NEGOTIATING THE EUROPEAN ECONOMIC AND MONETARY UNION

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ABSTRACT

The European Economic and Monetary Union (EMU) began on January 1, 1999. The European Central Bank (ECB) has been set up in Frankfurt, Germany, and the Euro created. Looking at the intergovernmental negotiations that led to the establishment of the EMU, it is not initially clear, however, which European Union (EU) governments actually supported the EMU (and the specificities of its structure, as contained in the Treaty on European Union and its Protocols). With an analysis of a small data set on government preferences as regards the EMU, this paper sheds some light onto the negotiation dynamics. Essentially, the paper finds that the German government, through the negotiations surrounding the EMU, obtained an outcome fairly close to its initial policy preferences. Similarly, bargaining outcomes are found to be close to the preferences of Italy and of some middle-sized members of the EU. France and the UK were not as successful and had to concede on a number of points, and Denmark’s original preferences were quite a distance from the final EMU provisions. These results are explained on the basis of spatial representations and two-level game dynamics.
The European Economic and Monetary Union (EMU) is a central development for both the existing and new members of the European Union (EU). The EMU constitutes a new dimension in international monetary relations that may change the economic and financial environment for global traders and investors. Generally, the EMU can be assumed to strengthen the EU’s integration process, as the new common currency, the Euro, is expected to increase the transparency of prices, reduce transaction costs and hence further strengthen the EU’s internal market.

The EMU officially started January 1, 1999, moving into Stage III of the overall development towards monetary union. Stage I of the EMU, initiated in June 1990, formed part of the internal market program that the European Community (EC) member states had launched in the framework of the Single European Act (SEA). The first stage in creating the EMU implied the abolishment of all remaining capital controls in the EC. One of the main elements of Stage II, in 1994, was the establishment of the European Monetary Institute (EMI) in Frankfurt, Germany¹. The EMI, essentially, was to prepare the establishment of the European Central Bank (ECB). It was headed by the former President of the Dutch central bank and current head of the ECB, Wim Duisenberg².

With the start of the EMU, exchange rates (“conversion rates”) among the domestic currencies of participating EU states, and between the Euro and national currency units as well, have become “irrevocably fixed”. Moreover, in the course of the year 2002, the national currencies of the EMU states will be replaced by Euro notes and coins. Hence, currencies such as the German mark, the French franc and the Dutch guilder will be taken out of official circulation.

To many observers, it seems especially paradoxical that Germany -- with its Bundesbank widely viewed as a kind of hegemon in the European Monetary System (EMS) -- agreed to establish the EMU. Accordingly, it is occasionally assumed that Germany lost in the agreement on the EMU: when the negotiations on the TEU concluded, public opinion in Germany seemed to be rather unfavorable towards EMU and the prospect of giving up the Deutsche mark. Moreover,

¹ During the intergovernmental bargaining process on the necessary steps to be taken towards the EMU, EC member states largely disagreed on the range of responsibilities to be attributed to the EMI (and on the geographical location for the EMI). The EMI’s main tasks were decided to be the monitoring of fiscal, macroeconomic and monetary convergence of member states in view of the EMU (a relatively modest set of responsibilities as compared to other proposals). On government preferences on this issue, see Moravcsik (1998: 382).
² The governments of France and the Netherlands engaged in some diplomatic efforts to have their own candidate chosen to preside over the ECB. The December 1997 European Summit meeting in Luxembourg agreed on Wim Duisenberg, at least for the first term in office. In subsequent negotiations on the issue, however, it was informally agreed that the head of the French central bank, Jean Trichet, would be President in the second term.
the intergovernmental bargaining process did not lead to full political union in the EU, as several German actors may have hoped for. By comparison, other observers find that the negotiation outcomes regarding the EMU were in fact close to the preferences of the German government.

As far as the provisions for the EMU and the ECB are concerned, it seems that the structure of the Bundesbank largely served as a model for the new institutional setup of the EMU. Dyson (1994:150), for example, judges the ECB's clear-cut priority of price level stability as stronger than the Bundesbank's, yet he sees the ECB as potentially weaker than the Bundesbank in its operational efficiency and capacity for rapid decision-making and implementation.

To what extent did other EC member states influence the intergovernmental negotiation process? What were their respective motivations? For example, did French or Dutch government representatives, with the establishment of the EMU, aim to firmly root re-unified Germany into the new European institutional and monetary structure? Could the EMU then, in essence, be viewed as a monetary agreement benefiting other EC states in exchange for their acceptance of German re-unification? Alternatively, the EMU might be interpreted as a strategic move by central bankers in EC states other than Germany to curtail the influence of the regional hegemon and to diminish the power of the Bundesbank in the framework of European monetary policymaking.

Among the crucial intergovernmental actors in the EMU negotiations, the German Chancellor, Helmut Kohl, appears to have been strongly devoted to establishing both the EMU and the European Political Union (EPU). One of his major motivations and personal rationales for this position may have been to firmly embed reunified Germany into Europe's new

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3 This opinion is expressed, for example, by Andrew Moravcsik (1998: 386): “The outcomes of the distributive conflict, I shall argue, consistently reflected the preferences of Germany – the country with the tightest domestic win set and the most to give up in the monetary negotiations.”

4 For a comparison of the institutional features of the Bundesbank and the ECB, see for example Loedel (1999) and Loedel (2001).

5 See article 2 of the Protocol on the Statute of the European System of Central Banks and the ECB.

6 A variety of explanations and a very detailed account of the EMU negotiations is offered in Dyson and Featherstone (1999). While the present paper aims to explore parts of the negotiation dynamics by analyzing government preferences and interactions among EU actors, the reader might resort to the Dyson and Featherstone volume in order to obtain a broad overview of the various details that were surrounding the negotiation process.

7 The Intergovernmental Conferences (IGC) on EPU, added to the negotiation agenda of the IGC on the EMU at a fairly late stage, dealt with crucial aspects for further European integration such as foreign and security policy, a revision of the decision-making procedures, the social charter and environmental cooperation.
institutional framework, a desirable move in light of the radically changing political environment in Central and Eastern Europe and the altered geopolitical situation.\(^8\)

There appears to be some evidence, in fact, that the German government, with France's support, was quite central in adding the EPU to the intergovernmental negotiation agenda (e.g., Woolley 1994, Dyson 1994). But what was the German government's motivation when, due to the centrality of the Bundesbank, it already profited from a relatively high bargaining potential with respect to the EMU? Was Kohl's personal conviction relevant? Was this strategy deliberately chosen by either the German government or officials of the Bundesbank to add complexity to the negotiations, or possibly to purposefully delay the EMU?\(^9\)

The TEU contains a "package" of provisions, of which the EMU is only one (albeit very crucial) element. Dyson (1994: 151) calls the new institutional foundations of European monetary integration and the European System of Central Banks (ESCB), including the ECB, "the single most powerful institutional development to emerge from the Treaty on European Union". Other elements of the TEU involved relatively modest steps towards a Common Foreign and Security Policy (CFSP) as contained in the EU's Pillar II, the cooperation in Justice and Home Affairs (JHA) in Pillar III and a strengthening of the Cohesion Fund (as part of Pillar I).

What was the role of "southern" EC states in these negotiations? Did they essentially receive a strengthening of North-South transfers by the Cohesion Fund as a "side-payment" in order to convince them to accept the EMU? This reasoning would make sense if one assumes that the burdens of adjustment to the EMU would be hard to bear for the less well-off member states. How influential, by comparison, were some of the smallest and middle-sized states in the negotiation process? Treaty revisions not only require unanimous acceptance by the intergovernmental negotiators but also ratification in domestic politics in all member states. This requirement might be expected to increase the bargaining leverage of smaller and medium-sized states in the intergovernmental negotiations (Martin 1994: 88).

Even more puzzling to the observer may be that the German government allegedly supported a strengthening of North-South transfers in the framework of the Cohesion Funds. In the words of Lisa Martin (1994: 91), "From a purely intergovernmental perspective, relying on state power as the key explanatory variable, Germany's decision to increase transfers

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\(^8\) An in-depth account of the role of Germany in the EMU and effects of both global monetary relations and domestic politics on the position of the German government on EMU and the Euro is Loedel (1999).

