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## **Money makes the world go round**

On European financial power relations and the reemergence of Neorealism's explanatory power in analyzing the management of the European debt crisis

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# Abstract

This thesis provides an analysis of the Eurozone's crisis management during the European debt crisis from a Neorealist perspective. It assesses the explanatory power of Neorealism for the counter-measures taken in response to the European debt crisis. The main argument is that in times of crisis, the member states of the European Union may fall back to Neorealist behavior, despite any integrating efforts made under non-crisis conditions. The thesis combines quantitative and qualitative analysis with the quantitative part descriptively assessing the financial power relations within the Eurozone and the qualitative part providing evidence for a crisis management congruent with Neorealist predictions. It is shown that the two financially most powerful states during the European debt crisis, Germany and France, decisively shaped the implementation of the EFSF, the ESM, and the European Fiscal Compact. Furthermore, evidence is given that those three counter-measures were implemented outside of the European Union legal framework and designed after intergovernmental premises. The thesis thus concludes that the three most important counter-measures to the European debt crisis can be explained and analyzed through the theory of Neorealism.

*Key words:* Neorealism, financial state power, European debt crisis, crisis management, Eurozone

*Word count:* 19,987

# List of Figures

Figure 1: Development of absolute amounts of intergovernmental lending in the Eurozone.....	39
Figure 2: Share of intergovernmental loans in the Eurozone from 2009 to 2014.....	41
Figure 3: Development of financial instability in the Eurozone from 2009 to 2014.....	44
Figure 4: Financial state power distribution in the Eurozone in the years 2010 and 2014.....	47
Figure 5: Share of guarantee commitments to the EFSF.....	57
Figure 6: Share of capital subscription to the European Stability Mechanism.....	62

# List of Tables

Table 1: State-rankings of financial stability from 2009 to 2015.....	45
Table 2: Documents and Data Analyzed.....	53

# Table of Contents

<b>1</b>	<b>Introduction .....</b>	<b>6</b>
1.1	Purpose and Research Question .....	6
1.2	Historical Perspective.....	7
1.3	Previous Research .....	8
1.3.1	Financial Power .....	9
1.3.2	Neorealist Study of the European Union.....	10
<b>2</b>	<b>Approaching the Concept of Financial State Power .....</b>	<b>12</b>
2.1	Offensive Understanding of Financial State Power.....	12
2.2	Defensive Understanding of Financial State Power .....	14
2.3	Summarizing Conceptualization .....	16
<b>3</b>	<b>Neorealism – Theory, Criticism, and Predictions.....</b>	<b>17</b>
3.1	Neorealist Theory .....	17
3.2	Neorealism and the European Union.....	19
3.2.1	Anarchy.....	19
3.2.2	Cooperation.....	20
3.2.3	Supranationality versus Intergovernmentalism .....	20
3.3	Neorealist Predictions of the Eurozone’s Crisis Management .....	22
3.3.1	Anarchy.....	23
3.3.2	Cooperation.....	24
3.3.3	A Supranational or an Intergovernmental Solution? .....	24
3.4	Hypothesis.....	25
<b>4</b>	<b>Research Strategy and Methodology .....</b>	<b>27</b>
4.1	The Case Study Research Strategy .....	27
4.2	Case Selection .....	28
4.3	Limitations and Potential Biases .....	30
<b>5</b>	<b>Quantitative Analysis .....</b>	<b>32</b>
5.1	Quantitative Research Design and Method .....	32
5.1.1	Operationalization.....	33
5.1.2	Data Collection and Analysis.....	36
5.1.3	Limitations and Potential Biases .....	38
5.2	Creditor Status.....	39
5.3	Financial (In)Stability.....	44
5.4	Comparing Both Indicators .....	46
5.5	Interpreting the Financial Power Distribution in the Eurozone .....	48
<b>6</b>	<b>Qualitative Analysis.....</b>	<b>51</b>

6.1	Qualitative Research Design and Method .....	51
6.1.1	Data Analysis .....	52
6.1.2	Data Collection and Interpretation .....	53
6.1.3	Limitations and Potential Biases .....	54
6.2	Reaching Agreement in International Negotiations .....	55
6.3	European Financial Stability Facility .....	56
6.3.1	Implementation Process, Coalition Building, and Prevalence of Anarchy .....	57
6.3.2	The Institutional Design: Intergovernmental or Supranational? .....	59
6.4	European Stability Mechanism.....	61
6.4.1	Implementation Process, Coalition Building, and Prevalence of Anarchy .....	62
6.4.2	The Institutional Design: Intergovernmental or Supranational? .....	64
6.5	European Fiscal Compact.....	64
6.5.1	Implementation Process, Coalition Building, and Prevalence of Anarchy .....	65
6.5.2	The Institutional Design: Intergovernmental or Supranational? .....	67
6.6	Summarizing Assessment.....	68
<b>7</b>	<b>Discussion .....</b>	<b>69</b>
<b>8</b>	<b>Conclusion .....</b>	<b>71</b>
<b>9</b>	<b>Bibliography.....</b>	<b>73</b>

# 1 Introduction

This Master's thesis provides an analysis of the financial state power relations in the Eurozone and assesses the explanatory power of Neorealism for the counter-measures taken in response to the European debt crisis. The main argument is that in times of crisis, the member states of the European Union may fall back to Neorealist behavior, despite any integrating efforts made under non-crisis conditions. By showing this, the thesis strives to contribute to the expansion of the Neorealist theory on the analytical body of the Eurozone.

The thesis combines quantitative and qualitative analysis with the quantitative part descriptively assessing the financial power relations within the Eurozone and the qualitative part providing evidence for a crisis management congruent with Neorealist predictions. Accordingly, the qualitative analysis is partly based on the quantitative analysis as the quantitative assessment of the financial power relations in the Eurozone establishes the basis for a profound understanding and traceability of state behavior during the crisis.

The thesis may contribute to the field of Global Studies by enhancing the knowledge of an event with such global repercussions as the European debt crisis and by contributing to the understanding of state behavior in international crisis situations.

## 1.1 Purpose and Research Question

When the European debt crisis hit the European Union member states were unprepared. The absence of any rules on how to counter such a crisis took the states by surprise and left them unsure of how to deal with the ever-increasing severity of the crisis. The resulting inaction in turn contributed to the volatility of the international financial markets and led to immense pressure resting on the member states of the Eurozone to solve the crisis as fast as possible (Gianviti et al., 2010).

This thesis argues that in this time of crisis and confusion, the Eurozone states stepped out of the institutionalized framework of the European Union which had turned out to be insufficient in dealing with the crisis and implemented counter-

measures that were achieved under anarchy and reflected the financial power relations within the Eurozone. As a result, it will be argued that, although Neorealism is said to not be applicable to the European Union framework, it offers a considerable amount of explanatory power to the international policy making in reaction to the recent European debt crisis.

In order to find evidence for this argument, the thesis is based on two main research questions. Those are, firstly, *“How was financial state power distributed among the states of the Eurozone between 2009 and 2014?”* and, secondly, *“Can the fiscal counter-measures taken in the course of the European debt crisis be explained by the theory of Neorealism?”*.

## 1.2 Historical Perspective

In order to set the historical framework for the following analysis, the subsequent paragraphs present some of the particularities of the European debt crisis with a focus on the development of the crisis and the reasons for its special severity.

In 2007, a global economic and financial crisis took shape, the implications of which the global community is still dealing with to this day. What started as a local economic crisis became a multidimensional crisis in recent years that still has significant effects on the worldwide banking system, global debt structures, economic growth and currencies. The starting point was a global recession that had its roots in the US subprime mortgage crisis from 2007. Because banks all around the world had invested in US mortgages, the bankruptcy of US banks had global repercussions leading to a worldwide financial and banking crisis.

Although the crisis affected many states, the European Union and especially its member states which share the currency of the Euro, the Eurozone, were particularly exposed to the crisis. As the subprime crisis in the US grew in severity, banks in the European Union were heavily affected because they were closely involved in business overseas. Eventually, the severe pressure on the European financial system led to the bankruptcy of many banks (Helleiner, 2014, p. 4). Since a number of those banks were considered as being critical to the financial system, however, several Eurozone states and the European Central Bank engaged in massive bank bailouts in order to prevent the system from

crashing. Additional to the bank bailouts, large-scale measures to support aggregate demand have been implemented in order to diminish the negative impact of the financial crisis. Bank bailouts and macroeconomic measures have been extremely costly and placed heavy burdens on the budgets of the Eurozone states. In order to deal with this burden, the states had to engage in massive lending which led to a sharp increase in public debt all over the Eurozone (Berlatsky, 2010). Although the sovereign debt crisis negatively affected all member states of the Eurozone, some member states, especially Greece, Spain, Ireland, and Portugal were more affected than others. Subsequently, joint measures by the Eurozone states and the European Central Bank were taken in order to tackle the impending danger of state bankruptcy. The severe financial and economic crises in several states would have forced those states into bankruptcy if they had not received the help of the international community. Even worse, the impending insolvency of Greece threatened to negatively affect the whole Eurozone due to its connectedness of financial systems and banking (Gocaj & Meunier, 2013, p. 241). Measures like the European Stability Mechanism, the European Fiscal Compact, and the creation of a European Banking Union were initiated later on to deal with the effects of the crisis.

Scholars and politicians agree that the crisis had immense negative effects on financial and economic systems all around the world. Eric Helleiner regards the financial crisis as the “worst global financial meltdown experienced since the early 1930s” (Helleiner, 2014, p. 1). There can be no doubt that the crisis had a crucial impact on the political and economic landscape of the European Union and especially the Eurozone.

### 1.3 Previous Research

Because of its regional as well as global importance, the European political and economic landscape in the aftermath of the financial crisis has been object of extensive research during recent years. The following paragraphs will present a short overview about the academic literature dealing with the European debt crisis and will put a special emphasis on the existing research on financial state power.

At the end of the chapter, it will be shown that the study conducted in this thesis strives to close two existing gaps in the academic literature on financial power relations and the theoretical study of the European Union.

### 1.3.1 Financial Power

What becomes apparent when dealing with financial power in an academic context is that the term ‘financial power’ is understood in quite a broad sense. In large parts of academic literature financial power is understood as any power that derives from a ‘financial’ background. There seems to be no generally accepted conceptualization of financial power. Naturally, this leads to a range of widely differing studies that are to be located in the research of financial power

Specifically in the context of the recent financial crisis, studies on financial power relations have shown, for example, that the amount of costs of the bank bailouts during the crisis were related to the power relations between the banking sectors and the state governments (Woll, 2014a; Woll, 2014b). Other scholars assessed how political structures limited the financial power of banks during the crisis (Pagoulatos, 2014) and how in return, power was used to prevent democratic control in order to protect financial markets during the crisis (Johal, Moran, & Williams, 2014). However, the majority of the research on financial power relations focusses on power relations between non-state actors, especially from the financial sector, and states. Only little research (see e.g. Donnelly, 2014) has been done on the financial power distribution at the state level.

One of the few attempts to do so was conducted by Gregory Chin and Eric Helleiner (2008). The two scholars assessed China’s increasing financial power in the international system by presenting an argument that its creditor position has enhanced the country’s ability to influence the international financial arena (Chin & Helleiner, 2008). Chin and Helleiner relate China’s prominent creditor position to its large reserves of foreign exchange and how it could potentially use these to manipulate the stability and value of other states’ currencies (*ibid.*, p. 91). Despite this source of power, Chin and Helleiner also highlight the potential downside of large foreign exchange reserves as it makes China more vulnerable to exchange rate risks and make the country dependent on the dollar, which is controlled by the US.

In general, there are two main kinds of studies of financial power in the academic literature to be located within the field of Political Science. This is, on the one hand, the study of financial power inherent to financial sectors. On the other hand, there are studies which focus on the assessment of the financial power of one or several states. The former category is often inspired by the significant power that financial systems have in relation to society and politics (e.g. Johal, Moran, & Williams, 2014; Woll, 2014b). This kind of power becomes most apparent whenever crises occur that have their origin in the financial system, as last happened during the financial crisis since 2007. The latter category of studies tries to explain how the presumed financial power of a certain state transforms into political power (e.g. Chin & Helleiner, 2008).

This Master's thesis contributes to the existing research on financial power by providing an analysis which focuses solely on power between states. Furthermore, in the context of the lacking literature on financial state power, this thesis may contribute to an advancement of the theoretical understanding of financial state power for it creates a comprehensive conceptualization of financial state power and subsequently applies this conceptualization to an empirical case.

### 1.3.2 Neorealist Study of the European Union

Since its emergence, the European Community, and later the European Union, has been the object of several theoretical debates and corresponding attempts to understand and explain the European cooperation in a theoretical way. Naturally, one of the most prevalent theories of International Relations, Neorealism, had its own take at explaining the European cooperation as well. During the Cold War, Neorealist theory explained the emergence of a European confederation mainly by the states' attempt to create a strong opposition to the Soviet bloc (Collard-Wexler, 2006, p. 415).

After the end of the Cold War, however, many Neorealists predicted the end of the European project due to the absence of a balancing threat (Kissinger, 1994). When this prediction did not fulfill itself and European integration even deepened, the theory of Neorealism had more and more difficulty explaining the ongoing state cooperation in Europe (Collard-Wexler, 2006). The Maastricht agreement in

1991, for instance, which paved the way for the shared currency of the Euro, poses an anomaly that Neorealists struggle to explain (Grieco, 1996). The ongoing difficulties of Neorealism to explain the European integration even led other scholars to claim the failure of the theory and called for its rejection. Critics of Neorealism even asked, in the light of those difficulties, “Is anybody still a realist?” (Legro & Moravcsik, 1999, p. 54).

However, instead of engaging in major reformulations of the theory to overcome its issues which the European Union, many Neorealists just refrained from dealing with the European Union which leaves an apparent lack of academic literature when it comes to empirical studies that strive to apply the theory of Neorealism to the European Union (Jørgensen, 2004; Hyde-Price, 2006). The main reason that so many Neorealist scholars decided to refrain from engaging with the European Union are the severe difficulties that the ongoing cooperation and integration of the European Union poses to the theory of Neorealism (Collard-Wexler, 2006).

Although some attempts have been made to explain the European Union from a Neorealist perspective, the European Union remains heavily under-theorized (Collard-Wexler, 2006, p. 398). Subsequently, the study conducted in this thesis contributes to the theoretical discussion of Neorealism’s explanatory power for the special case of the European Union.

As has been shown, this thesis contributes to the academic literature in a twofold way. Targeting the gaps identified above, the thesis aims to both contribute to the theoretical discussion about financial state power while simultaneously enhancing the explanatory power of Neorealism concerning the European Union.

## 2 Approaching the Concept of Financial State Power

State power is one of the core concepts of several branches in international relations, not only Neorealism, and many theories have the notion of state power at the heart of their argumentation. However, although there is a considerable branch of academic literature that explores financial power in various empirical contexts, there is an apparent lack of literature that deals with financial state power in a theoretical way.

