressing the global imbalances' and stated 'I would argue that the UK is playing its part dealing with its own imbalances and seeking to promote exports. Clearly, this is a role not just for the IMF but also for the G-20' (quoted in Fingar 2010). Prime Minister Cameron initiated a letter to the French G20 presidency in 2011, asking for joint action against global imbalances (Chu 2011).

Ultimately, Italy, the UK, and France supported the political regulation of imbalances, while the German government stressed the virtues of free trade and competitiveness. The positions of the governments involved in the debate on global imbalances correlated with the economic interests of crucial domestic sectors. While in Germany the export sector was directly affected by the (potential costs of) the new global economic governance initiative, in Italy, France, and the UK the interests affected were not concentrated in a specific sector, but involved the cost-benefit calculations of all

companies threatened by import competition and therefore had a direct interest in reducing the competitive pressure from imports.

In the case of Germany, the export sector contributes roughly one-third of the GDP and possesses strong and well organised associations, primarily the German Chamber for Industry and Trade (DIHT) and the Association of German Industry (BDI). Both associations' presidents warned against caps for exports. For example, the President of the German Chamber for Industry and Trade (DIHK), Hans Heinrich Driftmann (2010), warned that everyone would lose from new restrictions on trade and that 'the best solution for economies with weak exports is anyway to work on their competitiveness'.

In contrast to Germany, the French, Italian and British trade balances were either considerably negative (France, UK) or in some years negative, in others slightly positive (Italy). In the four years relevant for the G20 debate (2010-2013) France showed a negative yearly balance between -87 and -123 billion Dollars, the UK between -153 and -170 billion Dollars, and Italy between -41 and +38 billion Dollars, while Germany ran a surplus of between +205 and +262 billion Dollars (OECD 2015). These numbers indicate severe import pressure on French and British domestic industry and a mixed picture for Italian industry. For all three countries, the numbers imply a weak competitiveness of a large part of domestic industry, which would have benefitted from new global governance limiting exports from surplus countries such as Germany, China, and Japan. Since firms threatened by import competition are not organized in associations (contrary to the export sector), sectoral lobbying on caps for exports could not be detected in France, the UK, and Italy, while German exporters clearly stated their rejection of multilateral restrictions on exports. The positions of the French, Italian, and UK governments in the G20, however, corresponded to the competitive problems and thus to the economic interests of domestic firms.

Overall, the case of global imbalances confirms the argument that governmental positions correspond to material interests, when global governance issues directly affect the cost-benefit calculations of economic sectors, in this case also of the non-organised firms threatened by import competition. European policy divergence was the result of the heterogeneity of domestic interests which inhibited the four governments from finding an 'agreed language' on the issue of global imbalances. In the end, the G20 did agree to monitor imbalances regarding trade, debt, savings and capital flows. Thus, a moderate compromise was found, supporting the societal approach's hypothesis that intergovernmental agreements are easier to achieve if divergences are interest-related and not dominated by ideas as in the previous case.

## **Conclusion**

The aims of this paper were twofold. First, it attempted to demonstrate the relevancy of the societal approach in explaining the domestic ideational and interest-related foundations of European governmental preferences towards multilateral and regional policy coordination. Second, it sought to explain the empirical puzzle regarding the reasons for the persistent policy divergence of European countries over the management of regional and global financial crises, despite commitments to joint action, common rules, and decades-long European integration. Thus, the paper is explorative in theoretically and empirically exemplifying how a domestic politics-oriented societal approach can contribute to the explanation of governmental preferences and European policy divergence.

The findings in the case studies evidenced that divergent governmental positions towards financial governance in the Eurozone and the G20 strongly corresponded to different societal ideas and/or interests in cross-country comparison. Thus, a domestic politics approach to policy divergence proved crucial for explaining the puzzle and a necessary complement to mainstream integration theories. Governmental positions were consistent with societal ideas and/or interests. Supporting the hypotheses of the societal approach, the case studies evidenced that societal ideas shaped governmental positions, when the governance issue at stake referred to the role of politics in steering the economy and did not

(or only diffusely) affect economic interests. Conversely, governmental positions corresponded to economic interests when the governance issue directly affected the cost-benefit calculations of specific sectors or firms. These arguments were evidenced in the two case studies on European policy divergence in the Eurozone crisis and in the G20.

In the case of the Eurozone crisis, societal ideas and interests largely reinforced each other, since the governance issues (transfer payments, conditions for aid, budget deficits, competitiveness) involved questions relating to both the fundamental role of politics in steering the economy and the cost-benefit calculations of economic sectors. In the first G20 case, societal ideas shaped governmental positions on stimulus and debt, since this issue related to the fundamental role of politics in steering the economy and only affected economic interests diffusely. Conversely, the second G20 case on global imbalances directly affected the cost-benefit calculations of the export sector (Germany) and of firms suffering from competitive problems (France, Italy, UK), whose interests shaped the respective governmental positions.

This paper's explorative claim was analysed in a preliminary and exemplary form. Future research will deepen the analysis though encompassing more country cases and a systematic test of the hypotheses with evidence from additional case studies.

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