\(^9\) The Bundesbank's favorable attitude towards linking EPU and the EMU is sometimes viewed as a deliberate attempt to render the establishment of the EMU impossible in practice (see Garrett
significantly is puzzling since it involves a significant concession by Germany to weaker states". Quoting James Morrow (1992: 164), she continues, "Why offer concessions when you will prevail without them?" There is little doubt, however, that Kohl's actions on the intergovernmental level -- as well as those of other leaders -- were influenced (and constrained) by domestic political circumstances.

To summarize, considering the preferences and rationales of the EC governments, it is somewhat unclear why the EMU was successfully incorporated into the TEU and what caused the German government in particular to favor the EMU and the linkage of the monetary union with the EPU and Cohesion Funds. Moreover, there is disagreement on whether Germany essentially "profited" or "lost" from the intergovernmental bargaining process when it agreed to give up its own strong currency while apparently obtaining provisions for the EMU that its government preferred.

Certainly, intergovernmental negotiations were not the only crucial factors for the establishment of the EMU. Organized interests favoring the EMU appear to have crucially shaped the proposals of the Delors Committee, for example. This committee included the central bank presidents of the EC states, representatives of the European Commission and individual experts on monetary integration. It was chaired by Jacques Delors, then President of the European Commission. In fact, the final provisions for the EMU are fairly close to the recommendations contained in the "Delors Report"\(^\text{10}\).

Quite generally, preferences of government delegations may have been a reflection of aggregate domestic societal interests. Hence, government preferences as voiced by the individual delegations largely constituted a representation of predominant domestic preferences\(^\text{11}\). This paper will not study the formation of government preferences in international cooperation with respect to the intergovernmental negotiations on the establishment of the EMU. While this topic would be most interesting to explore, it is beyond the scope of the paper. Rather, this contribution essentially begins after the point at which government preferences have been formed\(^\text{12}\).

The organization of the paper is as follows. Section I provides a short description of developments in European monetary cooperation before the EMU negotiations. This section

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\(^{10}\) See Committee for the Study of Economic and Monetary Union (1989).

\(^{11}\) In Germany, however, it seems that relatively few domestic interest groups actually favored the EMU (e.g., Verdun 1995).

\(^{12}\) For a preliminary analysis of some of the aspects studied in this article, see Hosli (2000).
provides an overview of the structure, institutional design and development of the EMS, in order to place the EMU negotiations into a broader context. Section II summarizes information on the distribution of government preferences regarding the move from the EMS to the EMU, as derived from a data collection based on expert interviews. Section III applies selected negotiation models to assess how well the initial preferences of the government delegations were reflected in the actual bargaining outcomes regarding the timing and structure of the EMU. According to this analysis, some EC governments appear to have performed better than others in the EMU negotiations. Section IV attempts to find explanations for these outcomes, taking a closer look at aspects such as issue-linkage and two-level game dynamics. Section V presents a summary of the findings and concludes the paper.

I. EUROPEAN MONETARY COOPERATION AND THE BACKGROUND TO THE EMU NEGOTIATIONS

In the early 1970s, the end of the fixed exchange rate regime of the Bretton Woods system confronted Western Europe and the EC member states with the challenges involved with increased currency volatility in international monetary relations. This uncertainty was considered detrimental to their trade relations and to regional integration efforts more generally. In 1970, the "Werner Plan" -- named for the Prime Minister of Luxembourg, Pierre Werner -- foresaw a three-stage approach to create a monetary union for the EC within a decade. While this plan proved largely premature in practice, the EC states nonetheless established a "common float" against the dollar. In the framework of a currency "Snake", participating EC states agreed to bilateral fluctuation margins of their domestic currencies of ± 2.25 percent, whereas the Snake could fluctuate ± 6 percent within the "dollar tunnel". But economic difficulties resulting from the 1973 oil price shock, economic recession and decreasing external value of the U.S. dollar eventually forced several EC states, including France, the UK, Italy and Ireland to abandon the Snake. Consequently, the Snake essentially developed into an "extended Deutsche mark zone", with only Germany, the Benelux states and Denmark left as members.

Towards the end of the 1970s, in a subsequent attempt to constrain exchange rate variability in the EC, a somewhat less ambitious plan for monetary integration developed. This plan was strongly supported by the President of the European Commission, Roy Jenkins, Chancellor Helmut Schmidt of Germany and Valéry Giscard d'Estaing, the President of France. A main driving force for the new proposal was -- apart from the aim of creating a shield for
domestic economies against adverse effects of international monetary uncertainty -- to pull France back into an EC regional exchange rate arrangement.

In March 1979, the EMS was set up. It consisted of two major elements: an Exchange Rate Mechanism (ERM) and a European Currency Unit (ECU). The ERM did not lead to a pooling of members’ official reserves, but it did create a parity grid among all EC currencies and an obligation for central banks to intervene when currencies moved towards the margins of their bilateral parities. Simultaneously, short and long-term credit facilities were strengthened in order to support central banks as they conducted needed financial market interventions. The ECU was set up as a basket currency. The weights of the individual currencies in the basket – all currencies being from EC states -- were determined by a formula based on members’ relative significance in economic and trade terms.

Official “central” rates between the ECU and the national currencies were set, essentially with each member's consent, by the Council of Ministers of Economics and Finance (the ECOFIN Council). After a series of realignments in the first years of the EMS, the system appeared to stabilize. Realignments became scarce, especially in the second half of the 1980s. Moreover, EMS members witnessed a convergence in their monetary performance. Both inflation rates and the dispersion of these rates among EC states gradually decreased. For example, for the twelve EC states as of 1986, the average annual change in the consumer price index (CPI) was 11.5 percent in the year 1979. After a slight increase in 1980 and 1981, inflation decreased almost continuously between 1981 and the latter part of the 1990s (with the exception of a moderate rise in both 1989 and 1990, coinciding with the onset of economic recession in several Western European states). In 1996, the average CPI for these twelve members was a mere 2.9 percent. Similarly, the variability in inflation rates of these states (measured by the standard deviation of inflation rates) on the basis of a slightly more varied pattern decreased from 6.3 percent in 1980 to 2.0 percent in 1996.\(^{13}\)

The reduction in both the level and relative dispersion of inflation rates among EC members, however, may have been only partially caused by the existence of the EMS. There was a growing international belief -- reflected in macroeconomic literature -- that the Keynesian notion of a trade-off between unemployment and growth, as expressed by the “Phillips curve”, could be valid in the short-term only.\(^{14}\) By contrast, lower inflation rates were increasingly perceived as beneficial to long-term economic growth and employment, even in countries that

\(^{13}\) On respective figures, see Quigstad (1992) or Hosli (1998).

\(^{14}\) On converging beliefs and preferences in EC states in the domain of monetary policy, see Sandholtz (1993).
had earlier applied a strategy of successive devaluation within the EMS paralleled by high inflation, in an attempt to boost domestic growth and employment (e.g., France).

Similar reductions in overall inflation rates were, however, also observed in countries belonging to the European Free Trade Association (EFTA)\textsuperscript{15}, including Austria, Finland, Norway, Sweden and Switzerland (Qvigstad 1992). Inflation rates of major world economic actors, like the U.S. and Japan, also tended to decrease. Nonetheless, the EMS may have contributed to monetary convergence in the EC by providing an institutional framework for EC states to reduce both exchange rate variability and price level changes.

Inflation figures for the years preceding the EMU negotiations indicate a continuation of this trend. However, convergence in monetary performance, especially in terms of relative price level changes, was only one aspect of the overall monetary situation for member states. Generally, the EMS was perceived as asymmetric in terms of the distribution of influence in the system. In the time period during which the EMS existed, the German Bundesbank gradually developed into the monetary institution that could set monetary policy independently, whereas the central banks of other EC states were largely compelled to follow its decisions\textsuperscript{16}. The Bundesbank enjoyed a powerful position largely due to its independence from domestic political pressures and the credibility attributed to its anti-inflationary policies.

By comparison, the preeminence of the Bundesbank certainly restricted the macroeconomic policy choices for various states, particularly with respect to domestic interest rates and strategies to boost the economy and combat unemployment. The EMS forced France, for example, to maintain the value of its currency within pre-determined bands. Therefore, France, along with other EC governments, may have had an interest in moving towards a more "symmetric" institutional foundation for EC monetary cooperation.