The main stumbling block when approaching financial state power in a theoretical way is that the majority of literature focusses on discourses on state power in general, not on *financial* state power in particular. Furthermore, the discussion on state power is traditionally shaped by a focus on military power. For a long time, military power has been regarded as the only important source of state power in international relations (Baldwin, 2013). After the end of the Cold War, however, the scholarly discussion started to increasingly incorporate other sources of state power as well. Thus, although the emphasis of the following paragraphs is on financial state power, the traditional focus on military power as the primary source of state power should be borne in mind.

In the following, several theoretical approaches to state power and especially *financial* state power will be presented. While giving an overview about some existing theoretical approaches to financial state power, a distinction will be made between an offensive and a defensive understanding of financial state power. Finally, the gathered definitional pieces will be merged into a conceptualization that is suitable for application in this thesis.

### 2.1 Offensive Understanding of Financial State Power

The classic Political Science definition of state power regards power as the ability of an actor causing another actor to do something that it would otherwise not do (Dahl, 1957; Baldwin, 2013). It is thus an offensive understanding of state power which relies on coercion as the mean to enforce one's own will. Deriving from

this offensive understanding of state power, there are a few scholars who tried to approach a definition of what is actually meant by *financial* state power. Some attempts are as broad as Albert O. Hirschman's (1945) conceptualization who states that "the power to interrupt commercial or financial relations with any country [...] is the root cause of the influence or power position which a country acquires in other countries" (Hirschman, 1945, p. 16). Others focus on an approach to the concept rooted in the empirical measures that assemble financial state power. Daniel W. Drezner (2009), who interprets financial state power as solely deriving from creditor status, identifies classical measures for a creditor state to wield financial power over a debtor state. According to him, those measures are 'dumping assets', reducing or stopping the purchase of new debt, shifting the composition of foreign holdings or devaluating the currency of the debtor (Drezner, 2009, p. 15).

One of the few scholars who engaged with the concept of financial state power in a more in-depth way is Susan Strange. In her structural power approach, the access to and the ability to influence international financial structures is one of four sources of structural power (Strange, 1994). According to Susan Strange, the authority to decide on the granting of credit highly influences dependent actors in terms of their ability to spend money (Strange, 1994, p. 90). Since the creditor gets to decide on the conditions to which the debtor has to ensure the repayment of his liabilities, he finds himself in a powerful position towards the debtor. Another important factor that is attributed to Strange's concept of structural power in finance is the influence on exchange rates between currencies (Verdun, 2000, p. 80).

For Susan Strange, financial power thus derives from "the sum of all the arrangements governing the availability of credit plus all the factors determining the terms on which currencies are exchanged for one another" (Strange, 1994, p. 90). The currency factor of Strange's conception of financial state power refers to the ability to conduct monetary policies with the goal of gaining a competitive advantage over another state. Currency intervention strategies are mostly intended to generate economic or fiscal advantages, respectively financial or economic power. Typical measures taken to influence a currency are extensive acts of buying foreign exchange while at the same time selling domestic currency in

order to devalue the currency (Bird & Willett, 2011, p. 126). Additionally, interfering in foreign exchange markets with the goal of preventing a currency from appreciating can also be examples of wielding financial power related to currencies (Bird & Willett, 2011, p. 123). All these measures are designed to achieve or maintain a competitive advantage over another state by having an exchange rate of the own currency that favors the economic and financial goals of the respective state. The main advantage of devaluing the domestic currency is to keep “imports lower and exports higher than they would otherwise be” (Bird & Willett, 2011, p. 123). Thus, this aspect of financial power is immediately and closely related to economic state power.

If one were to follow Susan Strange’s structural power approach, financial state power results from the ability to influence the international financial structures. The two main components that a state needs to succeed with this task are a creditor status and/or the ability to influence currencies, respectively exchange rates. Although these two sources of financial state power do not have to exist concurrently, it is of benefit for a state to enhance the own capabilities on either dimension.

In the special case of the Eurozone, the second factor, currencies, is of less importance. Since the Eurozone countries share the same currency, actions directed towards an influence of another state’s currency with the goal of achieving a competitive advantage over said state are naturally pointless. The monetary union of the Eurozone thus negates the relevance of the Strangian second source of financial state power. Hence, for an analysis of the financial state power relations within the Eurozone, only the first indicator, creditor status bears explanatory power.

## 2.2 Defensive Understanding of Financial State Power

Although the offensive understanding of state power is undoubtedly the predominant one in the study of International Relations, some scholars point out that defensive forms of state power do exist. Corresponding contributions stem mainly from the field of Security Studies and focus on defensive state capabilities

that enable resistance to military coercion from other states. Relevant capabilities in this context represent “defensive power, invulnerability, the ability to resist harm intended by others” (Fischer, 1982, p. 205).

Defensive state power in its military sense is then defined by Dietrich Fischer as follows: “An important component of national defense without threat to others is to make oneself less vulnerable, and to become less dependent on others, i.e., more self-reliant” (Fischer, 1982, p. 214). Although Dietrich Fischer clearly refers his statement to forms of military capabilities, his point of view can be readily transferred into the spheres of financial state power. Accordingly, in the context of finance, state power refers to any resources that enable a state to protect itself from harming financial influence.

Corresponding financial resources can, for instance, be the holding of large currency reserves. Disposing of huge amounts of reserves enhances a country's ability to withstand currency crises and thus increases a state's autonomy (Chiu & Willett, 2014, p. 12). If a nation holds too large currency reserves, however, it reduces its flexibility to change the composition of its reserves without taking the risk of heavy financial repercussions (Chiu & Willett, 2014, p. 12f.).

When pursuing this perception of defensive financial power even further, the stability of a state's financial system is directly linked to a state's ability to resist financial influences. Large and resilient financial resources, for example, can increase a country's financial stability and therefore enhance its financial power (Donnelly, 2014, p. 985). Apart from those readily measurable financial resources, such as currency reserves, financial stability also contains factors like the composition and soundness of the financial system within a state (Holló, Kremer, & Lo Duca, 2012). Since a stable financial system is more resilient to external (and internal) factors that could potentially harm the financial and economic well-being of a state, it bears a source of defensive financial state power.

## 2.3 Summarizing Conceptualization

The review above has shown that there are two different forms of financial state power: an offensive and a defensive interpretation. Following those two conceptualizations, offensive financial state power can be understood as all financial measures or conditions that enable a state to cause another state to do something that it would otherwise not do. Correspondingly, defensive financial state power encompasses the ability to protect oneself from potentially harming financial influences. Because both definitions have strong arguments and can be seen as complementary, the following analysis will consider both forms of financial state power.

An important question that has to be asked when discussing financial state power is the question whether it is always a zero-sum game or if there are certain conditions under which it becomes non-zero-sum. The answer to this question is highly dependent on the definition of state power which is applied. If financial state power is regarded in its offensive interpretation as the ability to cause another state to do something it would otherwise not do, financial state power would be rather a zero-sum game. This is grounded in the relational focus of this conceptualization of power. If financial state power is seen as being always relative, the gains of one state do result in another state's equal loss (Baldwin, 1979, p. 187). Within its defensive definition, however, financial power may become a non-zero-sum game. If states increase, for instance, their financial stability, they become less vulnerable to financial crises. Although this would be defined as an increase in financial power, it would not be zero-sum because the increase of power is not accompanied by a simultaneous decrease of another state's financial power.

Now that the conceptual basis for an analysis of financial state power has been given, the next chapter will set the foundation for the empirical analysis by introducing the research strategy and methodological framework of the study.

# 3 Neorealism – Theory, Criticism, and Predictions

In order to provide a basis for an answer to the second research question, "*Can the fiscal counter-measures taken in the course of the European debt crisis be explained by the theory of Neorealism?*", the following paragraphs will present the theoretical foundation needed for such an assessment. Based on this, the difficulties of using Neorealism to explain the European Union will be subject to a critical assessment. Finally, it will be argued how Neorealism would predict the design of the Eurozone's crisis management, which will eventually lead to the formulation of a hypothesis.

## 3.1 Neorealist Theory

Although the discipline of International Relations offers a wide variety of schools of thought, there is no school that regards state power as more central than does the school of Realism and its reformulation, Neorealism. Realism has such a strong focus on power that it is even sometimes called 'power politics' (Kadera & Sorokin, 2004, p. 212). Deriving from Realism, Neorealism emerged as one of the key perspectives on International Relations within the past decades. Although there are some crucial differences between the theories, Realism and Neorealism share the same set of basic premises. This is, firstly, the anarchic nature of the international system implying that there is no supervisory authority that could play a regulatory role. Secondly, (Neo-)Realists assume that states are uniform, homogeneous and rational actors and furthermore the only actors that matter on the international level (Waltz, 1979). Thirdly, states differ from each other only through their power potential. From a (Neo-)Realist perspective, power is the only thing that counts in the international system. It is the only thing that enables states to enforce their interests and to maintain their own security (Waltz, 1979). The preservation of this security is the primary concern of states.

Apart from those similarities, Neorealism has some distinct assumptions. The central of these assumptions is the state's motivation to strive for power which,

for Neorealists, is caused by the structure of the international system. Because of the anarchic nature of the system, states can only ensure their survival and independence by being powerful enough to withstand the influence of other states. As a result, states continuously strive to maximize their power. This strong focus on the systemic nature of the international system is accompanied by the assumption that states always try to defend their position in the international system *relatively* to the other states.

Neorealism assumes an international system in which every state's interest is solely its own survival and the maximization of its power. As a result, cooperation between states is extremely hard to achieve for two main reasons. The first is the states' fear of being cheated. Because cooperation under anarchy follows the rules of the prisoner's dilemma, defecting is the dominant strategy (Collard-Wexler, 2006, p. 400). Secondly, states will not engage in cooperation if they fear that the relative gains of their cooperation partner will be higher than their own (Grieco, 1988, p. 487).

According to those assumptions, cooperation can only occur under certain circumstances. One of those situations is when a hegemon establishes rules or structures that negate the fear of cheating. Another is met when the number of states involved in an international negotiation is high and through cooperation, proportional relative gains could be realized (Collard-Wexler, 2006, p. 400). Finally, states can engage in cooperation if they are facing an external threat which impedes the ability of states to independently ensure their survival. This is especially a defensive Neorealist argument and assumes that in situations of high external threat, states may consider the risks of cooperation as being lesser than potential costs induced by the external threat (Collard-Wexler, 2006, p. 401).

One important characteristic of Neorealist theory that should be borne in mind is its focus on military power as the most important; some scholars would even argue the *only* important, determinant of states' decision making. However, Neorealist literature has remarked that economic and financial gains are immediately tied to military power, as economic strength is a prerequisite for the funding of military capabilities (Snidal, 1991, p. 703). Thus, financial soundness as a requirement for economic strength is of interest to Neorealism as well.

## 3.2 Neorealism and the European Union

As prevalent as the theory of Neorealism might be in the study of International Relations, it is, of course, not free from critique. Several scholars have pointed out that its state-centric view of international politics leads to major theoretical problems. One of those theoretical problems is the European Union. The political entanglement and the seemingly voluntary transfer of power to superordinate international institutions, like the European Commission and the European Parliament, represent a development that cannot be readily explained by Neorealism. Critics of Neorealism then pinpoint three major issues which Neorealism fails to explain in the framework of the European Union. Those are, firstly, the absence of anarchy, secondly, the progressive cooperation among the states of the European Union, and, thirdly, the ongoing transfer of sovereign rights to supranational institutions which is a process that seems to contrast Neorealist predictions. In the following, these three points of critique will be described in order to set the basis for the subsequent analysis.

### 3.2.1 Anarchy

It is especially Neorealism's most basic assumption, anarchy, which is widely conceived as not being applicable to the European context (Collard-Wexler, 2006). Through the ongoing assignment of power to European institutions, the European Union has become a supranational organization with considerable decision-making authority. Instead of anarchy, the political Europe has subordinated itself under a semi-hierarchical ordering principle (Rosamond, 2000). Many scholars argue that this entanglement can hardly be regarded as anarchy (Collard-Wexler, 2006). Anarchy in the understanding of Neorealism is defined as the absence of any 'world government' or a similar authority which can impose rules and structure in the international system (Waltz, 1979, p. 88). This condition has been mitigated by the institutional framework of the European Union as it implemented several hierarchic structures that set the framework within which its member states have to operate. If anarchy is not given at the European level anymore, however, Neorealism fails to describe state behavior in this international system.

This critique has been picked up by Neorealist scholars who argue that it is still possible that the systemic pressure induced by anarchy determines the decisions of states under a semi-hierarchical system (Collard-Wexler, 2006, p. 420). The main argument here is that the framework of a semi-hierarchical system like the European Union only lowers the intensity of anarchy but does not change its underlying premises. If this would be the case, the explanatory power of Neorealism is dependent on the relative intensity of anarchy in any given situation. If anarchy is, in certain situations, less mitigated by the institutional and legal framework of the European Union, Neorealist theory gains explanatory power for those specific situations or events.

### 3.2.2 Cooperation

Closely related to the Neorealist assumption of anarchy is the ability of states to cooperate. The extent of inter-state cooperation both horizontally and vertically in the European Union constitutes an anomaly to Neorealism (Collard-Wexler, 2006, p. 402). Despite the Neorealist claim that cooperation in the international system is extremely hard to achieve, the progressive institutionalization and deepened entanglement in the European Union seem to prove otherwise.

From a Neorealist perspective, it is extremely hard to explain why cooperation between the states of the European Union has not only being sustained, but even extended from ‘low politics’, e.g. social and economic affairs, to ‘high politics’, such as foreign policy (Collard-Wexler, 2006, p. 402). The inter-state cooperation of the European Union is indeed remarkable in the sense that over the past decades it has developed towards touching on the ‘core’ areas that determine state security. Deriving from an economic alliance on coal and steel, the cooperation extended to other economic and financial areas up to recent efforts to establish an even closer union by formulating a Common Foreign and Security Policy (CFSP) (Collard-Wexler, 2006).

### 3.2.3 Supranationality versus Intergovernmentalism

Two central concepts that play an important role in any discussion about the institutional framework of the European Union are supranationality and intergovernmentalism. In this context, a supranational institution is a body which

is located 'above' sovereign states and can act without being dependent on the authorization of national governments. Intergovernmentalism, on the other hand, describes the cooperation of governments without the authoritative participation of other actors (Wessels, 2008, p. 39).

The institutional bodies of the European Union differ in terms of the extent to which they can be regarded as supranational or intergovernmental. The European Commission and the European Parliament, for instance, can be identified as the most supranational bodies of the European Union. The Council of Ministers and the European Council, on the other hand, are intergovernmental institutions which, despite an ongoing transfer of sovereign rights to the supranational bodies, still possess of great power in the decision-making processes of the European Union. Although the European Union has been subject to a steady process of integration and a transferring of power to its supranational institutions, the European Council is still regarded as the most powerful body in the European Union to date (Goebel, 2013, p. 123).

However, even the fundamentally intergovernmental institution of the European Council has shown signs of progressive supranational functioning in its operation. The basis for this development set the Lisbon Treaty through which the possibility of qualified majority voting has been implemented in the decision-making process of the European Council. The voting procedure of qualified majority is regarded as being a supranational characteristic as it leads to a situation in which individual member states may lose their right for final decisions (Wessels, 2008, p. 41). Because qualified majority voting does not require unanimity for decisions to be adopted, it may happen that a member state has to implement policies which it is strictly opposed to.