Jacques Delors, having served in the French banking sector and in the French Ministry of Finance before becoming the President of the European Commission, was clearly devoted to establishing the EMU. Moreover, since national monetary autonomy was constrained by the EMS for most EC states, moving towards establishing the EMU may have appeared to generate relatively few additional costs to several central bankers. Finally, compliance with the monetary convergence criteria as defined by the TEU seemed doable for most members, at least before

\textsuperscript{15} On the rationale of the EFTA and its commercial, macroeconomic and monetary developments as compared to the EC, see for example Saether and Skonholt (1997) or Hosli (1997).

\textsuperscript{16} A similar function was exercised by the Bank of England during British hegemony in the international monetary system at the end of the nineteenth and beginning of the twentieth centuries. On eras of monetary hegemony, competition among national currencies and the respective roles of states and central banks, see Cohen (1998).
economic recession set in. But fulfilling the fiscal criteria – with limits on budget deficits and
government debt – proved to be more difficult in practice, even for France and reunified
Germany. Indeed, Germany did not meet the criterion of the general government deficit -- which
should be no more than three percent of GDP -- in the mid-1990s (the same being true for
France).

In Germany, despite some initial skepticism, the Bundesbank demonstrated a surprisingly
supportive stance with regard to the establishment of the EMU (see Kennedy 1991). Karl-Otto
Pöhl, President of the Bundesbank, in fact turned out to be one of the central members of the
“Delors Committee”, which largely prepared the provisions for the EMU. Members of the Delors
Committee, including representatives of the Bundesbank, have even been described as an
“epistemic community” that decisively shaped the EMU (Verdun 1999).

Hence, the EMS was widely viewed as having contributed to less exchange rate
variability among the EC currencies (at least until the currency turmoil of the early 1990s). In
addition, the credibility of national anti-inflationary policies, largely “borrowed” from the
Bundesbank, was quite helpful for most EMS members.

This is the general background onto which the EMU negotiations can be placed. Although
there is some evidence of the interests and policy positions of relevant actors in the
process, there certainly is no abundance of data on actual preferences that governments held
regarding the EMU. There is, however, a small data set available that contains information on EC
governments’ policy positions towards the EMU. These data might tell us something about the
relative strength and “success” of actors in the bargaining process, indicate the position individual
governments held in the negotiations and provide explanations for the negotiation outcomes and
their consequences in distributional terms. They will be used subsequently to explore some of the
contending issues and apparent paradoxes regarding the creation of the EMU.

II. Government Preferences on the EMU

Information on preferences of crucial actors with respect to the EMU and the ECB is
provided in articles by Jan van den Bos (1994: 62-65) and Jacek Kugler and John Williams
(1994: 208-12), both contained in an edited volume by Bruce Bueno de Mesquita and Frans
More specifically, in their contribution, Kugler and Williams present evaluations of the bargaining processes, based on the preferences of EC governments (and other influential actors) and the structural and institutional aspects of the EMU. In addition, information is provided on the relative importance actors attached to the issues to be negotiated. A concise summary of the data on both preferences and salience is given in Van den Bos (1994: 64). All data were collected by the means of interviewing experts. In practice, experts, mostly government negotiators, were asked to locate members' policy positions on a specific scale, which was pre-determined by the researchers. The data collection is largely constrained to policy positions of government representatives, but this information can certainly be compared to data on the preferences of domestic actors and public opinion in EU member states.

This data collection is special because it provides information on government preferences before the respective negotiations began -- information that is currently no longer available from direct sources. Data on salience (again as reported by the government experts) add additional value to the information. Preferences were assessed ex ante, i.e. before the start of the respective negotiations. However, the methods of data collection and the precise timing of the expert interviews are difficult to discern from either Van den Bos (1994) or Kugler and Williams (1994). It seems that the data on the "kind of banking arrangement" were collected just before the June-July 1989 summit meeting in Madrid, and the data on the remaining "contending issues" (i.e., all other categories) were collected before the December 1991 meeting in Maastricht. Despite these limitations we will use this data set in an attempt to gain some specific insights into the negotiation dynamics of the EMU (keeping the possibility in mind that biases may exist in the data).

In the Bueno de Mesquita and Stokman volume, different models were applied and compared to replicate the negotiation dynamics and, more specifically, to forecast equilibrium policy outcomes for various policy areas. Among the most prominent models in the book are Bueno de Mesquita's expected utility model and the exchange model of Stokman and Van Oosten. The expected utility model starts out with the initial median vote of the relevant actors as

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17 This book also contains information on preferences and bargaining dynamics in other areas, such as emission limits for exhaust gases of motor vehicles, controls on radioactive contamination, and air transport liberalization.
18 See Van den Bos (1994: 56). For other policy decisions, preferences were partially derived from the publication *Agence Europe*.
19 For such information, see for example Verdun (1995) or Moravcsik (1998; especially 379-471).
20 Note that Kugler and Williams also use information on changes in government preferences between the summit meetings.
the predicted policy outcome; the exchange model uses the arithmetic mean. In both models, actors are viewed as trying to improve their utility throughout the course of the decision-making process. In the expected utility model, this is essentially done through challenging other actors when players expect an increase in utility by applying such strategies. In the exchange model, by comparison, vote-trading and logrolling are central to the negotiation dynamics. At the end of the volume, the models are compared in terms of their relative predictive capacity, and both the exchange and the expected utility models are found to perform relatively well\textsuperscript{21}. The focus of the current article is somewhat different, however. Of interest in this analysis is not the refinement of models to obtain accurate predictions for policy outcomes but rather the assessment of how well the results of the negotiation outcomes reflect the initial preferences of individual member states that were involved in the negotiations. Essentially, then, the article is simply interested in how close actual negotiation outcomes are to the initial preferences of government delegations. As this article draws on information provided in the Bueno de Mesquita/Stokman volume but uses the data for a somewhat different purpose, the models presented below differ significantly from the analysis dealing with the negotiation dynamics of the EMU by Kugler and Williams (1994).

Table 1 summarizes the relevant information on government preferences\textsuperscript{22}. Data on the preferences of government delegations are reported according to the 1994 publication. But with respect to salience, an adaptation is introduced: as models need to be invariant to the scales of their measured quantities, data on preference intensities, in this study, are transformed from the original data set by raising them to the power of 3.1\textsuperscript{23}. This modification follows a suggestion by Christopher Achen (1999) in a study on the possible enhancement of measurement in this data collection resulting in refinement of model prediction.

Table 1 thus presents the original data on preferences and the transformed data on salience. It replicates the original categorization of issues with respect to the EMU that were to be negotiated. More specifically, according to Kugler and Williams (1994), the first category ("kind

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\textsuperscript{21} Note, however, that a transformation of the data on saliences -- necessary to allow for invariance of saliences to the measurement scale -- considerably increases the predictive accuracy of simpler models of decision-making. See Achen (1999).

\textsuperscript{22} The data are from Van den Bos (1994: 64).

\textsuperscript{23} In the original analysis, the scale for the intensity of preferences ranges from 0 to 100, with 50 corresponding to a "neutral" position of an actor towards an issue. This causes some problems when using the values in respective models, as the scores are unlikely to represent actual salience. For example, does "of vital importance" (raw salience score 100) imply only twice as much impact in calculations as "neither important nor unimportant" (raw salience score 50)? The top of the measurement scale needs to be stretched relative to the bottom part, and a transformation is required (see Achen 1999: 11). The relationship between the measured salience $s_{ij}$ on issue $j$ and
of banking arrangement") was a major issue that the EC government largely disagreed about before the 1989 Madrid summit meeting. The other categories are "remaining issues" that were to be solved, probably within the framework of the final 1991 meeting in Maastricht. Of course, any such compilation of categories will simplify the analysis of the bargaining process and provide information only on selected aspects that the researchers considered particularly important in the intergovernmental negotiation process. The contents of the relevant dimensions will subsequently be used in forms as close to the original data compilation as possible. Nonetheless, it should be mentioned here - and we will later incorporate this information into the analysis - that categories two through six might essentially be subsumed into category one of the data set.

[Table 1 about here]

Not taking the possibility of condensing the data into account for the moment, there were six categories in total containing preferences on both institutional issues and the transition schedule (widely perceived to be the two most crucial contending issues in the EMU negotiations). Although the description is somewhat tedious, it is necessary to briefly focus on the substantive contents of these categories.

The first category, entitled "kind of banking arrangement", encompasses data on a scale starting with a preference to maintain the status quo (scaled as 1 by the researchers) in terms of monetary integration and continuing to the view that a common central bank should only be created after some market-led convergence among the EC economies would be achieved (20). The view that a central bank should be established at a later stage in a government-led convergence process is located at 80 on the scale. The top of the scale (100) reflects a preference for a "supranational" type of bank to be established during a process of government-led convergence. On the basis of the expert interviews, the preference of the German delegation is scaled as 80, the one of France as 100. Belgium, Greece, the Netherlands, Portugal and Luxembourg are reported as being in agreement with the German position 80. But Denmark and the UK are classified as having preferred an outcome closer to the status quo, their preferences

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\text{the theoretical salience } s_{ij} \text{ of the form } s_{ij} = s^*_{ij}, \text{ and Achen estimates } \alpha \text{ to be } 3.100 \text{ (Achen 1999: 11).}
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24 In fact, the Madrid meeting failed to lead to an intergovernmental agreement on this aspect. Only in the final Maastricht meeting was this major issue resolved.

25 In addition, it is possible that this compilation does not encompass all relevant issues that were to be dealt with in the negotiations (a point to which we will return later).
being located at 50 on this dimension. The data, evidently, refer to a phase in which the
governments of both Denmark and the UK already realized that entire “non-action” and full
maintenance of the status quo appeared to be a rather remote policy option.

With respect to preferences on the institutionalization of the EMU (column three of table
1), France favored an early start. The top of the scale (100), reflecting the ideal point of the
French delegation, stands for institutionalization “at the earliest possible” date (which, in practice,
was 1992). Location 80, the “bliss points” of the Italian and Spanish delegations, represents the
view that institutionalization was to become effective once the Single Market was actually in
effect. Somewhat delayed institutionalization — until the changes accompanying monetary and
fiscal convergence would be completed — was scaled as 30 in the data collection and was
apparently advocated by the delegations of Germany, the UK, Denmark, Ireland and Portugal.

A next category in the data compilation refers to “power over policies” (column four).
This category contains attitudes regarding which actors should direct and execute monetary
policy in the framework of the EMU. The main contending issue in this category was the
distribution of power between the new ECB and the governors of the national central banks.
Positions on the scale that were advocated in practice by government representatives ranged from
40 to 100. 40 indicated a preference that power should be exercised by a council of national
central bank governors exclusively; this council would hence set and execute monetary policy by
itself. This solution, apparently, was favored by the delegation of Luxembourg. The next
preference on the scale (60) indicated that a council of national central bank governors should
direct policies, whereas a European Bank Board would execute them. This preference was held
by the governments of Denmark, Greece, Ireland, Italy, Portugal, Spain and also by the
delegation of the UK. The governments of Belgium, France and the Netherlands, by comparison,
advocated a solution in which the council of national central bank governors and the European
Bank Board would largely share policy competencies (70). The German delegates are reported as
having favored the solution that an independent European Bank Board would set and execute
policy alone (100)26.

Preferences with respect to the “scope of responsibilities” to be attributed to the ECB are
shown in column five of Table 1. From the data collection, it is evident that some governments
would have liked to provide the new central bank with a wide range of policy competencies,
some even favored allowing the ECB to directly intervene in the macroeconomic policies of EU

26 This assessment corresponds with the observation of some authors that the German government
was not reluctant to curtail the powers of its own central bank. See Kennedy (1991), Wolf and
member states. For example, the Greek delegation was reported to have advocated that the ECB have the authority to intervene in members’ domestic economies (100). French government representatives, with a preference located at 90 on this dimension, did not prefer an influence quite as extensive, but they were nonetheless in favor of some intervention in the domestic economic sphere (even beyond just providing the ECB with the authority to control inflation with interest rates based on the new common currency). In the assessment of the scope of responsibilities to be attributed to the ECB, the French delegation is reported as having been followed closely by the preferences of the government representatives of Ireland (80) and Spain (80). The Italian delegation, with a score of 75, advocated an intermediate position between this choice and the preference that the ECB should have the authority only to guide member states with respect to inflation (65), an option favored by Belgium, Germany and the Netherlands. Purely “executive functions” for the ECB, by comparison, were preferred by the delegations of Denmark and Portugal (both located at 30 on the scale). The preferences of the representatives of the UK and Luxembourg were located at 40 and 50, respectively. The most radical view on this dimension – in practice not advocated by any EU government – would have been that the ECB’s responsibility be limited to the management of accounts (located at position 1 on the scale).

Another dimension of the research is the issue of the harmonization of national economies. Government positions on this issue were assessed on a scale beginning – with the values realized in practice – with the view that harmonization should not be directed collectively, but should essentially be left to the monitoring of domestic governments (30). This preference, according to the data, was held by the governments of Greece, Ireland, Italy, Portugal, Spain and the UK. A position even somewhat closer to favoring a purely market-led process of harmonization was advocated by Denmark (25). Located on the top of the scale of this dimension is the view that macroeconomic convergence should be managed collectively, by first linking the major economies and then managing the convergence of the smaller ones (100), a position apparently advocated by the French delegation. An intermediate position on this issue was that major economies should be linked first, providing the possibility for others to catch up (60), a policy preferred by Belgium, the Netherlands and Luxembourg. The German delegation is reported as having held a preference of 50 on this issue, being slightly more in favor of leaving responsibilities for harmonization to the national authorities.

The last dimension for which data have been collected concerns the relationship between the common currency -- then still called the ECU -- and the domestic currencies of the EC states,

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27 It is surprising, however, that the UK and Greece for example, according to the data collection, held identical preferences on this issue.
and the goal of controlling currency fluctuations. Positions on the scale that were realized in practice range from the preference that all national currencies be included into the new ECU basket (40), a position apparently advocated by the delegations of Denmark and France, to the view that a "hard ECU" should be established. The latter option embodied the "parallel currency approach", according to which a strong ECU should be introduced to compete with the EU's domestic currencies, a suggestion made by the UK. The position of the UK delegation, accordingly, is located at 100 on the scale. Several EC states, however, appear to have supported a proposal by which one strong currency would essentially replace the existing ones (60) –most likely according to the model of the Deutsche mark. At -- or close -- to this position on the scale, we find the preferences of the delegations of Luxembourg (60), the Netherlands (60), Belgium (70), Greece (70), Ireland (70), Italy (70), Portugal (70) and Spain (70).

Certainly, some categories of this data compilation may be subject to discussion and criticism, as is the assignment of figures on preferences (and their intensities). Generally, it is difficult to represent policy choices on "ordered dimensions" -- the categorization of preferences on the relationship between the ECU and the domestic currencies, for example, illustrates this. In addition, the dimensions may not be fully independent of each other. Finally, interviewing experts to discover their preferences has the advantage of consistency (by comparison, secondary sources may not be directly comparable to each other), but it cannot be ruled out that a certain bias is introduced due to the role and background of these experts in the negotiation process²⁸. As it is difficult ex post to verify whether certain biases in the data collection exist, we will keep this caution in the back of our mind when conducting the analysis but will still use the data set, as it is quite unique and may help to shed light onto some intriguing issues as we study the bargaining process on the EMU.

In addition to classifying members' preferences on these dimensions, on the basis of the same interviews, data on the intensity of actors' preferences were collected (these data are also reported in Van den Bos 1994 and Kugler and Williams 1994). For example, both France and Germany are shown to have held relatively strong preferences on the issue of the timing of the EMU institutionalization (although advocating rather different solutions to the problem²⁹).

Regarding the scope of responsibilities to be attributed to the ECB, Germany, France and the UK strongly preferred specific policy options (with the UK favoring fewer policy

²⁸ For example, it appears that the core of interviewed experts for this data collection were from the delegation of the Netherlands, and the data analysis was largely conducted by a Dutch team.