As a result, apart from the Neorealist difficulties to explain the absence of anarchy and the lasting state cooperation within the European Union, its supranational system poses another difficulty to the theory. In general, Neorealists constitute that the transfer of a state's tasks and competencies to a superordinate institution are contrary to every state's goal of preserving its autonomy and thus security. It is not easy to explain from a Neorealist standpoint why the European states continue to follow a way of supranational integration instead of engaging in

purely intergovernmental cooperation, which in a Neorealist world is already hard to achieve.

In order to try and explain the supranationality of the European Union, Neorealists argue that states may indeed choose to participate in supranational integration under certain circumstances. For instance, if states perceive that the potential disadvantage of not participating in a supranational institution would be higher than the security of maintaining their independence, they may choose to engage in supranational integration. This possibility gets more and more likely the larger and more powerful the group of states is which pushes forward the supranational institution (Gruber, 2000).

Although this explanation may provide an answer to the question why states participate in supranational institutions in very distinct situations, there can be no doubt that a Neorealist would prefer an intergovernmental solution over a supranational approach (Collard-Wexler, 2006).

### 3.3 Neorealist Predictions of the Eurozone's Crisis Management

Now that it has been shown that the European Union poses an empirical example that is difficult to explain with Neorealism, the financial state power conceptualization given in the second chapter will be applied to the case of the Eurozone. Furthermore, it will be assessed how the theory of Neorealism would predict the design of the Eurozone's crisis management. Those theoretical predictions will then be used in the empirical part of the thesis to test whether in situations of severe crisis the states of the Eurozone disregard their institutional interconnectedness and fall back to Neorealist behavior.

Having conceptualized financial state power as consisting of an offensive and a defensive component, there are distinct goals identifiable that Neorealism would expect a state to pursue.

States in Neorealist theory are power maximizers. They constantly strive to maximize their power in relation to other states. In general, creditor states should be expected to maintain or even extend their relative creditor status by any means necessary. In regard to the defensive aspect of financial state power, states should

be expected to take any measures intended to increase their financial stability and to improve their ability to resist current or future threats to their defensive financial capabilities.

However, having a state system like the European Union considerably prevents individual states from rigorously maximizing their financial power or to take actions regardless of their impact on other member states. The institutional framework of the European Union forces its member states to find solutions that are compatible with its institutional rules and circumstances. In short, the European Union defines the distinct framework conditions on which the states have to orient themselves.

Furthermore, the monetary union of the Eurozone sets strict parameters of fiscal policies in which the member states can engage to preserve their financial security and economic well-being. Because of the area's financial and institutional entanglement, any measures intended to influence the currency of the Euro or to restore the financial markets' confidence in the currency area have direct repercussions for the rest of the Eurozone. As a result, the states are forced to take those repercussions into consideration if they want to prevent potential negative externalities for themselves.

Bearing in mind the states' behavior in regard to financial power and taking into consideration the limitations of the European Union identified above, the theory of Neorealism can be used to identify specific strategies for the Eurozone's crisis management.

### 3.3.1 Anarchy

The first and most important prerequisite that has to be met for any predictions that utilize Neorealist theory is anarchy. If anarchy is not prevalent in the international system, Neorealism loses all of its explanatory power. The reason for this is that anarchy is needed to enable power play between the states. Only under anarchy, powerful states can coerce their will on weaker states, unimpaired by a superordinate authority.

If it is already hard for Neorealism to explain why the member states of the European Union gather under a superior institution in times of peace, it seems to be even more exceptional that the states maintain such a behavior under crisis

conditions. In times of crises, when the states' survival is at threat, it is reasonable to assume that states would refrain from any binding, superior institutional framework and strive to establish a situation in which only the states themselves dispose of decision-making power.

As a result, what should be expected from the state behavior in the face of the European debt crisis is that the counter-measures would be implemented not under the umbrella of the European Union but under the anarchy of the international system.

### 3.3.2 Cooperation

A similar line of thought also applies to any prediction about cooperation between the Eurozone states. Resulting from their primary interest, survival, states would be expected to act according to preserving this most important goal. This means that Neorealism would expect every state to take any measures that will, rationally seen, provide it with the highest chance of survival, respectively the maximization of its power. In reverse, states would not be expected to take any measures out of altruism or similar motives. Being only focused on their own well-being Neorealism expects states to readily cheat on other states if this would be the solution bearing the highest benefit for the acting state.

As a result, state cooperation would only to be expected if the cooperating states would perceive the potential negative externalities resulting from non-cooperation more severe than the risks that come with cooperation and the threat of being cheated.

### 3.3.3 A Supranational or an Intergovernmental Solution?

As has been shown before, the supranational way of European governance is something that Neorealism struggles to explain. The theory has no answer to the question why a state should voluntarily agree to the implementation of voting procedures that could potentially implement decisions against its own will.

In a supranational framework, a state gives up, at least partially, his sovereign rights within certain policy areas. For instance, the European Union has a long tradition of taking a very active role in the implementation of new laws particularly in the fields of economic and trade policy, social policy, and transport

policy. Since the Treaty of Lisbon, the legislation within those fields lies in the hands of the Council of the European Union and the European Parliament. Those two institutions are able to pass European law independent of the preferences of individual member states. Since both bodies ‘only’ need a qualified majority to pass the majority of law, in the worst case, European Union wide policies can be implemented against the will of an individual member state, despite potentially negative externalities such policies may have for said state.

Consequently, the voluntary transfer of sovereign rights to a supranational institution like the European Union is a hard case for Neorealism to explain. Such a supranational framework should be expected not to be in the interest of any Neorealist thinking actor. Accordingly, the process of solution finding in response to the crisis should be expected to follow an intergovernmental, rather than a supranational path.

### 3.4 Hypothesis

The Neorealist predictions identified in the paragraphs above lead to the formulation of a hypothesis which the subsequent analysis will orientate itself towards. This hypothesis will be formulated in the following section.

The European framework sets strict institutional rules which severely prohibit the member states from acting freely in following only their own interests. The transfer of sovereign rights to the supranational framework of the European Union prevents the power of decision-making from being fully in the hands of the member states. Especially in the area of economic and financial policy the European Union has a long history of very close interconnectedness and many policy areas have been given up to the administration of the European Commission, the European Parliament, and the Council of the European Union.

Following Neorealist assumptions, such a decision-making framework cannot be in the interest of the power-maximizing, rationally acting states. This should be even more relevant when crisis conditions threaten the financial security of a state. If the financial and economic well-being of a state is suddenly at risk to such an extent that it threatens the whole foundation of its financial security and

financial power, it should be expected that states refrain from any attempts to take actions intended to promote a structure which takes away the decision-making power from them. It should be expected that in times of crisis the European Union would be of secondary importance to the states and that they return to a behavior aimed at protect the own well-being. In case that cooperation is needed in order to maintain their security, states would be expected to engage in an intergovernmental approach to solution finding instead of engaging in deeper supranational integration.

My hypothesis is thus that in crisis situations states can be observed to fall back into Neorealist behavior *even* in such an institutionalized state union as the European Union.

In order to find evidence for this hypothesis, it has to be shown that the member states of the Eurozone have acted according to Neorealist predictions during the implementation of the counter-measures to the European debt crisis. Those predictions have been made in the section above concerning three main criteria: anarchy, cooperation and supranationality. It is those three criteria which have to be fulfilled in order to provide evidence for the hypothesis. As a result, it shall be shown that the three most important counter-measures to the European debt crisis were, firstly, negotiated under anarchy. Secondly, that the cooperation leading to the implementation of the counter-measures reflected the financial power relations among the Eurozone states and, thirdly, that the institutional design of the measures was intergovernmental instead of a supranational. The qualitative part of this thesis will thus be structured according to those three criteria.

Before the empirical analysis will be conducted, the research strategy and the underlying methodology will be presented in the next chapter.

## 4 Research Strategy and Methodology

In order to find evidence that supports the aforementioned hypothesis, a methodological framework will be designed in the following chapter that is suitable for the specific purpose of this thesis' analysis. The methodology is based on a mixed-methods approach combining quantitative and qualitative analyses. The aim of the quantitative research is to descriptively explore the power relations in the Eurozone in the years of the European debt crisis. It shall provide a ranking of states according to their financial power in both offensive and defensive terms. The qualitative analysis then strives to find evidence for the hypothesis that states fell back into Neorealist behavior in the specific situation of the European debt crisis. Qualitative evidence shall be found by exploring the three most important counter-measures taken to counter the European debt crisis.

### 4.1 The Case Study Research Strategy

The research strategy that will be applied in this study is a comparative case study design. A comparative case study design has been chosen because of its particular suitability to discover contrasts, similarities or patterns with the goal of developing theory (Campbell, 2010, p. 174). Since the goal of this thesis is to extend the application of Neorealist theory to the case of the Eurozone by generating an in-depth, contextual understanding of the events during the European debt crisis, the comparative case study design suits this purpose. Accordingly, the specific case at hand is the crisis management of the member states of the Eurozone in the course of the European debt crisis. The reason for choosing the crisis management of the Eurozone as a single case, and not the individual behavior of the member states as multiple cases is that the focus of the study lies rather on the overall composition of the implementation processes than on a close examination of every single state's behavior.

As the case under investigation is a single case, not multiple cases, the following exploration corresponds to a within-case analysis which is the "in-depth exploration of a single case as a standalone entity" (Paterson, 2010, p. 970). Within this single case, however, multiple organizational entities might be

explored. For instance, a within-case study might contain the negotiations between several allies or the behavior of multiple organizations in a certain industry (Campbell, 2010, p. 174f.). As Barbara L. Paterson puts it, within-case studies involve

an intimate familiarity with a particular case in order to discern how the processes or patterns that are revealed in that case support, refute, or expand (a) a theory that the researcher has selected or (b) the propositions that the researcher has derived from a review of the literature and/or experience with the phenomenon under study. (Paterson, 2010, p. 970f.)

In the case of this thesis' particular case study design, propositions derived from a quantitative analysis of chosen financial indicators in the Eurozone will be tested against qualitatively raised data concerning international policy making in order to expand the application of theory of Neorealism. It thus comprises both purposes of a within-case analysis as identified by Paterson.

Typically, within-case analyses begin with a rich descriptive part which provides a profound and deep understanding of the context and individual characteristics of the analyzed case (Paterson, 2010, p. 972). This first descriptive part of the analysis aims to set the basis for following conclusions to be drawn. Correspondingly, in this thesis, the quantitative part sets the basis for theoretical predictions that will be subject to the subsequent qualitative analysis.

## 4.2 Case Selection

The case that was chosen for this comparative case study is the Eurozone in the course of the European debt crisis between the years 2009 and 2014. This specific period was chosen to illustrate how the crisis management developed from the start of the European Debt crisis in 2009 over the implementation of counter-measures between 2010 and 2012 until 2014 when possible effects of the Eurozone's crisis management could be observed. While the severity of the crisis and its immense effects on the socio-economic landscape of the European Union make this case worthwhile to explore, there are several more reasons for choosing this case while simultaneously justifying the choice of the Eurozone as the analytical object of this thesis.

First of all, there is the anomaly which the European Union, and thus the Eurozone as well, poses to Neorealism. In order to develop theory and enhancing its explanatory area, it is necessary to deal with special cases that put the theory to a test. For this purpose, the unusualness of the Eurozone offers a rich case to explore. Choosing the Eurozone as the analytical object of this thesis furthermore contributes to the knowledge about this regionally as well as globally important structure and may thus produce knowledge transferable onto other fields.

Apart from the potential theoretical benefits, the case selection may also contribute to the understanding and development of future ways to tackle similar crises. The European debt crisis has had severe economic, political, and social repercussions all over Europe and the rest of the world. Thus, exploring the underlying mechanisms that steered the responses to the crisis helps to further expand the knowledge about the case at hand and can potentially help by identifying new aspects to consider for future policy-making.

Lastly, the case selection has some very practical advantages. Choosing the Eurozone as the case for this study offers a rich set of benefits concerning comparability. The area's strong financial entanglement particularly increases the quality and richness of the available data about financial statuses, enhances the comparability due to the share of the same currency, and provides a comparatively solid documentation of the measures taken in the framework of the financial crisis. Achieving a high comparability is seen as the main force behind case selection for comparative case studies (Yanow, Schwartz-Shea, & José Freitas, 2010, p. 111) and thus further supports the choice of taking the Eurozone as the case for this thesis. Moreover, the case selection overcomes potential pitfalls of the comparative framework by sharing the same years of comparison, the organizational framework, and the political context (cf. Campbell, 2010). This makes the potential findings of the study more robust towards critique concerning the comparability of objects analyzed here.

To sum it up, the case selection offers advantages for both theoretical and practical considerations. While the unusualness of the Eurozone to Neorealism bears the chance to expand the theory in this direction, the size and global importance of the Eurozone makes it a promising case to explore regarding the handling of the financial crisis. Furthermore, the interconnectedness of the area enhances the basis of available data and improves the comparability. Although the

thesis may benefit from those particularities, however, there naturally are certain limitations and potential biases to be borne in mind.

### 4.3 Limitations and Potential Biases

Just like any other research, this work is subject to certain limitations and potential biases that may weaken the expressiveness of the analysis. In order to relate the limitations to the respective issue they apply to, each section of this thesis that deals with methodology has its own sub-chapter in which those concerns will be tackled. Accordingly, the following paragraph only deals with the limitations of the chosen case study design.

One particular point worthy of discussion is the choice of regarding the crisis management of the Eurozone during the European debt crisis as a single case and not multiple cases. The main reason for choosing a one-case design is that the focus of the study lies on the Eurozone's joint crisis management which influenced all member states of the Eurozone the same. Furthermore, although the Eurozone will be regarded as one case, it is multiple differences which will be looked at within the framework of this specific case. Since different entities will be compared within the case, the case study design should be rather regarded as a single-case design that puts the focus on its internal differences and comparison. Naturally, an alternative research design could have taken the individual member states of the Eurozone as multiple cases and then compare those different cases with each other. In contrast to a single-case design, however, such a solution was felt to lose the specific focus on the Eurozone as a distinct entity. The focus of this study is thus on the specific construct of the European community rather than looking at its multiple member states as the central object of interest. Since everything which will be analyzed in this thesis is seen in the context of the distinct Eurozone environment, the choice has been made to regard the crisis management of the Eurozone during the European debt crisis as one single case under consideration.

Now that the overarching research strategy has been defined, the basis has been set for the first analysis of this thesis' mixed-methods approach. In the following

chapter, the quantitative analysis will be conducted. The chapter starts by describing the applied methodological framework and the methods of data collection. Subsequently, the empirical analysis will be carried out with the goal of exploring the power relations in the Eurozone during the European debt crisis.

# 5 Quantitative Analysis

Resting upon the conceptualization of financial state power given in the second chapter, the financial power distribution in the Eurozone will be descriptively analyzed in the following chapter. This analysis will then serve as the basis for the qualitative analysis which will be carried out later.

## 5.1 Quantitative Research Design and Method

The quantitative part of this thesis consists of a time-series comparison. The underlying research question is *“How was financial state power distributed among the states of the Eurozone between 2009 and 2014?”*. In order to assess the financial power distribution in the Eurozone, the thesis builds on two main indicators which are investigated empirically. Those two indicators are:

1. The creditor distribution within the Eurozone as a determinant of financial influence (offensive financial state power)
2. The financial (in-)stability of the Eurozone states as a determinant of resistance against financial crises or similar harming financial influences (defensive financial state power)

The two indicators will be the object of a time-series analysis based on official data published by Eurostat and the European Central Bank. The first indicator will be examined using data from Eurostat. The analysis of the second indicator will be based on the Composite Indicator of Systemic Stress published by the European Central Bank.

In order to enable a statement about the financial power relations within the Eurozone during the crisis data for a time period starting with the first year of the European debt crisis in 2009 until the year 2014 will be analyzed.

The sample of states that will be included into the analysis consists of 16 states which represent the 2009 composition of the “Eurozone”; the group of states sharing the common currency of the Euro. The sample purposely disregards states which have become members of the Eurozone after 2009. This decision has been made because the goal of the comparative study is to draw a concise picture of the

financial state power distribution between 2009 and 2014. In order to avoid changes in the sample between the individual years, the same set of states will be kept for all years of the analysis. Hence, the 16 states included in the sample are (in alphabetical order): Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Slovakia, Slovenia, Spain, and Portugal.

In the course of developing the research design for this thesis, other than the mentioned two indicators have been taken into consideration but were dismissed due to various reasons. Among others, it had been thought investigate the size of the financial sectors in the individual states as an indicator of the influence certain states have on the financial system. Another possible approach was to incorporate the amount of foreign exchange reserves that the member states of the Eurozone hold as an indicator of influence on the international currency system. While the former was dismissed due to the assumed weak link between the size of financial sectors and financial state power, the latter was eventually disregarded because the monetary union status of the Eurozone prevents the indicator from having an influence of financial state power. Another indicator that could have been analyzed was the individual credit ratings of the Eurozone states as a determinant of financial leeway. It was dismissed because it could not be brought into conformity with the concepts of financial state power used in this thesis.

In the end, the two indicators proposed above seemed to promise the most valuable and solid basis for the research design. Nevertheless, other indicators could as well have been chosen.

### 5.1.1 Operationalization

The following paragraphs transform the concept of financial state power into the two chosen indicators. Subsequently, the indicators will be related to numeric variables in order to enable a statistical analysis.

The first indicator is the creditor distribution within the Eurozone. This indicator represents what Susan Strange understands as a possibility to influence financial structures. The ability to provide loans to other states bears a significant source of

financial state power. A creditor in the international system gets to decide on the terms of the credit, for it can influence these terms according to its own preferences and strategic goals. Being a creditor in the financial system thus affects a state's ability to cause another state to do something that it would otherwise not do. This is due to the condition that the debt structure in a given international structure is generally subject to terms dictated by the creditor states of that system. Creditor status thus has an effect on the offensive understanding of financial state power. Providing credit can transform into political influence which in turn may strengthen a state's ability to cause another state what it would otherwise not do.

Despite the financial power that a creditor position certainly grants, it is important to note that creditor-debtor relationships are not necessarily a zero sum game. Indeed, in some cases the welfare of the creditor depends on the welfare of the debtor. As a result, creditor states cannot always simply decide to stop granting credit to another state without also potentially weaken their own economy. This phenomenon is highly affected by the extent to which the economy of the creditor state is dependent on the credit granted to the debtor state. Although it can be stated that a creditor-debtor relation is generally more beneficial for the creditor state in terms of financial power, potential negative externalities for the creditor state should not be overlooked.

In order to enable a statistical analysis of the indicator, the creditor distribution has to be related to a numeric variable suitable for a statistical analysis. For this reason, data on intergovernmental lending within the Eurozone will be used as the empirical basis of the first indicator.

Intergovernmental loans are credits that a government grants another government and can be regarded as being a measure for crisis situations when the regular channels of states to fund their expenses (e.g. through government bonds) break down. The reason that intergovernmental loans are mainly a measure for crisis situations is that they place states in a situation of dependence on other states, which is generally not in any state's interest, especially if it has other alternatives (Helleiner, 2014).

The data on intergovernmental lending used in the upcoming analysis covers government loan assets with other EU governments as counterparties. It thus

represents a valid indicator to measure the creditor status of countries in the distinct context of the European Union. The data can be filtered to cover only the states of the Eurozone which then provides the possibility to view this space as the discreet object of analysis.

The second indicator analyzed in this thesis is the financial stability of the Eurozone states. Financial stability can be defined as the ability to resist financial stress (Holló, Kremer, & Lo Duca, 2012). Thus, it relates to financial power in the way that a lower financial stability generally induces a higher vulnerability to external shocks such as financial crises or other occurrences that could potentially harm the domestic financial system. Financial stability thus influences the defensive understanding of financial state power by determining the resistance of a state against financial crises or similar harming financial influences.

The numerical variable which will be used for the analysis of the financial stability within the Eurozone is based on data derived from the Composite Indicator of Systemic Stress (CISS). The CISS was composed and published by the European Central Bank and “measures the current state of instability, i.e. the current level of frictions, stresses and strains (or the absence of these) in the financial system” (Holló, Kremer, & Lo Duca, 2012, p. 2) of a state. It consists of five sub-indices covering the current level of stress in the following segments of the financial sector: bank and non-bank financial intermediaries, money markets, securities (equities and bonds) markets as well as foreign exchange markets (Holló, Kremer, & Lo Duca, 2012).

In the design of the CISS, the level of ‘financial stress’, which is measured by the composite indicator, is equaled with the current instability of a state’s financial system as a whole (Holló, Kremer, & Lo Duca, 2012, p. 8). It is thus an ex-post assessment of financial instability. The composite concept of financial instability used as the basis for the calculation of the CISS is based on several different symptoms that are associated in academic literature with financial (in)stability. Those are an increase in financial market uncertainty, an increase in disagreement among investors, an increase in the asymmetry of information between borrowers and lenders, and a reduced preference for holding risky assets and/or illiquid assets (Holló, Kremer, & Lo Duca, 2012, p. 9).

It is reasonable to assume that the two indicators show certain interdependencies and connections with each other. The CISS, as a highly aggregated indicator, takes into consideration a lot of different sub-indices some of which may have points of contact with spheres that also influence the intergovernmental lending procedures.

In fact, there is a distinct interdependency between the first and the second indicator that should be mentioned here. As described during the operationalization of the first indicator, intergovernmental credits are a means which comes into practice when regular forms of borrowing money are failing. They can be regarded as the last resort when private investors have lost confidence in a state and refuse to engage in granting it more credit. In contrast, an unstable financial system is certainly a factor that influences the decision not to trust in the ability of a state to pay back its debt. Because the CISS only measures the *current* level of systemic instability, however, it does not make any predictions on how this stability will develop. It thus encompasses only a part of the relevant data included in the decision-making on granting credit.

In order to answer the question if the two indicators analyzed here are directly influencing each other, the correlation between the two variables has been measured. With a correlation coefficient between the total amount of intergovernmental lending and the overall financial instability of the Eurozone of about -0.58, the two variables indeed show a moderate negative relationship.

### 5.1.2 Data Collection and Analysis

The empirical material used to analyze the first indicator consists of primary statistical sources obtained from Eurostat, the statistical office of the European Union. The data was collected from the official homepage of Eurostat. It is part of the Government Finance Statistics (GFS) data which is collected by Eurostat on a regular basis.

As a reaction to the Eurozone crisis, Eurostat started collecting data on intergovernmental lending in 2010. The questionnaire of this data “covers quarterly data on stocks of loans related to claims of other EU Member States” (Eurostat, 2011, p. 3). Any amounts related to the European Financial Stability Facility (EFSF) were initially not included in the data and were collected

separately. From 2011 onwards, however, credit granted by the EFSF has been included in the statistics on intergovernmental lending (Eurostat, 2012).

The data on intergovernmental lending (IGL) covers government loan assets with other EU governments as counterparties. The processed data shows who the largest creditors in the Eurozone are. In relation to the total intergovernmental lending volume, the data shows who provides the highest share of intergovernmental loans in the Eurozone and thus portrays which country disposes of the largest capabilities to influence the creditor structures within the Eurozone.

The data for the second indicator originates from the European Central Bank (ECB) and was collected from its official homepage. The Composite Indicator of Systemic Stress dataset is part of the ECB's series on monetary and financial statistics and is available on a monthly basis for a certain set of countries. The value range of the CISS ranges from 0 to 1 with values which tend towards 0 representing high financial stability and 1 representing high financial instability (Holló, Kremer, & Lo Duca, 2012).

The processed data then shows what countries are financially unstable and how the member states financial stability has changed over time.

The data analysis will rely on descriptive statistical methods in order to present an assessment of the distribution of intergovernmental credit and financial stability in the Eurozone. For the first indicator, the respective shares of the individual member states in the total amount of intergovernmental lending in the Eurozone will be calculated in order to enable a comparison between the individual member states. Because the second indicator is based on an index calculating the share of each country is not practical. Instead, the individual values are compared directly.

With the goal of providing a descriptive overview of the relationships, several graphs and figures will be presented that show the main features of the data collection. Subsequently, anomalies and specific characteristics of the data will be presented. In order to show whether the distribution of intergovernmental loans is highly unequal or equal, a variance analysis assessing the standard coefficient of variation will be conducted. The data was processed and prepared using the spreadsheet application Microsoft Excel.

### 5.1.3 Limitations and Potential Biases

One limitation that has to be dealt with concerns the operationalization of financial state power. It is not being claimed that the two indicators analyzed in this thesis are the only indicators to measure financial power. However, over the course of the creation of this work, the two indicators have been repeatedly questioned and tested for their suitability. The result is that the analysis of these indicators should be seen as a contribution to the overall knowledge of the concept and measurement of financial state power rather than a claim for being the only way to approach such a measurement.

Another point worthy of discussion is the choice of analyzing lending instead of borrowing. The reason for this is that lending was regarded as relating closer to offensive financial state power than borrowing. Moreover, the indicator of financial instability essentially identifies borrowing countries as their financial instability index increases the more they borrow. It is also more comprehensive than just analyzing borrowing figures since it also includes information about countries whose borrowing share would be zero.

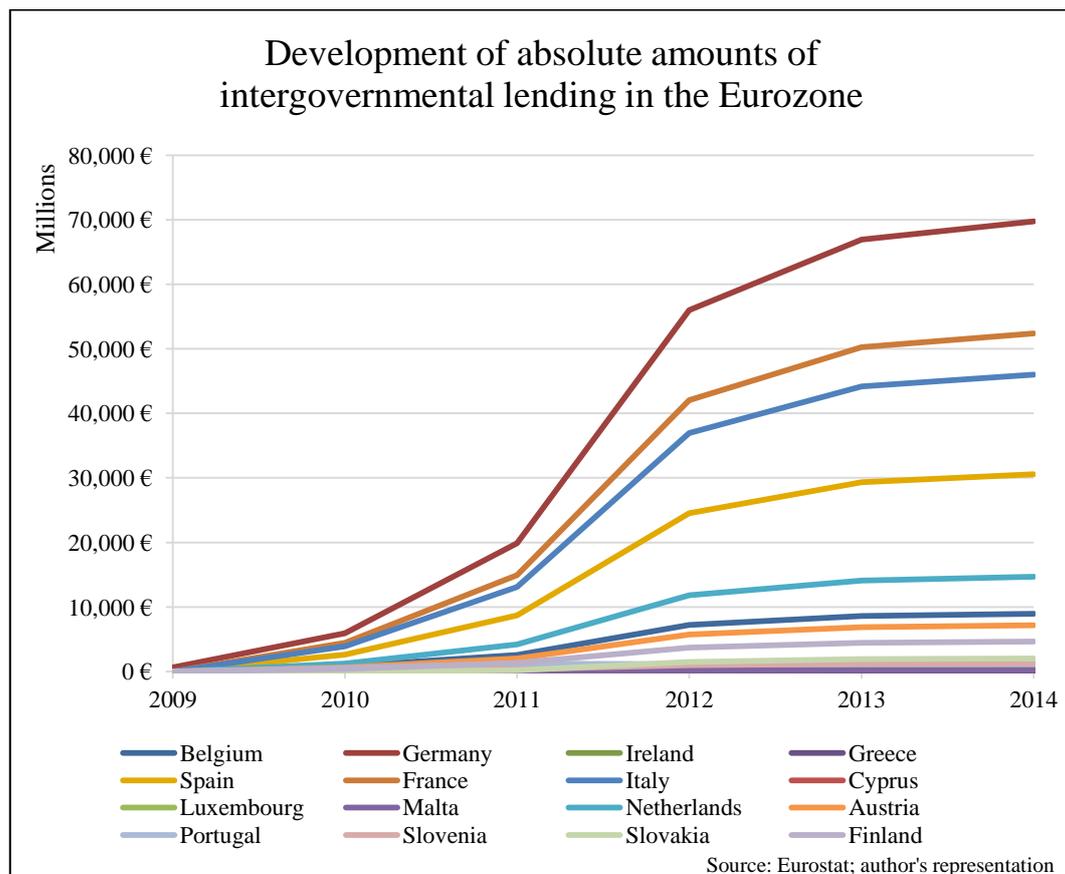
Furthermore, the data used for the analysis has some limitations in itself. This is especially the case for the second indicator, financial stability, which is unfortunately not available for all member states of the Eurozone. It covers only 11 out of the 16 states to be analyzed. The missing states are (in alphabetical order): Cyprus, Luxembourg, Malta, Slovakia, and Slovenia. Although there is a number of missing states for this indicator, the decision has been made to include it nonetheless. The reason behind this is that financial (in)stability is regarded as being so critical to defensive financial state power that its analysis is still considered as adding a lot of valuable insight and explanatory power, despite its possible limitations.

Finally, the choice of leaving out states which became members of the Eurozone after 2009 naturally diminishes the expressiveness of the results in a certain way. When interpreting the conclusions which will be drawn in the analysis, it always has to be borne in mind that the analysis does not consider the financial power of the countries that joined the Eurozone after 2009.

## 5.2 Creditor Status

In the following subchapter, creditor status as an indicator of offensive financial state power will be analyzed. For a first overview, the following figure shows how the absolute amounts of intergovernmental lending have developed from 2009 to 2014. Subsequently, those absolute amounts will be put in context by calculating every individual country's share in the total sum of intergovernmental loans.

*Figure 1: Development of absolute amounts of intergovernmental lending in the Eurozone*



The above figure indicates that there has been a continuous increase with a rapid growth from 2011 to 2012. The upswing in 2011 is related to a heavy increase in lending to Greece, Ireland and Portugal. Furthermore, the figures from 2011 onwards include loans made by the European Financial Stability Facility (Eurostat, 2012). The total amount of credit granted increased from 0.7 billion Euros in 2009, over 6.9 billion Euros in 2011 to 240 billion Euros in 2014. At the end of the third quarter of 2014, the share of intergovernmental lending in the gross domestic product of the Eurozone equaled 2.4 percent (Eurostat, 2015).