²⁹ In the case of France, the high preference for early institutionalization may partially reflect President Mitterrand's desire to create an "irreversible" process that would allow for a quick transition to stage II of the EMU.
responsibilities for the ECB than the German delegation, and the German delegation fewer than the French one). The relationship between the new common currency and the domestic currencies was of the utmost importance to Germany\textsuperscript{30}, whereas countries such as Greece, Ireland, Luxembourg and Portugal paid relatively little attention to this issue of the negotiation package.

The actual bargaining outcomes on all categories — as contained in the provisions of the TEU with respect to the EMU — have been classified by Kugler and Williams (1994: 206) and located on the respective scales. As assessed by the authors, the final banking arrangement is close to the view that the ECB should be established after a process of market-led convergence \((R_{BA} = 85)\). With respect to the timing of institutionalization, the result essentially is a compromise between delayed institutionalization (until the changes accompanying monetary convergence have occurred) and institutionalization once the single market has come into effect \((R_{TM} = 50)\). In the category “power over policies”, it was decided that the ECB and the national central banks would essentially share policy powers \((R_{PP} = 70)\). The outcome regarding the range of responsibilities attributed is that the ECB should have more than just the power to advise on inflation but that it should not directly interfere in domestic macroeconomic policies \((R_{SR} = 70)\). In the category “harmonization”, the outcome closely corresponds to the preference “link the major economies and let others catch up with them as they can” \((R_{RE} = 60)\). In the final category that was studied, the bargaining result reflects the preference that, essentially, a single currency should replace the existing domestic currencies \((R_{CU} = 75)\). However, competition would not be introduced between the new and existing currencies, nor would the new currency by necessity involve all EC states from the beginning.

Table \(1\) also provides data on the median position in terms of the distribution of preferences among EC governments on the respective scales. It is striking that the actual bargaining results are quite close to the preference of the “median EC government” for almost all categories (apart from the issue of “harmonization”)\textsuperscript{31}. We will return to this later.

Given the set of actors, policy preferences, and preference intensities — and assuming preferences were assessed correctly and revealed sincerely — who belonged to the “winners” and “losers” of the intergovernmental bargaining process? I.e., whose preferences did the actual

\textsuperscript{30} Somewhat striking with respect to the coding, however, is that the UK appears to have been quite neutral on this issue (raw salience score: 50), in spite of the fact that it had tabled the proposal for a “competing currency approach” (a preference located at 100 on the scale).

\textsuperscript{31} However, the position of the median voter as a forecast for policy outcomes, in several other issues analyzed in the Bueno de Mesquita and Stokman volume, has limited predictive accuracy (see Achen, 1999: 15).
bargaining outcomes most clearly reflect\textsuperscript{32}? The following section explores this topic by employing some simple bargaining models.

III. Assessing "Value Scores" in Negotiations

In a first approach, assume that two very critical actors for the overall "EMU deal" were the governments of France and Germany. These two powers, in the history of European integration, have rather often been able to strike crucial political agreements. Most importantly, the very establishment of the EC and its preceding institutions is often viewed as a compromise between the primarily industrial interests of Germany and the predominantly agricultural interests of France. Indeed, these two powers also played a significant role in the negotiations on the EMS, as the extensive analysis by Ludlow (1982), for example, illustrates. A central role in the negotiations probably should also be attributed to the government of the UK. The UK was initially skeptical about the EMU project and, in a later attempt to participate more actively in the negotiations, suggested the "hard ECU" plan (essentially a "market approach" to EU currency harmonization, in which a new common currency would compete with the existing national ones). The plan, however, was suggested in a relatively late phase of the negotiations and did not find the support of most other EC states\textsuperscript{33}.

Which delegations were most "successful" in the bargaining process on the EMU? Success in negotiations, intuitively, implies that the final outcome is close to one's own initial policy preferences. The aforementioned data compilation can be used, for example, to derive "value scores" for the governments of France, Germany and the UK with respect to the negotiation outcomes. The analysis applied here will follow suggestions on deriving value structures for bargaining games more generally, as suggested by Ralph Keeney and Howard Raiffa (1991). In a first, fairly simple, approach, one might consider the values on the issues to simply be additive\textsuperscript{34}.

\textsuperscript{32} In the following, we will not account for challenges of players to other actors, for exchanges of voting positions between governments or for changes in preferences between summit meetings (elements that are crucial, however, to the analysis by Kugler and Williams, 1994).

\textsuperscript{33} The Bundesbank viewed this plan with skepticism. It feared that the introduction of a "parallel currency" would increase inflationary pressure in the EC. By comparison, Spain, Italy and France were partially in favor of the UK proposal (see, for example, Wolf and Zangl, 1996: 370).

\textsuperscript{34} Additive value scores essentially imply that members' preferences on different dimensions are separable.
Let the maximum attainable score for each relevant player be a value of 100 for each category in columns two through seven of Table 1. Compared to the actual negotiation outcome on issue j, denoted by $R_j$, the score for player i on issue j is:

$$v_{ij} = 100 - |R_j - x_{ij}|$$  

(1)

In equation (1), $v_{ij}$ denotes the value player i derives from the negotiation outcome on issue j; $x_{ij}$ denotes his or her most preferred policy on the issue and $R_j$, the bargaining outcome. When the issues are independent of each other, simple additive scoring sums the respective values for each player in order to derive an overall score ($V_i^A$) for player i, according to equation (2).

$$V_i^A = \sum_{j=1}^{n} v_{ij}$$  

(2)

In a first approach, assume that only France, Germany and the UK were crucial in the intergovernmental bargaining game. The governments of these states may be assumed to have been equally powerful a priori, as these EC states were of almost equal size (at least before German reunification) and generally held equal voting weights in the EU’s institutions (until the adaptation of the seat distribution for the 1994 elections to the European Parliament). Their “value scores” can then be calculated on the basis of equations (1) and (2), which essentially provide a measure for the distance between their respective ideal points and the bargaining outcomes for each category. With regard to the desired banking arrangement, for example, the value score for France is $v_{BA}^{F} = 100 - |R_{BA} - x_{BA}^{F}| = 85$. For the UK, it is $v_{BA}^{UK} = 100 - |R_{BA} - x_{BA}^{UK}| = 65$. By comparison, Germany’s score is $v_{BA}^{G} = 100 - |R_{BA} - x_{BA}^{G}| = 95$. Thus, in this relatively broad first category, the additive value scores indicate that, for the German delegation, the final bargaining outcome was rather close to its initial preferences.

Another possibility consists of extending the set of actors. In the next scenario, assume that all twelve EC members were important to the overall negotiation outcomes on the EMU.

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35 A similar measurement technique could be used in the framework of the spatial theory of voting by assessing the Euclidean distance. The absolute value of the distance between the bargaining result and an actor’s ideal point on the scale is here compared to the maximum possible value of 100. (Scales are considered to be one-dimensional.)

36 When interdependence exists, value scores may for example be multiplicative instead of additive (Keeney and Raiffa, 1991: 139). This possibility will be explored below.
According to this line of reasoning, a state's political strength or economic size should not matter for its performance in the intergovernmental negotiations, because treaty reform requires both intergovernmental agreement and subsequent domestic ratification in all states. Applying equation (1) to all twelve EC governments that were involved in the EMU negotiations leads to the results shown in Table 2. (The table includes the assessments presented above for the UK, France and Germany for the major category "kind of banking arrangement").

[Table 2 about here]

The calculations illustrate that most of the twelve EC states did well with respect to some EMU provisions but obtained results rather remote from their ideal points on other dimensions. For instance, for the government of France, the outcome was rather unfavorable with respect to the timing of EMU institutionalization but corresponded closely to its preference regarding the distribution of power over policies. Similarly, for Germany, the outcome with respect to the scope of responsibilities attributed to the ECB was much closer to its initial preferences than the outcome regarding the power over policies (as German negotiators favored attributing more power to the ECB than to the representatives of national central banks). The overall outcome with respect to the "kind of banking arrangement" appears to coincide with the initial Italian position, the timing of institutionalization with the preferences of Belgium, Greece and the Netherlands.

An assessment of the overall EMU negotiations, summing the results for the three major players over the six categories, generates total additive value scores (V) on the basis of equation (2). Respective outcomes for France, the UK and Germany, out of a maximum of 600 points, are \( V^F = 440 \), \( V^UK = 450 \) and \( V^G = 515 \). Thus, according to this overall assessment, Germany performed better than France and the UK in the EMU negotiations, and the UK did slightly better than France.