Apart from the development of the absolute amounts of intergovernmental loans, it is of interest which shares the individual members of the Eurozone hold in the total amount of intergovernmental lending and whether those relative figures have changed.

Figure 2: Share of intergovernmental loans in the Eurozone from 2009 to 2014

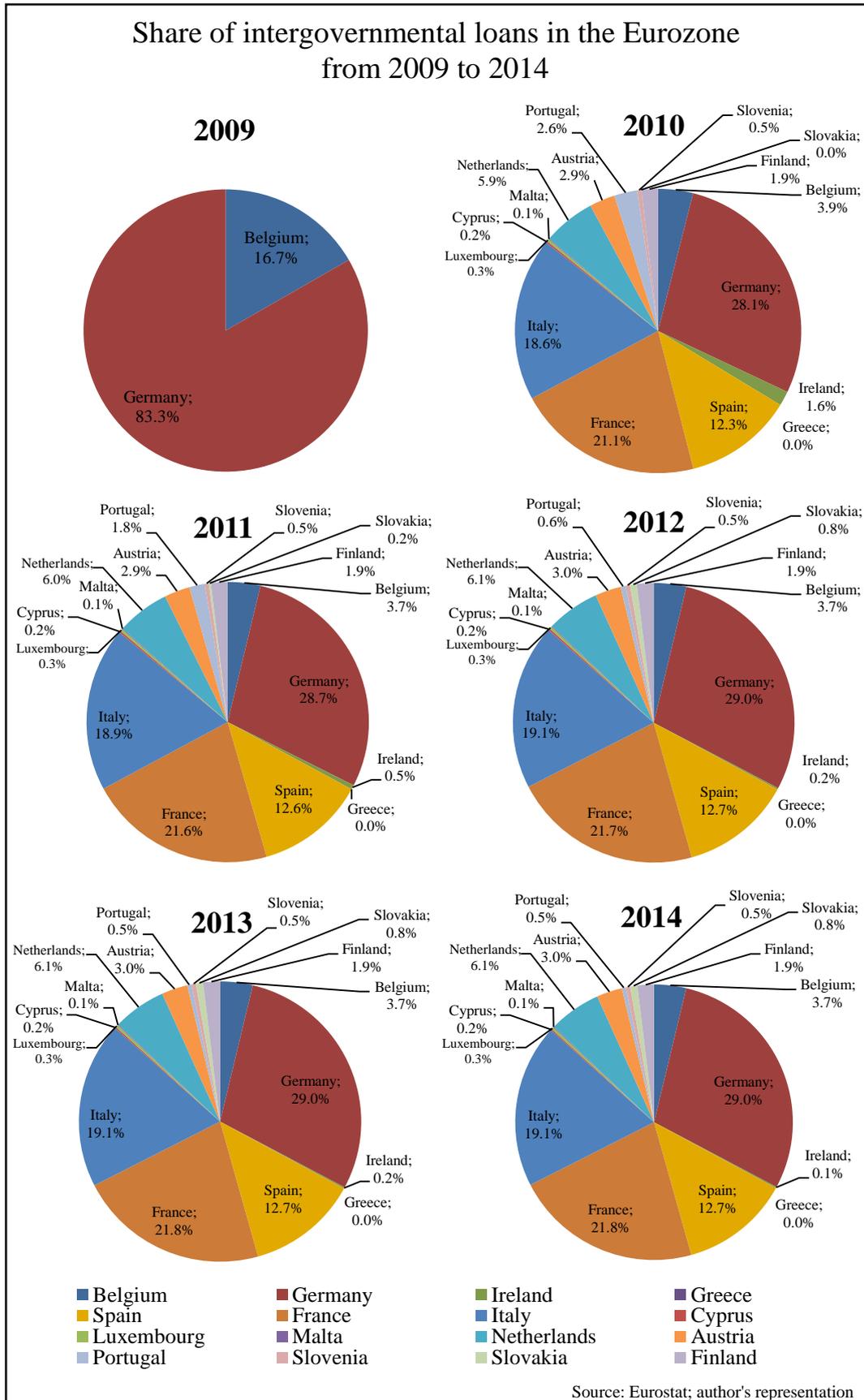


Figure 2 shows the shares of total intergovernmental loans in the Eurozone from 2009 to 2014. In 2009, the only states engaging in intergovernmental lending were Belgium and Germany. From 2010, however, the other member states started to contribute to the intergovernmental lending in the Eurozone as well, with the exception of Greece. For Slovakia, which entered the Eurozone in 2009, intergovernmental lending has been reported from 2011 onwards.

Germany has been the largest creditor state throughout all the years under investigation which, since 2010, is followed by France (second), Italy (third), and Spain (fourth largest creditor state). In 2014, those four countries together were responsible for 82.6 percent of the Eurozone's total intergovernmental lending capacity.

Induced by its central role in the European debt crisis and therefore receiving the majority of the credit granted, Greece has not been contributing to the intergovernmental lending capacity in the Eurozone. Having to use intergovernmental support themselves, Portugal's and Ireland's share of intergovernmental loans has been subject to a comparatively sharp decrease from 2010 (2.6 and 1.6 percent) to 2014 (0.5 and 0.1 percent). Holding roughly the same share as those two countries, Slovakia (0.8%), Slovenia (0.5%), Luxembourg (0.3%), Cyprus (0.2%), and Malta (0.1%) are completing the set of countries with the lowest share of intergovernmental lending in the Eurozone.

One of the key findings apparent in figure 2 is that the share of intergovernmental loans stayed roughly unaltered between the years 2010 and 2014. Although the absolute amounts of intergovernmental credit have increased, the share between the Eurozone countries has not changed much. The reason for that is that the contribution rates of the individual Eurozone states were based on the equity interest each state holds in the capital of the European Central Bank (European Commission, 2010, p. 26). Those rates are recalculated every five years and are based on the population and the economic output of a country. The small adjustments in individual shares that can be observed mainly between 2010 and 2012 can be explained by the exit of Greece, Portugal, and Ireland from the rescue programs, such as the European Financial Stability Facility (EFSF), because of the countries' own financial trouble during these years. Apart from the visual impression, this finding is backed by the standardized coefficient of

variation which stays approximately the same for the years 2011 until 2014 (0.34 to 0.40).

The analysis of the intergovernmental lending capacities in the Eurozone has revealed that the creditor distribution in the Eurozone has stayed roughly the same since 2010, resulting in relatively consistent offensive financial power relations. Germany, holding the largest share of intergovernmental lending can then be identified as the most powerful country in terms of offensive financial power, followed by France, Italy, and Spain.

### 5.3 Financial (In)Stability

The following subchapter analyzes financial (in)stability as an indicator of defensive financial state power. Figure 3 provides an overview about the development of each state's financial instability from 2009 and 2014. Following this, the individual member states will be ranked in comparison to the other Eurozone states in order to show which countries were the comparatively most stable, respectively unstable.

Figure 3: Development of financial instability in the Eurozone from 2009 to 2014

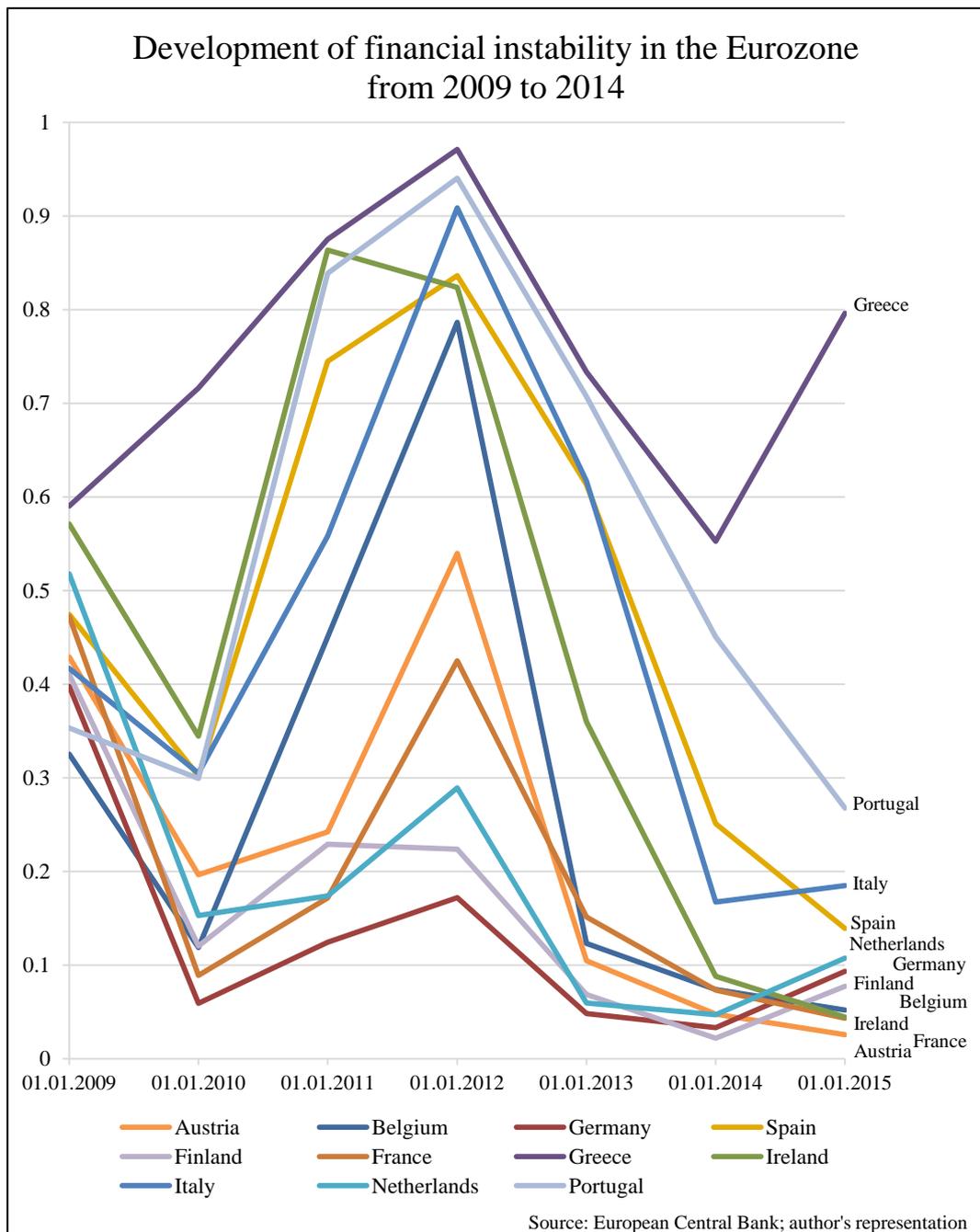


Figure 3 shows that the financial instability of the Eurozone states has been subject to partly heavy fluctuations. Not only Greece, Portugal, and Ireland but also Spain, Italy, and Belgium experienced sharp increases in financial instability starting with the beginning of the European debt crisis at the end of 2009. After a phase of generally increased financial instability in the Eurozone between 2010 and 2012, state financial systems started to become more stable again from 2012 onwards. An exception is Greece which, although becoming initially more stable, experienced another increase in its financial instability since the beginning of 2014. As a result, the financial instability of Greece is still many times larger compared to the other Eurozone states.

It can be constituted that all of the Eurozone members suffered from a decreased defensive financial state power between 2010 and 2012 as a result of a generally increased financial instability. The extent to which the countries have been affected, however, differed rather significantly. While some states like Germany, Finland, the Netherlands, and France maintained relative financial stability during those years, other states, like Greece, Ireland, Portugal, and Italy experienced a sharp increase in financial instability.

The individual rankings of every single state in relation to the other member states of the Eurozone become even clearer in the following table.

*Table 1: State-rankings of financial stability from 2009 to 2015*

Year State	01.2009	01.2010	01.2011	01.2012	01.2013	01.2014	01.2015
Austria	6 (-)	6 (-)	5 (↑)	5 (-)	4 (↑)	4 (-)	1 (↑)
Belgium	1 (-)	3 (↓)	6 (↓)	6 (-)	5 (↑)	6 (↓)	4 (↑)
Germany	3 (-)	1 (↑)	1 (-)	1 (-)	1 (-)	2 (↓)	6 (↓)
Spain	8 (-)	8 (-)	8 (-)	8 (-)	8 (-)	9 (↓)	8 (↑)
Finland	4 (-)	4 (-)	4 (-)	2 (↑)	3 (↓)	1 (↑)	5 (↓)
France	7 (-)	2 (↑)	2 (-)	4 (↓)	6 (↓)	5 (↑)	2 (↑)
Greece	11 (-)	11 (-)	11 (-)	11 (-)	11 (-)	11 (-)	11 (-)
Ireland	10 (-)	10 (-)	10 (-)	7 (↑)	7 (-)	7 (-)	3 (↑)
Italy	5 (-)	9 (↓)	7 (↑)	9 (↓)	9 (-)	8 (↑)	9 (↓)
Netherlands	9 (-)	5 (↑)	3 (↑)	3 (-)	2 (↑)	3 (↓)	7 (↓)

Portugal	2 (-)	7 (↓)	9 (↓)	10 (↓)	10 (-)	10 (-)	10 (-)
<p>Note: A lower number represents a higher financial stability.  (-): no change compared to the previous year  (↑): improved ranking compared to the previous year  (↓): lower ranking compared to the previous year  Source: European Central Bank; author's representation</p>							

As can be seen in table 1, the member states of the Eurozone experienced significantly different developments concerning their financial stability. Ireland, for instance, although having had a very unstable financial system from 2009 to 2011, ranked among the countries with the highest financial stability as of 2015. Portugal, on the other hand, has developed from one of the financially most stable countries in 2009 to the country with the second highest financial instability since 2012. Belgium and Italy have also experienced a reduction of their financial stability while Finland and the Netherlands were able to improve their financial stability until 2014, followed by a drop until 2015.

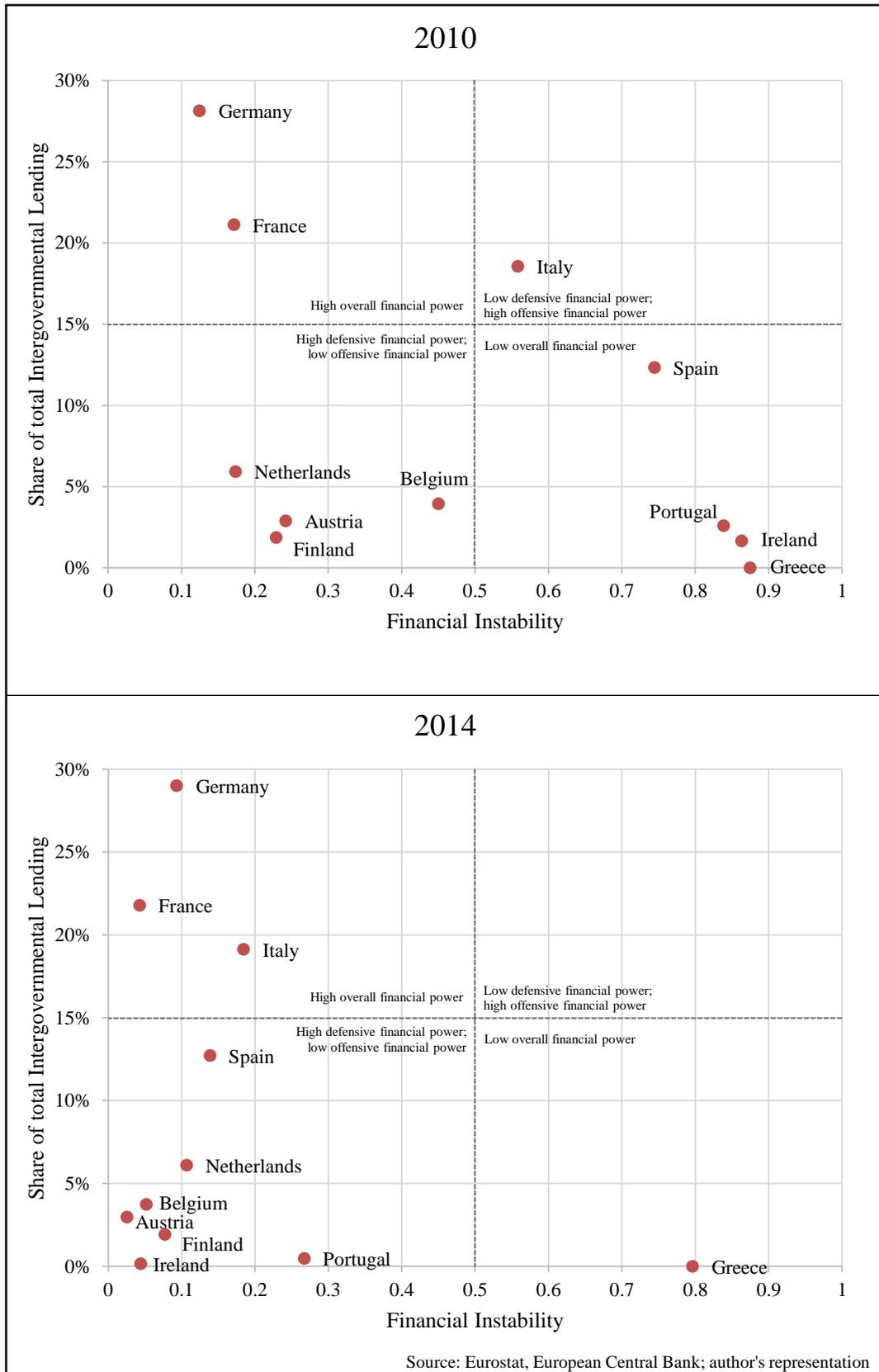
Furthermore, what can be observed is that Greece was the country with the lowest financial stability throughout all the years under consideration. Consistently among the financially most stable countries has been Germany, although its financial system became more unstable in 2014.

Of particular interest for this thesis are the years from 2010 until 2012, when important counter-measures to the crisis have been implemented. Table 1 shows that the countries with the highest financial stability during that time were Germany and France, followed by Finland, the Netherlands, Belgium, and Austria. All in all, the findings above indicate that Germany can be regarded as the country with the most defensive financial state power during the first years of the European debt crisis with Greece representing the weakest country in this regard.

## 5.4 Comparing Both Indicators

In order to express the differences between the Eurozone states even more and to prepare the data for the upcoming theoretical assessment, the following figure shows the relative position of the Eurozone states compared to each other and according to their performance on the two indicators.

Figure 4: Financial state power distribution in the Eurozone in the years 2010 and 2014



What becomes apparent when comparing both, creditor status, as an indicator for offensive, and financial instability, as an indicator for defensive financial state power is that Germany, followed by France, were the overall most financially powerful states of the Eurozone during the European debt crisis. Both countries score very well on both the offensive and the defensive indicator of financial power. Apart from that, it can be seen that Italy, although having had a high share of total intergovernmental lending and thus offensive financial state power, suffered from a rather high financial instability which prevented the country from taking a place beside Germany and France in 2010. By 2014, however, Italy was able to reduce its financial instability and thus joined Germany and France in the group of the financially most powerful states of the Eurozone.

Furthermore, it can be constituted that, all in all, Greece, Ireland, and Portugal have been the three countries which were the least financially powerful states in 2010. This is valid for both the offensive and the defensive understanding of financial power as those countries perform badly on both of the indicators. Spain, although contributing a significant share of intergovernmental lending, was financially very unstable and thus included in the group of the least powerful states. Spain, as well as Ireland, and Portugal, however, were able to regain defensive financial power until 2014, leaving Greece as the only country with a lack of power in both the offensive and defensive category.

What can be seen apart from those individual findings is that, except for Greece, the financial systems of the Eurozone states became generally more stable from 2010 to 2014 while the countries' shares of intergovernmental lending stayed roughly the same.

## 5.5 Interpreting the Financial Power Distribution in the Eurozone

The comparative analysis of the two indicators revealed how the financial power relations in the Eurozone were shaped between 2009 and 2014. The question now to be asked is how Neorealism would make sense of the Eurozone's financial power relationships. In the ideal-typical anarchical international system of Neorealism, the stronger states would be expected to impose their will on the

weaker states. Since there is no supervising institution, the rules of power politics would enable that powerful states coerce others or impose their will on them. Naturally, this predictions stands in sharp contrast to the institutional environment of the European Union and the state-dominated Council of the European Union in which, on paper, all states are equal and have equal voting rights.

What the empirical analysis of the first indicator, offensive financial state power, revealed is that there is a small number of states which hold about 82.6 percent of the total intergovernmental lending capacity of the Eurozone. Those four states, namely Germany, France, Italy, and Spain, thus dispose of significant abilities to influence the financial power structures of the Eurozone. This small group of states, however, shrinks even further when the second indicator, defensive financial state power, comes into play. Because the financial stability of Italy, and especially Spain was comparatively low, their overall financial power position was diminished. As a result, Germany and France were the only two states that were powerful in both the offensive and the defensive category of financial power.

Although the European financial power relations are thus dominated by those two states, none of them are able to obtain a hegemonic position. As a result, though the financial power structures show a significant imbalance towards those two powerful states, presumably none of them is able to dominate the financial structures on their own. Thus, in order to push through their interests, even Germany as well as France would have to seek a partner for cooperation, preferably another powerful states in order to minimize the number of actors whose interests would have to be taken into consideration.

In short, what Neorealists would expect is that the financially powerful states of the Eurozone, with especially Germany leading the way, would impose their will on the weaker Eurozone states, like Greece, Ireland, and Portugal. In case this was not possible for one state alone, this state would be expected to search for a powerful state to cooperate in order to push through its interests.

Judging from the empirical analysis, the most powerful cooperation of states would be between Germany and France, for those countries holding together just over 50 percent of the overall contributions to the Eurozone's intergovernmental lending capacity and having comparatively high financial stability.

Again, however, it has to be noted that all these predictions of Neorealism can only be met if the prerequisite of anarchy is prevalent. If this is not the case, Neorealism loses its explanatory power.

## 6 Qualitative Analysis

In the following chapter, the qualitative analysis will be conducted. In order to set the methodological basis for the analysis, the chapter starts with the description of the qualitative research design and the method to be applied. Following this, there will be a short sub-chapter dealing with the prerequisites for international cooperation. Finally, the qualitative evidence will be presented and conclusively analyzed.

### 6.1 Qualitative Research Design and Method

Especially for mixed-methods studies, document analysis represents a valuable method to complement and expand data derived through another (quantitative) method (Bowen, 2009). In the case of this study, document analysis will be used to answer the second research question: *“Can the fiscal counter-measures taken in the course of the European debt crisis be explained by the theory of Neorealism?”* which partly draws on the results of the quantitative analysis. The aim of the qualitative part of this thesis is thus to find evidence for the hypothesis that the three arguably most important measures implemented in the course of the European debt crisis can be explained by the theory of Neorealism.

Document analysis as a research method is particularly useful for case studies as “documents of all types can help the researcher uncover meaning, develop understanding, and discover insights relevant to the research problem” (Merriam, 1988, p. 118). It may furthermore be the only viable method to research historical events as documents may then be the only source of data obtainable for the researcher (Bowen, 2009, p. 29). Documents, such as protocols, drafts of treaties, reports or similar evidence, can provide historical insight and can help the researcher to make sense of the roots of specific historical events as well as explore the conditions that triggered a certain phenomenon (Bowen, 2009, p. 29). Particularly drafts from certain stages of a process can be used to track change and development of this respective process. Naturally, relying on documents issued by third parties always bears the risk that these documents may be influenced heavily

by the respective preferences of the issuing actor. Thus, when using documents to conduct research one has to be aware of the source of the documents and the potential implications this might entail. Closely related to this remark is one of the disadvantages of document analysis: insufficient detail. Because documents are produced to fit another purpose than research, they might not provide all the information in sufficient detail for the purpose of the study (Bowen, 2009, p. 31f.). Finally, an important question to be asked is how many documents should be included in a document analysis in order to be scientifically sound. Glenn A. Bowen (2009) responds to this question by making the remark that the researcher should be less concerned about the quantity of the documents to be analyzed than the quality they can provide regarding the finding of an answer to the research question (ibid., 33).

In some cases, previous studies can be a useful source of data if the raw data analyzed in the respective study is not available to the researcher (Bowen, 2009, p. 28). This can be especially the case for historical research as certain sources may be unobtainable (Bowen, 2009, p. 29).

### 6.1.1 Data Analysis

In order to find evidence for the hypothesis that international policy making in the Eurozone can be explained by Neorealism, the three arguably most important counter-measures to the European debt crisis will be analyzed. Those are the European Financial Stability Facility (EFSF) from 2010, the European Stability Mechanism (ESM) from 2012, and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, known as Fiscal Compact, from 2012. While the first two measures were implemented to provide financial assistance to Eurozone states in need of help, the Fiscal Compact is an international treaty aimed at preventing crises such as the European debt crisis from ever happen again.

In the course of battling the effects of the crisis, particularly the EFSF and later the ESM were designed to bring back stability to the troubled financial markets which had lost confidence in some of the badly hit Eurozone states. They were the biggest and most important counter-measures that had been taken during the European debt crisis (Gocaj & Meunier, 2013) and thus constitute suitable

instances to explore in order to find evidence for the argument that the Eurozone’s crisis management is congruent with Neorealist predictions. The Fiscal Compact, on the other hand, is less a rescue mechanism than a safety measure to prevent excessive debt levels in the future. As such it completes the path taken during the European debt crisis and presents the third important measure worthwhile to explore.

Because the negotiations for the three counter-measures are historical events that can no longer be observed, relying on reports and analyses documenting the process of the negotiations is seen to be the most reliable method to gather data on those events. Furthermore, to gain even deeper insight into the processes accompanying the negotiations, a number of chosen studies conducted on the three measures will be analyzed.

### 6.1.2 Data Collection and Interpretation

The empirical material used for the qualitative part of this thesis comprises primary as well as secondary sources consisting of legal documents as well as studies conducted on the phenomena under investigation. The data was collected from the official homepages of the investigated bodies and from common sources of academic literature. The following table shows the documents that were analyzed and the specific data which was drawn from them.

*Table 2: Documents and Data Analyzed*

Document	Data analyzed
European Financial Stability Facility Framework Agreement (EFSF, 2011)	Terms, legal structure, and organization of the EFSF and amount of individual member state commitments
European Stability Mechanism Treaty - consolidated version following Lithuania's accession to the ESM (ESM, 2015)	Terms, legal structure, and organization of the ESM and amount of individual member state commitments
Treaty on Stability, Co-ordination, and Governance in the Economic and Monetary Union (European Council, 2012)	Content and legal structure of the Fiscal Compact
Leadership in Hard Times: Germany, France, and the Management of the Eurozone Crisis (Schild, 2013)	Data from interviews with government officials from France and Germany
The Court of Justice approves the creation of the European Stability Mechanism outside the EU legal order: Pringle (de Witte & Beukers, 2013)	Legal assessment of the EFSF and the ESM

Suspending vetoes: how the euro countries achieved unanimity in the fiscal compact (Tsebelis & Hahm, 2014)	Comparison of the individual drafts of the Fiscal Compact and tracking of the corresponding negotiations
Time Will Tell: The EFSF, the ESM, and the Euro Crisis (Gocaj & Meunier, 2013)	In-depth information/analysis of the Franco-German partnership in the face of the European debt crisis

Apart from the seven main documents presented above, the document analysis will be supported by a number of less significant resources that are used as sources for some specific, individual circumstances. Because their representation would go beyond the scope of this chapter, the presentation of those individual sources was waived.

The assessment of the policy making processes leading to the three chosen counter-measures to the European debt crisis will be organized according to the following structure.

First, the general framework of the respective measure will be briefly described. Second, it will be assessed whether the most important prerequisite for Neorealism, anarchy, was given as the basis for a decision explainable by Neorealism. Following this, the decision-making process for each counter-measure will be presented and it will be constituted whether specific state coalitions can be identified that were the driving forces behind the implementation of the individual counter-measures. Finally, it will be assessed whether the design of each counter-measure should be regarded as supranational or intergovernmental.

Following a chronological order, the implementation of the European Financial Stability Facility (EFSF) will be analyzed first, followed by the European Stability Mechanism (ESM) and then the European Fiscal Compact.

### 6.1.3 Limitations and Potential Biases

The qualitative analysis of this thesis is affected by two main limitations. Those are, firstly, the limited number of analyzed documents, and, secondly, the use of secondary sources.

As table 2 shows, the analysis will rely on seven main documents which are split into official documents (the treaties implementing the counter-measures) and studies conducted on the topic. In general, it could be presumed that the reliability

of qualitative research would increase with the amount of used sources. In the specific case of the method of document analysis, however, as has been mentioned before, the researcher should not be so much concerned with the quantity of the analyzed documents but rather their specific suitability and the amount of useful information they bear for the individual case of the analysis. Hence, every effort has been made to ensure a composition of the analyzed documents that provides an optimal suitability for the case of this study.

Besides the amount of analyzed documents, the inclusion of secondary sources, respectively studies conducted on the topic at hand, implies a limitation in itself. Naturally, secondary sources are always influenced by the socialization of the respective issuer and the process of their individual compilation. However, since it was not possible to consult first-hand witnesses of the negotiation process, for example through interviews, the analysis must rely on secondary sources for this part of the thesis. Being aware of the aforementioned problem of possible personal or institutional influences by the authors of the respective studies, the data which has been taken from those studies has been chosen with due diligence.

## 6.2 Reaching Agreement in International Negotiations

This short subchapter will underline the conditions that have to be met in the international system in order to achieve cooperation, may it be in the form of an international treaty or other, similar, forms of cooperation.

The signing of international treaties always bears one central obstacle that has to be overcome in order for the treaty negotiations to be successful: unanimity of all signing parties. Every state that is supposed to be part of an international treaty has to accept its conditions or otherwise it can simply choose to opt out and not to sign the treaty.