Before extending these calculations to more actors in an alternative scenario, let us assume that scores were not additive, but that some issues were in fact interrelated. Van den Bos (1994: 62) mentions that the first category – the kind of banking arrangement – was the actual centerpiece of the negotiations, whereas the other five categories reflect elements of this major issue that became especially controversial in the subsequent negotiations. Hence, one can either solely focus on column one or use a different formula to derive scores on overall bargaining performance, e.g. by weighing category one fully but adding an average of the other five categories to derive the overall score. The respective equation to obtain value scores may then be
\[ V_i^M = V_i^{BA} + \left( \frac{V_i^{TT} + V_i^{PP} + V_i^{SR} + V_i^{HE} + V_i^{CU}}{5} \right) \] (3)

This approach calculates a "multiplicative score" according to Keeney and Raiffa (as we multiply dimensions two through six by a factor of .2 each and category one by 1.0). The maximum possible value score for an actor, based on equation (3), is 200. The resulting value scores for Germany, France and the UK are \( V_M^G = 179 \), \( V_M^F = 156 \) and \( V_M^{UK} = 142 \). Hence, when assessed by this formula, in an analysis limited to the "big three" EMU players, Germany is again found to have performed best, but the relative rankings of France and the UK are now reversed as compared to the analysis conducted above.

Of course, results derived for these scores largely depend on the quality of the data (and partially on the formula to derive value scores). Thus, calculations based on the data compilation above may have limitations. Nonetheless, these simple calculations of value scores have one result in common: they find that the negotiation outcomes are quite close to the initial ideal points of the German delegation. Depending on the technique to obtain total value scores, however, the government of either France or the UK is found to have fared second best.

Certainly, one could introduce the effect of agenda-setting into the analysis. For category one, one might posit that Germany, especially because of the participation of high-ranking Bundesbank officials, was very influential in the Delors Committee. A main document of this group is the "Delors Report"\(^3\), written by a committee under the chairmanship of Jacques Delors which involved the Presidents of the EC countries' central banks. Perspectives among central bankers on the EMU may generally not have deviated much from each other (for example, there basically was agreement on the necessity to make central banks independent from politics and about the benefits of lower inflation). This would imply that the distribution of preferences within the Delors Committee was relatively homogeneous. In addition, the relatively favorable attitude of some central bankers towards the EMU may have been caused by the fact that certain banks were more controlled by domestic political pressures than, for example, the Bundesbank. This may have led them to perceive fewer costs in moving ahead towards a common European monetary arrangement. Establishing the EMU and a new institutional structure in which national banks would gain independence from politics -- a precondition for moving towards stage II of the EMU -- and in which national central bank governors would form the new ECB's Governing
Council could then have appeared to be quite an attractive solution to several central bank representatives.

Hence, we posit that an agenda-setter -- and possibly the Bundesbank within it -- may have crucially set the stage for the negotiations. A spatial representation of government preferences, here for the central dimension “kind of banking arrangement”, can illustrate possible effects (Figure 1).

[Figure 1 about here]

Acting strategically, the Delors Committee, if it favored a quick transition towards the establishment of a powerful collective central bank, could have suggested a solution to the right of what even the most “integrationist” EC government preferred. If decision-making in the Intergovernmental Conference occurred on the basis of implicit majority voting, then the proposal could have been located at a point where the “median government” would still prefer the Committee’s proposal to the status quo (i.e., in practice, a point up to almost 160). But, evidently, intergovernmental bargaining did not occur on the basis of majority voting, and there were no “up or down” decisions on prior proposals but continuous bargaining processes in an intergovernmental framework. If unanimity on the issue was required, by comparison, a strategically acting Delors committee would have had to choose a proposal that countries on the very left-hand side of the scale would still prefer to the status quo. Hence, in Figure 1, such a proposal could be located at (almost) 100, making the delegations of Denmark and the UK just prefer this proposal to the status quo.

Intuitively, this reasoning contains some convincing elements. But, of course, there may be doubts about whether the Delors committee was such a truly strategic actor or whether it instead derived its policy position on the basis of intensive bargaining and negotiation among its own membership (with some members, possibly, acting as agenda-setters within it). It is striking, however, that for almost any category in the analysis (especially pronounced in the categories “power over policies” and “harmonization”), the bargaining outcomes are indeed located “to the right” of the preference of the median government on these uni-dimensional scales.

Let us now return to the “value scores” approach to see whether it can explain more. In a further step, assume that not only these three actors, but all twelve EC governments also were important in the EMU negotiations, as the TEU needed to be ratified domestically in all EC

37 On the significance of this report, see for example Kugler and Williams (1994: 186) and Van den Bos (1994: 50-1).
states. The total value scores for all EC states in the EMU negotiations, on the basis of equations (2) and (3), are given in Table 3.

[Table 3 about here]

Table 3 is striking on mainly two dimensions. First, it illustrates the relatively “good performance” of some middle-sized states, such as Belgium, the Netherlands and Luxembourg, in the negotiations, according to both the additive and the multiplicative formula. Italy also performed well as assessed by both approaches. (But all of these states, as displayed on the one-dimensional scale, were “center players”.) Second, assuming that France, Germany and the UK were about equally powerful in the intergovernmental negotiations on the EMU, the bargaining outcome, as compared to the players’ initial preferences, demonstrates an outcome that is quite favorable to the German delegation. With respect to the first finding, it is striking that Denmark, which has relatively strict domestic ratification procedures, did not perform well in the negotiations, only scoring 425 points according to the additive and 137 points according to the multiplicative formula. (On the one-dimensional scale above, however, Denmark can also be seen as an “extreme player”.) Finally, countries such as Spain, Portugal, Ireland and Greece did quite well in the bargaining process. This finding, in fact, provides little support for the hypothesis that the participation of these countries in the EMU was basically “bought” by the more northern states with the side-payment of an increase in financial transfers in the framework of the Cohesion Fund.

Another possibility to explain these negotiation outcomes is to assume that particular issues were more crucial to some states and hence to include the relative intensity of preferences into the analysis. Members more interested in an issue, generally, are expected to “fight harder” for it. For example, Germany appears to have had a strong interest in at least the first four issues listed in Table 1, attaining the maximum obtainable score (1001.1) for the intensity of preferences on the transformed scale. Assuming that a greater interest in an issue makes a negotiating party less willing to compromise, could this explain, for example, Germany’s better

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38 A somewhat less benign interpretation is that many of the interviewed experts were Dutch (although care was applied in the data collection process not to introduce such biases).
40 This information is provided in Van den Bos (1994: 64) and Kugler and Williams (1994: 208-12).
41 Several models in the Bueno de Mesquita and Stokman volume do include this information. Bargaining and especially vote-trading is assumed to be critically determined by the degree of interest that actors have in a specific policy issue.
performance with respect to the bargaining outcomes than the ones of the French and the UK
governments? Calculations taking this additional information into account might be made, for
example, along the lines of the “Compromise Model” presented in the Bueno de Mesquita and
Stokman volume\textsuperscript{42}. Formally, if there are \( n \) actors, let the most-preferred position (ideal point) of
actor \( i \) on issue \( j \) be \( x_{ij} \) and denote the power of actor \( i \) by \( c_i \). The expected policy outcome on
issue \( j \) (\( y_j \)) is then assessed as

\[
y_j = \frac{\sum_{i=1}^{n} s^a_{ij} c_i x_{ij}}{\sum_{i=1}^{n} s^a_{ij} c_i}
\]

(4)

where \( s^a_{ij} \) denotes the salience actor \( i \) attributes to issue \( j \) (as judged by the interviewed expert),
taking the transformation of raw salience scores into account.