This prevalence might not be of particular importance in situations where the respective treaty is an agreement which does not necessarily require all states' participation. In the special case of the European debt crisis, however, any treaty to be signed required the participation of the whole Eurozone in order to be effective. The Eurozone's characteristic as a monetary union which is deeply

financially entangled made it necessary to show unity and strength towards the financial markets in order to calm the situation and rebuild confidence in the Euro.

As, in this case, each state possesses a veto power it is of utmost importance to persuade, or coerce, each individual state to participate in the treaty and to not use its veto power. From this angle, the creation of the three counter-measures analyzed in the following subchapters should be looked at. It should be borne in mind that the implementation of each of those policies had to be achieved through unanimity among the Eurozone states. A special case presents the European Fiscal Compact which, although made under unanimity, did not require the ratification of all Eurozone countries in order to go into effect (European Council, 2012, p. 22). The implications of this particular content will be discussed in section 6.5.1.

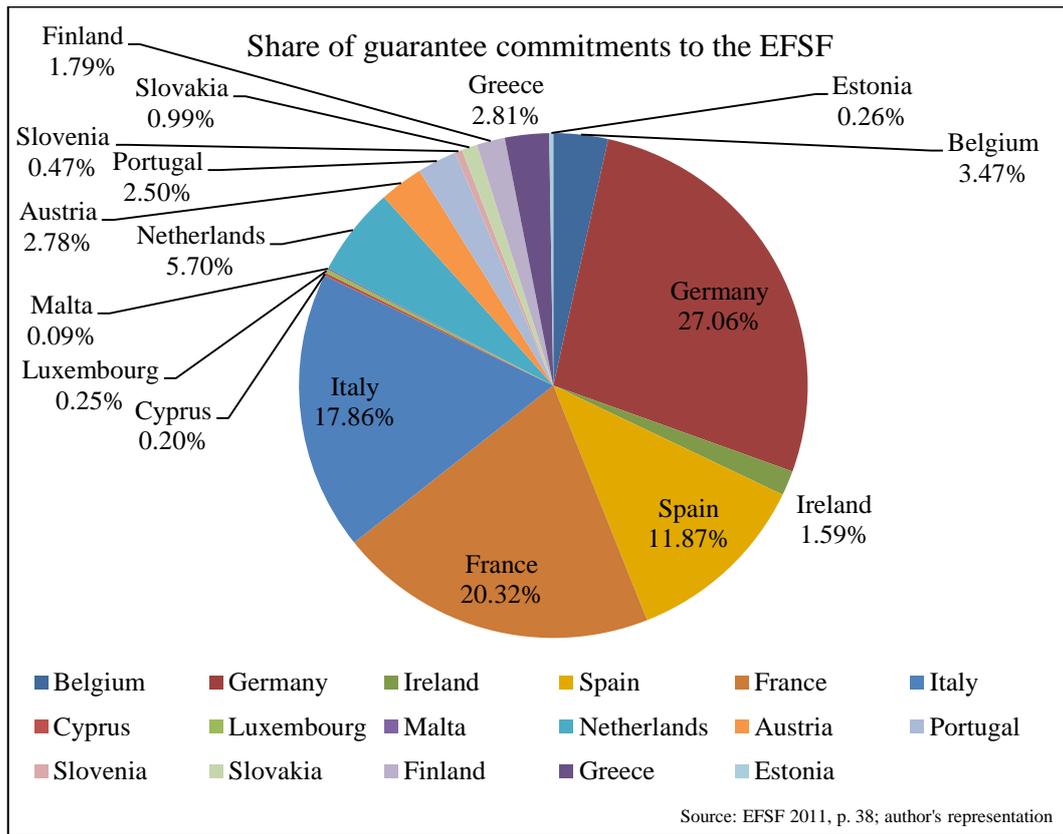
### 6.3 European Financial Stability Facility

The European Financial Stability Facility (EFSF) was, after the hastily adopted stability support loans to Greece in May 2010, the first big measure that was taken in the framework of the Eurozone in order to set up a range of policy measures aimed at countering the European debt crisis. Its purpose is to

financially support euro-area Member States in difficulties caused by exceptional circumstances beyond such euro-area Member States' control with the aim of safeguarding the financial stability of the euro area as a whole and of its Member States (EFSF, 2011, p. 1).

The EFSF was incorporated on June 7<sup>th</sup>, 2010 and became fully functional on August 4<sup>th</sup>, 2010 when Italy ratified the framework agreement and thus 90% of the guarantee commitments had been provided (EFSF, 2010). It was implemented as a temporary mechanism to calm the financial markets which were in turmoil over the severe financial situation of Greece and the possible resulting implications for the whole Eurozone. The EFSF was given a lending capacity of up to 780 billion Euros in 2011, after the capital was increased from 440 billion Euros to 780 billion Euros in October 2011. The share of the contributions that each member state holds are as follows:

Figure 5: Share of guarantee commitments to the EFSF



It is important to note that Greece, Ireland, and Portugal have become ‘Stepping-Out Guarantors’ which means that they refrained from further guarantees and accordingly lost their rights to participate in subsequent voting of the EFSF (EFSF, 2011, p. 22).

### 6.3.1 Implementation Process, Coalition Building, and Prevalence of Anarchy

In order to find evidence for the argument that the establishment of the EFSF follows Neorealist predictions it is necessary to explore under which circumstances the EFSF was created and whether it was negotiated under anarchic conditions or within the law framework of a superordinate institution, like the European Union. Subsequently, it will be explored how the actual legal framework is designed and whether its decision-making procedure is mainly supranational or intergovernmental.

An in-depth exploration of the EFSF’s legal framework shows that it is neither an institution of the European Union, nor an international organization but a private company incorporated in Luxembourg with the only shareholders of the

company being the Eurozone states (EFSF, 2011, p. 1). Furthermore, the EFSF was not a treaty established under European Union law but an executive agreement between the leaders of the Eurozone countries (EFSF, 2011, p. 1). It was thus not negotiated within the institutional framework of the European Council. Indeed, observers of the negotiation process indicate that

the members of the Council from the 17 euro area countries “switched hats” and transformed themselves into representatives of their States at an informal diplomatic conference; in that capacity, they adopted a decision by which they committed themselves to establish a European Financial Stability Facility (EFSF) outside the EU legal framework. (de Witte & Beukers, 2013, p. 808)

In short, the leaders of the Eurozone purposely left the area of the European Council in order to reach a decision under common international law. This step outside of the European Union framework led to a backslide into the anarchy of the international system as assumed by Neorealism. Since the supranational institutions of the European Union were virtually left out of the negotiation and implementation process, the states became the only and thus dominant actors again. The absence of any superordinate institution then enabled power politics and the interests of the powerful states to be forced upon the weaker states.

After having shown that the most important prerequisite of Neorealism, anarchy, was prevalent during the implementation and creation of the EFSF, in the following paragraphs, it will be examined whose preferences have been dominant during the implementation process.

As has been mentioned before, the EFSF was negotiated in turbulent times when the financial markets were in great turmoil and there was rising concern of the Eurozone falling apart if some of its member states were to go bankrupt. In this troubling situation, it was particularly two member states of the Eurozone who pushed forward counter-measures to the crisis and took leadership roles in the implementation process: Germany and France. These two states dominated the negotiation processes and took a leading role in designing and finally implementing the EFSF (Gocaj & Meunier, 2013; Schild, 2013).

On the one hand, Germany’s and France’s considerable financial power enabled the two states to take a leadership position in handling the crisis, but, on the other hand, also committed them to take action because their high financial

investments might be in danger if the Eurozone were to fail to cope with the crisis. It was thus a two-edged sword with which France and Germany had to deal and involved a high risk both for immense negative externalities for the relationship of the two states, as well as economic repercussions for the whole of the Eurozone.

The main reason for the cooperation of these two states to tackle the crisis resulted from their similar interest to prevent massive financial damage to their economies. It was in the interest of both Germany and France to achieve a fast and effective solution to the impending Greek default (Schild, 2013). After the two countries had decided to take the leading role, the cooperation efforts between France and Germany even went so far that they agreed to bilaterally coordinate their positions in the framework of the counter-measures to the debt crisis ahead of all important Eurozone meetings in order to ensure a joint appearance (Schild, 2013, p. 32). Joachim Schild identified at least 20 of such bilateral meetings between 2010 and 2012 (*ibid.*, p. 34). Furthermore, the hallmarks of German-Franco leadership and exercise of power are also evident in the composition of the EFSF's management board, which is led by the German Klaus Regling and his deputy Christophe Frankel, a Frenchman (EFSF, 2015a; EFSF, 2015b).

It should be noted that there were other states proposing solutions to the crisis, such as Belgium which suggested a European Debt Agency that would act as a central administrator of the Eurozone debt and was supposed to negotiate common interest rates for new debt (Leterme, 2010). However, those proposals were rejected in the light of the Franco-German leadership pushing forward their own solution (Gocaj & Meunier, 2013, p. 243).

### 6.3.2 The Institutional Design: Intergovernmental or Supranational?

As has been shown, the implementation of the EFSF was pushed forward by the two (financially) most powerful states of the Eurozone. So far, the implementation process is thus consistent with Neorealist predictions. What is then of interest is whether the EFSF shows a more intergovernmental or supranational design.

As mentioned before, the EFSF was established outside the European Union legal framework and can thus be regarded as the product of negotiations under anarchy. The meeting of this prerequisite then enabled power politics, as assumed by Neorealism, to take center stage in the negotiation process. Since there were no

authoritative institutions above the states which could influence the implementation in a structuring way, Germany and France were able to shape the Eurozone's crisis management according to their preferences. It is evident that the implementation of the EFSF outside of the European Union framework with the states as the only shareholders of the company makes the EFSF an intergovernmental measure. However, it is interesting to explore whether this intergovernmental nature is also reflected in the internal design of the organization.

During the creation of the EFSF, the question arose whether the European Council or the European Commission should be entrusted with the design and the implementation of the mechanism (Gocaj & Meunier, 2013). Naturally, the bodies of the European Union strived for some form of control over a mechanism that has such significant impact on the financial well-being of the Eurozone states. However, efforts of the Commission to implement a stabilization fund within the framework of the European Union aimed towards selling bonds and borrowing new credit using guarantees from member states were denied by Germany (Barber, 2010). Although, in the end, the legal framework of the EFSF includes observer rights for the European Commission and the European Central Bank (EFSF, 2011, p. 23) it is far from being a European Union institution.

Apart from refusing a significant participation of the supranational bodies of the European Union, the intergovernmental character of the EFSF is also reflected in its institutional design and voting procedures. The decision-making of the EFSF follows two distinct procedures. While the first procedure is the adopting of decisions through simple majority, the other is unanimous decision-making (EFSF, 2011, p. 24). While in unanimous decision-making the approval of all states is needed, the voting rights of each member state in simple majority voting are equal to the share of its contributions to the EFSF's capital stock. Simple majority voting is used for the majority of administrative and operational decisions (EFSF, 2011, p. 25f.). Unanimous decision-making, however, comes into practice for the most important decisions, namely decisions of principal nature or the provision of loans in order to support member states in case of trouble (EFSF, 2011, p. 24).

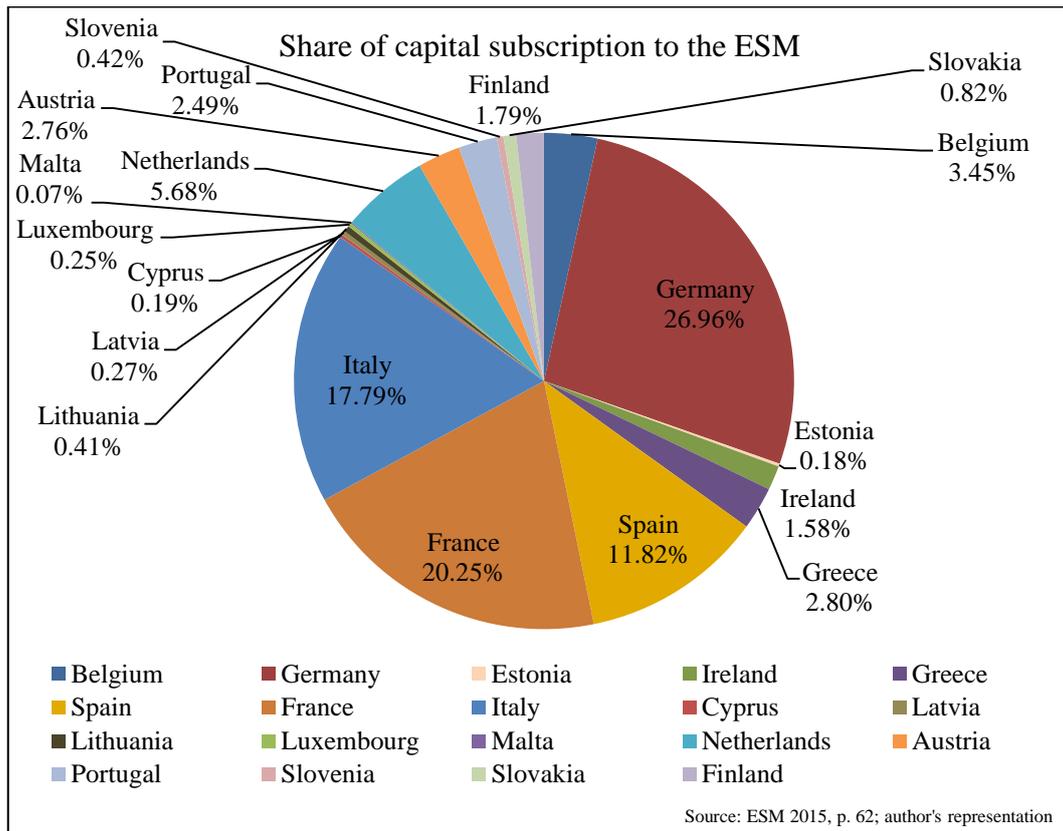
As a result, the institutional design of the EFSF should be regarded as intergovernmental rather than supranational, as governments play the central role in its decision-making procedures while the European Union's supranational institutions are granted barely any influence. Furthermore, its primary purpose, the provision of loans, is determined by an intergovernmental way of decision-making.

## 6.4 European Stability Mechanism

The European Stability Mechanism (ESM) was the second major measure implemented to counter the European debt crisis and was established at the end of September 2012 (ESM, 2015). Its purpose is to “mobilise funding and provide stability support [...] to the benefit of ESM Members which are experiencing, or are threatened by, severe financing problems [...] to safeguard the financial stability of the euro area as a whole and of its Member States” (ESM, 2015, p. 10).

As such, it suits the same purpose as the EFSF and can be seen as the successor to the EFSF. Contrary to the EFSF, however, the ESM is not a rather informal executive agreement but an international treaty (de Witte & Beukers, 2013, p. 812). The main reason behind the implementation of the ESM as successor to the EFSF was the need for a permanent rescue mechanism, instead of a temporary one like the EFSF, in order to calm the financial markets which were still in turmoil over the impending default of Greece.

Figure 6: Share of capital subscription to the ESM



As can be seen in figure 6, the share of capital subscription to the ESM corresponds to the shares of the EFSF and is oriented towards the equity interest each state holds in the capital of the European Central Bank.