Setting the voting leverage of all EC states equal to \( c_i = 1.0\textsuperscript{43} \), as these negotiations were
intergovernmental in character, and then inserting the preferences (and transformed scores for
salience) of first three and then all twelve EC governments into equation (4), provides figures on
the “predicted policy outcomes” in Table 4. Generally, the estimates for twelve members provide
results that are closer to the actual outcomes than calculations on the basis of three states for
dimensions one, two and three of the data compilation but further away for categories four, five
and six.

\[\text{[Table 4]}\]

Limiting the analysis to France, Germany and the UK and applying equation (4), the
expected policy outcome with respect to the “kind of banking arrangement” is \( Y_{BA} = ((75^a \times 1 \times 100) + (100^a \times 1 \times 80) + (90^a \times 1 \times 50)) / ((75^a \times 1) + (100^a \times 1) + (90^a \times 1)) = 73.69. \) In this
category, the actual bargaining outcome (85) as compared to the predicted one is closer to
Germany’s initial preference (80) and closer to the one of France (100) but further away from the

\textsuperscript{42} This model is transformed by Achen (1999) into an “invariant compromise model”. Surprisingly, applying the invariant compromise model to the decisions analyzed in the Bueno de Mesquita and Stokman volume generates, in a comparison with all other models, the highest predictive accuracy. Stokman and Van Oosten (1994: 115) attribute the compromise model to Van den Bos (compare Achen 1999: 4).

\textsuperscript{43} In the Bueno de Mesquita and Stokman volume, \( c_i \) is usually estimated by a government’s voting weight in the Council.
initial preference of the UK. (Assessed on the basis of twelve EC members, the predicted outcome would be slightly higher on the scale, at 75.47.) With respect to the timing of institutionalization, applying equation (4) generates $Y_{TI} = 56.21$ for three EU members and 56.05 for twelve (as compared to the actual outcome of 50). Hence, the actual policy outcome as compared to the forecasted one is more favorable for both Germany and the UK but less advantageous for France. In the category “power over policies”, the forecasted outcome is 79.33 for three and 72.24 for twelve members, and the real outcome is 70. The actual outcome as compared to the forecasted one is hence favorable for France and the UK but disadvantageous for Germany. With respect to the scope of responsibilities to be attributed to the new central bank, $Y_{SR} = 65.0$ for three members and 60.84 for twelve as compared to $R_{SR} = 70$. As Germany’s initial preference was 65, the forecasted outcome on the basis of three members would have reflected Germany’s preference better than the actual one. The outcome is favorable for France but not for the UK. In the category “harmonization”, the actual policy outcome as compared to the forecasted one is favorable for France (but not for Germany), whereas, in the last category, it is favorable for Germany and for the UK.

The comparison between the actual and the predicted policy outcomes on the basis of equation (4) indicate, however, that prediction on the basis of this model is not precise for most categories of the EMU negotiations\(^4\). Moreover, the forecasts make no improvement over the median as a predicted outcome. The cursory overview indicates that – especially when keeping the weighting of categories in mind, as in the assessment for the multiplicative value scores – if the intensity of preferences that governments held is included in the analysis, then there is no bias against the relative performance of Germany when comparing the predicted with the actual policy outcomes. But the analysis is not very reliable, as the forecasted outcomes are quite a distance from the actual policy outcomes according to this simple model.

In the remainder of this article, we will hence return to the simple finding that the actual bargaining outcomes were relatively close to the initial preferences of the German delegation, and we will try to find explanations for this (apart from the fact that the German government may have been a “center player” with respect to some of the relevant issues, along with Belgium, the

\(^{44}\) Note, however, that decision-making procedures on the EMU were quite different from those in other policy fields analyzed in the Bueno de Mesquita and Stokman volume. Most significantly, in the EMU negotiations, unanimity among governments in the framework of summit meetings was needed, whereas most other decisions analyzed could be taken by a qualified majority of votes in the respective compositions of the Council of the EU (then the “Council of Ministers”).
Netherlands and other smaller and middle-sized states). The analysis will not be systematic but, rather, will provide some cursory evidence that might additionally explain this leverage.

IV. Issue-Linkage and Two-Level Game Dynamics

A possibility is that the categories of Table 2 do not encompass all relevant issues. For example, they may neglect the fact that the TEU provisions allow for an influence of the EU Council on the determination of the EMU’s external exchange rate arrangements (e.g., Garrett 1994), a policy option that was likely to be closer to the preferences of France than of Germany. Similarly, it does not include preferences on issues such as how the “convergence criteria” should be defined or what the procedures should be for an EC state to qualify for early participation in the EMU (although it seems that the convergence criteria may have been closest to the preferences of the German government). Thus, the overall bargaining outcome on the EMU may not have favored the German negotiators as much as the values presented above indicate.

Moreover, it is likely that the unitary-actor assumption as applied in the analysis so far may fall short of explaining the full range of negotiation complexities (even when limited to the domain of intergovernmental negotiations). Can any evidence be found – at least on the basis of secondary sources – that two-level game dynamics influenced the negotiation process?

Essentially, the case of the EMU lends itself well to an analysis from the perspective of two-level game theory because bargaining on the EMU occurred in two sequences: (i) intergovernmental negotiations on the EMU provisions as contained in the TEU and (ii) ratification of the Treaty in the EC member states45. Treaty revisions in the EU not only required unanimous acceptance by the intergovernmental negotiators (i.e., on “Level I”) but also ratification in domestic politics (“Level II”) in all member states.

In the framework of two-level games, “we may define the ‘win-set’ for a given Level II constituency as the set of all possible Level I agreements that would ‘win’ – i.e., gain the necessary majority among the constituents -- when simply voted up or down” (Putnam 1988: 437). Hence, when the bargaining compromise of Level I gets back to Level II for ratification, the proposal is voted up or down (i.e., amendments to the proposal are no longer possible).

Stricter domestic ratification procedures – such as, for example, stricter requirements for ratification in the national parliament – tend to reduce the size of the domestic win set. Generally, the smaller a country’s win set, the higher the risk of “involuntary defection” on the

45 In accordance with national ratification procedures, this was on the basis of a vote in parliament, a referendum, or both.
intergovernmental agreement. By comparison, voluntary defection in the framework of EU intergovernmental negotiations is rather unlikely: parties will generally keep to their promises mainly because they know that they will meet again in the future. According to the logic of two-level games, however, involuntary defection and the fear of it can be just as fatal to prospects for cooperation as voluntary defection.

Generally, the size of a win set influences the prospects for an international agreement, but it may also affect the distribution of gains resulting from the international bargain. The size of the win set, however, can be influenced by the negotiators, by adding issues to the negotiation agenda. In addition, the size of the domestic win set may be misrepresented strategically in the intergovernmental bargaining process, in order to obtain more concessions on Level I.

Likewise, depending on the distribution of preferences among the relevant actors, the preferences of the negotiators may shape (or constrain) the domestic win set of \( x_0 \). The negotiator -- usually representing the "government" -- will be interested in obtaining a bargaining agreement on Level I that is an element of its "preferred-to set" of \( x_0 \). This set is the set of policy options that the negotiator prefers to the status quo and may be denoted by \( P_n(x_0) \). Generally, the smaller the intersection of the "preferred-to set" of a negotiator with the domestic win set, the smaller the overall range of possible agreements that can be accepted on both Level I and II. But both larger domestic win sets and large preferred-to sets tend to increase the prospects for feasible agreements. The preferences of negotiators may differ from those of a domestic majority, and, as long as a compromise proposal is not an element of the negotiator’s preferred-to set, it will not be accepted on Level I when agreement has to be unanimous. Generally, negotiators on Level I face two simultaneous challenges: finding solutions that obtain majority support on Level II and obtaining an agreement as close as possible to their own preferred policies.

Hence, the configuration of domestic preferences and the negotiators’ preferences determine the feasible bargaining range. It is likely, however, that Level I negotiators are uncertain about the contours of the domestic win sets and that this lack of information may be exploited strategically.

Continuing to reason along the lines of the two-level game perspective, the fact that the TEU was ratified implies that agreement among the negotiators on Level I was possible (for the EMU components of the TEU, this is not astonishing, considering the data on preferences above).