#### 6.4.1 Implementation Process, Coalition Building, and Prevalence of Anarchy

The ongoing European debt crisis and the still existing threat of a chain reaction of state insolvencies forced the Eurozone states to take further measures beyond the 2010 implemented EFSF. However, some member states, particularly Germany, were against an adaptation or extension of the EFSF because of its temporary nature and the resulting diminished effect on the financial markets. As Gocaj & Meunier (2013) constitute: “Germany was adamantly opposed to expanding the EFSF’s powers but supported [...] a permanent rescue mechanism that would allow a method for orderly default” (ibid., p. 247). As a result, the creation of a permanent rescue mechanism, the ESM, was accelerated.

Just like the EFSF, the ESM was created outside of the European Union legal framework. In fact, the foundation of the ESM followed a very similar process to

the design of the EFSF. The main reason for that was the path dependency which the EFSF induced (Gocaj & Meunier, 2013). The immense political costs that the creation of the EFSF already demanded paved the way for a similar, but permanent, institution. If the states had chosen a completely new rescue structure with different mechanisms, the bargaining processes on the national and the international level would have started again. Given the urgency for action to calm the financial markets and to stabilize the financial situations in some of the member states it seemed easier and less costly to rely on already proven mechanisms (Gocaj & Meunier, 2013, p. 249). As a result, the functioning of the ESM and the EFSF is very similar which is not only reflected in the fact that they were both implemented outside the European Union legal framework but also in their institutional design.

Similar to the implementation process of the EFSF, the adoption of the ESM as a permanent version of the EFSF was particularly expedited by a coalition between Germany and France. In the highly debated joint declaration of Deauville, Angela Merkel and Nicolas Sarkozy called for the establishment of what would later become the ESM (European Council, 2010). The perceived need for an expanded rescue mechanism that was able to provide stability was also shared by the troubled Eurozone states. Member states that had received aid from the EFSF spoke out for an implementation of a permanent mechanism as suggested by France and Germany. Ireland, for instance, expected lower interest rates from a change of the present mechanism, while Portugal mainly criticized the delays of the EFSF in providing aid when needed (Gocaj & Meunier, 2013, p. 247; Wise, 2011).

As a result, the implementation of the ESM as a permanent version of the EFSF reflected the preferences of the powerful Franco-German coalition with support from several states in need of financial support. Furthermore, the management board of the ESM is composed of the same leadership team as the EFSF with the German Klaus Regling as CEO and the French Christophe Frankel as his deputy (ESM, 2015). This composition can be seen as another evidence of the Franco-German decisive influence.

#### 6.4.2 The Institutional Design: Intergovernmental or Supranational?

Unlike the EFSF, which is a private company, the ESM is an international organization. Despite this difference, the EFSF and the ESM both show strong intergovernmental features.

Bodies of the European Union were integrated in the legal framework of the ESM by granting the European Commission and the European Central Bank the right to send observers to the meetings, though they do not have any voting rights (ESM, 2015, p. 14). The decision-making procedure of the ESM is similar to the procedure of the EFSF with the exception that qualified majority voting of 80 percent has been added to the two procedures of the EFSF: simple majority, and unanimous decision-making. While simple majority voting is only used for very few administrative tasks, qualified majority voting is used for decisions concerning the personnel of the ESM or other operational tasks (ESM, 2015, p. 16f.). As for the EFSF, however, unanimity is required for the most important decisions such as providing financial support to troubled member states (ESM, 2015, p. 15). All in all, it can thus be concluded that the ESM, just like the EFSF, is based on an intergovernmental rather than a supranational institutional structure.

### 6.5 European Fiscal Compact

Being the third major counter-measure against the effects of the European debt crisis, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, also known as the European Fiscal Compact, completes the policies analyzed here. Its purpose is to

strengthen the economic pillar of the economic and monetary union by adopting a set of rules intended to foster budgetary discipline [...], to strengthen the coordination of their economic policies and to improve the governance of the euro area, thereby supporting the achievement of the European Union's objectives for sustainable growth, employment, competitiveness and social cohesion. (European Council, 2012, p. 9)

The Fiscal Compact represents another attempt to foster economic and fiscal discipline in the Eurozone and stands in close connection to the other implemented measures. In fact, the granting of financial assistance from the ESM

was made conditional on the ratification of the European Fiscal Compact as of March 2013 (European Council, 2012, p. 7). This restriction was the result of Germany's and France's interest in preventing reluctant member states of the Eurozone from defecting from the rules implemented with the Fiscal Compact (Schild, 2013, p. 38).

Contrary to the ESM, and its predecessor EFSF, however, the Fiscal Compact was designed to be applicable to the whole of the European Union, not exclusively the Eurozone. Nevertheless, the obligations set by the Fiscal Compact differ between the member states of the Eurozone and the rest of the European Union. European Union member states that are not part of the Eurozone may decide on a voluntary basis whether they want to fulfill the provisions of the Fiscal Compact or not. Legally binding nature is only set for the member states "whose currency is the euro" (European Council, 2012, p. 8). The Fiscal Compact was signed by 25 of the then 27 member states of the European Union, with the exception of the United Kingdom and Czech Republic (European Council, 2012).

### 6.5.1 Implementation Process, Coalition Building, and Prevalence of Anarchy

Just as the implementation processes of the EFSF and the ESM, the adaption of the Fiscal Compact was characterized by the leadership of Germany and France. Having experienced the Franco-German alliance that pushed the rescue mechanisms of the EFSF and the ESM forward by relying on bilateral consultations and their joint power, other member states "even refrained from submitting their own contributions to the crucial debates on [...] the fiscal compact, taking a reactive stance towards the proposals emanating from Franco-German consultations" (Schild, 2013, p. 36).

The negotiations for the Fiscal Compact were, right from the beginning, outlined by Germany with reluctant support from France. Germany, being the largest creditor and one of the very few Eurozone states with a positive net lending figure, wanted this treaty to bind the other member states to tougher fiscal rules in order to avoid future debt crises (Schild, 2013). Although the German position initially was to change the European Union treaties in order to embed stricter fiscal rules in primary European Union law, the refusal of the United

Kingdom to participate in the Fiscal Compact made this goal unattainable (Gocaj & Meunier, 2013).

Germany, unable to persuade the United Kingdom to follow its proposal, did not give up its leadership position and decided to step out of the European Union legal framework and to push forward a treaty under international law. That the other member states followed this proposal, and finally agreed to a treaty that mirrored the demands of Germany (Tsebelis & Hahm, 2014), can be seen as evidence for the power position of Germany in the Eurozone.

Within the negotiation process for the implementation of the Fiscal Compact, it became clear yet again that no powerful opposition to the Franco-German coalition existed. Although the southern states, such as Spain and Italy refrained from the idea of stronger fiscal rules within the Eurozone, they had no option of forming a coalition of states which would have been able to build a powerful opposition to France and Germany. The high financial pressure resting on both Spain and Italy thus forced them to align once more with the interests pushed forward by the alliance of France and Germany (Schild, 2013, p. 37).

In addition to this, Merkel and Sarkozy made it very clear that they would be willing to use their power if necessary to “‘force march’ the eurozone towards stricter rules to ensure that a debt crisis could never happen again” (Tsebelis & Hahm, 2014, p. 1396). The immense pressure that was put on the Eurozone states to adopt stricter fiscal rules in a very short time is also displayed by the length of the negotiations. The Fiscal Compact was pushed through in a very short period of time with only two months between the first draft until the final version (Tsebelis & Hahm, 2014).

Furthermore, the forcefulness and power with which Germany and France wanted to enforce new regulatory fiscal mechanisms for the Eurozone is also displayed in a special feature of the Fiscal Compact. Since it is an international treaty, it required the unanimous consent of all signing parties to be decided upon. However, in order to ensure that its binding fiscal rules apply to all signatories, Article 14(2) of the treaty includes a clause that the rules of the treaty come into force when at least 12 member states of the Eurozone ratified the treaty (European Council, 2012, p. 22). This clause was implemented following pressure from Germany and France which wanted to ensure that all signatories followed their

described obligations and would not let the treaty fail due to a missing ratification of a national government (Tsebelis & Hahm, 2014).

### 6.5.2 The Institutional Design: Intergovernmental or Supranational?

Because the United Kingdom refused any participation in the proposed treaty, the states decided to move out of the European Union legal framework during a European Council meeting between December 8 and 9, 2011 (European Council, 2011, p. 7). Subsequently, the treaty to be adopted was decided to be an intergovernmental treaty under international law.

However, although the Fiscal Compact is an international treaty outside European Union law, it incorporates several institutions of the European Union. For instance, the monitoring of the fiscal rules was assigned to the European Commission (European Council, 2012, p. 14). The Court of Justice of the European Union (CJEU), on the other hand, has been commissioned to rule on the implementation of the Fiscal Compact's rules into national law of the respective member states. For all other rules, for instance the compliance of national budgets with the principles specified in the treaty, the CJEU has no jurisdiction (European Council, 2012, p. 5).

The European institutions have thus been granted only very limited influence. Although the European Commission has been enabled to monitor compliance with the fiscal rules, it has not been given the power to sanction possible violation of those rules (European Council, 2012). As a result, while disregarding the rules of the Fiscal Compact may imply negative externalities imposed from other signatories of the treaty, negative consequences imposed by the European Union institutions would not be expected. The institutional design of the Fiscal Compact shows that, on the one hand, European Union institutions have been superficially integrated into the treaty, when it comes to critical issues, however, they have not been granted much power.

To sum it up, just like the EFSF and the ESM, the European Fiscal Compact can be regarded as reflecting mainly intergovernmental rather than supranational traits.

## 6.6 Summarizing Assessment

Now that the evidence from the qualitative analysis has been collected, several statements can be made concerning the congruence of the three analyzed counter-measures and Neorealist predictions.

Firstly, all three counter-measures have been implemented outside of the European Union legal framework. This means that they were negotiated outside the structuring influence of the legislature of the European Union and the involvement of the European Commission and the European Parliament. As a result, leaving this superordinate framework represents a step back into the anarchy of the international system. Within the negotiations for the counter-measures, the member states of the Eurozone acted as representatives of their states just like they would at any other international conference. Neorealism's most prevalent prerequisite, anarchy, was thus met.

Secondly, the cooperation patterns that could be observed during the negotiations of the measures reflected the financial power relations within the Eurozone. Germany and France, the two most powerful actors, together disposing of more of half the financial power distribution in the Eurozone, were the two leading actors in the negotiations and decisively shaped their outcomes. It could be observed that Germany did do even more than France, which is compatible with the state's status as the financially most powerful country of the Eurozone. Furthermore, it has been shown that the weaker states have not been able to push through their interests and, in the later stages of the negotiations, even refrained from bringing in significant own proposals of how to deal with the crisis.

Thirdly, the institutional design of all three counter-measures clearly favors intergovernmental over supranational structures. This is particularly evident in the voting procedures implemented in the EFSF and the ESM which rely on unanimity as the procedure to pass the most important decisions, namely the providing of financial assistance. The intergovernmental character of the Fiscal Compact becomes evident in the roles that have been assigned to the European institutions which can be regarded as being no more than superficial.

To sum it up, all three analyzed counter-measures were implemented under anarchy, reflected the financial power relations within the Eurozone, and followed an intergovernmental rather than a supranational design.

## 7 Discussion

After having summarized the qualitative evidence, the question remains how those outcomes shall be interpreted and what meaning can be attributed to them.

What seems to be apparent is that the crisis situation in the course of the European debt crisis initiated a strong demand for European leadership. However, the qualitative evidence of this thesis has shown that, despite all previous integrating efforts, the supranational European institutions have not taken the leading role in the crisis management but the leadership rather originated from individual member states that were powerful enough to push forward their interests. Naturally, in such a situation in which the state becomes the dominant actor again, Neorealism becomes more relevant.

In fact, as has been shown, it is indeed possible to see and interpret the crisis management of the Eurozone states through the lens of Neorealism. What Neorealism would predict, that the most powerful states take a leadership role by pushing forward their interests, and if necessary force their will on others, has happened. The financial power Germany and France had at their disposal during the crisis enabled them to take this leadership role, without having to severely fear being challenged by other member states of the Eurozone. Even other powerful states like Italy were not able to contest the German-Franco leadership. Although Italy could have potentially been a part of a “trio” of powerful states, the country’s problems concerning defensive financial power seems to have prevented a stronger leading role in the negotiation processes.

Still, the question has to be asked why Germany and France cooperated throughout the whole phase of crisis management instead of free-riding or pursuing their interests on their own or via a different coalition. The most likely explanation for this is that neither France nor Germany were able to build a winning coalition on crucial issues without relying on the other state as a partner. This is backed by the power relations identified in the quantitative part which prove that it would have been indeed very difficult for either country to form a coalition that would have been decisive without the other. Thus, it seems reasonable that they cooperated, building a strong coalition which was able to almost fully dictate the policy making in response to the crisis. That the other

member states of the Eurozone decided to follow the lead of the two countries could be explained by their fear of greater loss if they would have decided not to participate in a joint crisis management. Presumably, the negative externalities of free-riding were perceived as being higher than the potential losses the weaker states would have to face if they did not choose to cooperate.

All in all, the findings might suggest that the theory of Neorealism should be revisited and its suitability to explain the politics in the European Union should be reassessed.

## 8 Conclusion

The two research questions of this thesis asked: *“How was financial state power distributed among the states of the Eurozone between 2009 and 2014?”* and, *“Can the fiscal counter-measures taken in the course of the European debt crisis be explained by the theory of Neorealism?”*.

The exploration of the first question, approached through a quantitative analysis has shown that, within the Eurozone, Germany and France had the most financial power with Greece, Ireland, Portugal, and Spain forming the least powerful group of states in 2010. The latter three states, however, were found to improve significantly until 2014 leaving Greece alone as the state with a lack in both offensive and defensive financial state power.

In the next step, the qualitative analysis, it has been shown that those power relations were reflected in the process of implementing three counter-measures to the European debt crisis. Together with their intergovernmental design and their negotiation under anarchy, the creation of the EFSF, the ESM, and the Fiscal Compact were found to be consistent with Neorealist predictions.

This thesis has thus shown that the implementation of the three most important counter-measures to the European debt crisis can be explained and analyzed through the theory of Neorealism. What is remarkable about this finding is that it seems to stand in contrast to the ongoing scholarly debate around Neorealism and the European Union which regards the former as not being applicable to the latter. However, this thesis has shown that in a time of severe crisis, the states of the Eurozone engaged in a solution finding which followed Neorealist predictions and turned its back to the supranational framework of the European Union for the sake of an intergovernmental way that was decisively shaped by the financially most powerful member states of the Eurozone.

The findings of this thesis then suggest that Neorealism still bears explanatory power for the analysis of the European Union which might call for a reanimation of the theory’s application to the specific European framework. Further investigation of the identified mechanisms is needed in order to test whether this falling back into Neorealist behavior is a common occurrence for states in times of crisis. Even without further investigation, however, the findings of this thesis

can contribute to the theoretical discussion surrounding the entanglement of the European Union and the suitability of certain International Relations theories to explain the unique object of research that is the European Union.

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