46 On such patterns in international cooperation, see Axelrod (1984), Keohane (1984), or Martin (1994).

47 This may be either because negotiators hold private information on the size of their own domestic win set not available to other negotiators on "Level I" or because they actually do not know the contours of their own domestic win sets.
But it also implies that the domestic win-sets of \( x_0 \) overlap in all states in which TEU ratification was successful. In set-theoretic terms, if \( W_G(x_0) \) is the domestic win set of the status quo in Germany, for example, and \( W_F(x_0) \) the domestic win set of \( x_0 \) in France, then successful ratification in both Germany and France implies that \( W_G(x_0) \cap W_F(x_0) \neq \emptyset \) (i.e., the area of overlap of the win sets of \( x_0 \) in both states was not empty – agreement on Level I led to a solution that obtained the necessary domestic majority support in both states). Hence, the TEU indeed was an element of the domestic win sets of the status quo, for example, in Germany and France, \( x_{TEU} \in W_G(x_0) \cap W_F(x_0) \) (in fact, this relationship applies to all EC states with the exception of Denmark, as we will see below).

The set of feasible policy outcomes, in a two-level game perspective, is the intersection of the domestic win set with the preferred-to set of the negotiator. For country \( i \), this is \( F_i(x_0) = W(x_0) \cap P_N(x_0) \). The intersection of the “preferred-to sets” of the negotiators and the domestic win sets must be non-empty for all states in order to allow for successful treaty reform.

Can actors strategically exploit uncertainty with respect to the size of domestic win sets? It is likely that in Germany – whether on the basis of personal convictions or strategic calculations -- Chancellor Kohl was more pro-EMU and more pro-EPU than a majority of the German public, possibly even more than the relevant parliamentary majority. It is hence possible that, in Germany, the difference between the preferences held by the public and the EMU negotiators was relatively large and that \( F_G(x_0) = W_G(x_0) \cap P_{NG}(x_0) \), accordingly, was rather small. Differences in opinion between the Bundesbank and the government, in particular, may have credibly demonstrated such domestic cleavages to outsiders. In France, by comparison, the distribution of domestic interests may have been more homogeneous\(^{48} \). For example, establishing a more symmetric monetary system in Europe was expected to benefit both the central bank and the government, including the French Ministry of Finance (e.g., see Dyson and Featherstone 1996).

A possibility for modifying the structure of negotiations, as mentioned above, is to add issues to the negotiation agenda. Traditionally, this strategy was viewed as a possibility to extend one’s power in one domain to obtain concessions from negotiation partners in others domains (e.g., Wallace 1976). Elaborating on this, however, Tollison and Willett (1979) have shown that issue-linkage may also serve the purpose of obtaining mutually beneficial outcomes that cannot be achieved by bargaining on issues separately. Sebenius (1983), responding to this, illustrates cases in which issue-linkage may serve to further the mutual interest of the bargaining parties,
whereas, in other circumstances, it may turn out to be counterproductive (by causing a breakdown of the negotiations, for example).

The data collection on government preferences above, however, provides some indication that agreement on Level I might have been possible on the EMU without the strategy of issue-linkage. But agreement on the EMU exclusively might not have been in the German domestic win set, whereas it is likely to have been in the preferred-to set of the negotiators, \( P_{nc}(x_0) \). Hence, linking two major issues – here especially the EMU and EPU – may result in an acceptance on the domestic level of proposals that would not be “voted up” by a domestic majority when decided upon separately. But, by using this strategy, prospects for domestic ratification in other EC states were also affected.

It is likely, however, that the size of the domestic win sets was unknown to negotiators on Level I. In fact, \( ex\ post \), is seems that the size of the domestic win set, when Level I negotiators agreed on the TEU as a package, may have been overestimated for France and Denmark. For example, Danish voters, in their first referendum on the TEU, voted down ratification of the Treaty, and French voters accepted ratification only by a very narrow margin.

The risk of involuntary defection seemed pronounced in Germany. This risk, however, also existed in other EC states (but appears to have been less known to actors on Level I). Thus, the size of the Danish domestic win set, \( W_{DM}(x_0) \), for example, may have been overestimated \( ex\ ante \) by the negotiators on Level I (and would have necessitated side-payments and more concessions to Denmark if this had been known). \( Ex\ post \), however, Denmark was able to obtain such a “side-payment” (mainly by getting an opt-out clause regarding both the EMU and Common Foreign and Security Policy, or CFSP). Analyses on the basis of the preference compilation in this article indeed demonstrate that the outcomes on the EMU provisions did not reflect the preferences of the Danish government. As compared to their initial policy positions, the Danish negotiators fared the worst of all twelve EC states in the intergovernmental negotiations on the EMU. By comparison, France did not obtain concessions \( ex\ post \). Although its initial preferences were not as close to the actual negotiation outcomes on the EMU as were those of the German delegation, France’s “value scores”, nonetheless, were clearly higher than those of the Danish delegation. The UK, similar to Denmark, obtained opt-out clauses on major parts of the TEU (including the EMU).

Two-level dynamics combined with issue-linkage may hence explain somewhat more of the apparent puzzles of the EMU negotiations. John Woolley (1994) provides several additional

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48 See Kugler and Williams (1994: 190): “In France, President François Mitterrand seemingly did not face organized opposition [to the EMU] other than on agricultural issues”.
insights into Chancellor Kohl’s bargaining constraints, which were in large part caused by domestic political conditions. On the one hand, increasing opposition in public opinion to the EMU was starting to materialize in Germany, strengthened by a wide-felt feeling that the SEA had overemphasized economic issues to the detriment of institutional revision (e.g., reducing the EC’s “democratic deficit” by enhancing the power of the European Parliament). Similarly, adding social policy and environmental cooperation to the negotiation agenda (and possibly agreeing to increased North-South transfers) could win support in the left spectrum of the German political party structure, such as among the Grünen (“Greens”) and the Sozial-Demokratische Partei Deutschlands (Social Democrats, or SPD). Extending the negotiation agenda with the issue of foreign and security policy, moreover, might win the crucial support of the center-right junior coalition party, the Freisinnung-Demokratische Partei (Free Democratic Party, FDP).

According to Woolley (1994), in Germany, it was important for Chancellor Kohl to win the support of Länder -- relatively strong domestic political actors -- by linking the EMU, inter alia, to revisions of the decision-making procedures in the framework of the EPU. In addition, revisions in terms of the scope of EU policies, partially determined by the principle of “subsidiarity” as contained in Article 3b of the TEU, and the creation of the new Committee of Regions favored Länder interests.

Although this evidence cannot fully confirm the assumption that domestic constraints influenced the bargaining behavior and leverage of the German government in the intergovernmental negotiations on the EMU, these accounts of the bargaining process and domestic politics, as compared with our earlier analysis of government preferences, provide some support for the hypothesis that the German delegation profited from divisions in domestic politics that illustrated the risk of “involuntary defection” to negotiators on Level I. Admittedly, however, Germany’s preferences in the intergovernmental bargaining process, at least for the

49 According to Kugler and Williams, among all EC states, domestic politics critically influenced negotiations on Level I only in the UK and Germany: “Only in the United Kingdom and Germany did we find that domestic actors could affect the ability of elites to negotiate at the summits. Domestic divisions in other EC countries did not substantially influence the negotiation postures of their representatives at the summits.” (Kugler and Williams 1994: 190).
50 An early account of the relationship between domestic constraints and international negotiations, including the role of the German Länder, is Bulmer (1983).
51 Hence, in this case, the hypothesis that the larger a perceived win set of a negotiator, the more he or she can be “pushed around” on Level I, would get some support. Conversely, a small domestic win set, as perceived by the negotiators, might constitute a bargaining advantage in accordance with the “Schelling conjecture” (Schelling 1960). In such instances, indeed, a negotiator could credibly claim “I’d like to accept your proposal, but I could never get it accepted at home” (Putnam 1988: 440).
major category of issues negotiated, were close to the median policy position among EC governments.

Hence, according to the analysis conducted in this paper, there are three major explanations for the outcomes that were relatively beneficial to the German government in the intergovernmental EMU negotiations. (i) The data compilation above is flawed. By being biased in favor of the interests of Germany and the Benelux states, it artificially inflates the benefits for these states as derived from the intergovernmental negotiations. (ii) The negotiation outcomes were close to the initial preferences of Germany (and some middle-sized states) because these states were "center players" on some of the most crucial policy scales. Their initial preferences constituted the median position regarding the "kind of banking arrangement" chosen, for example, and agenda-setting by the Delors committee may have critically set the stage for agreement on the final policy outcomes. (iii) Germany's leverage in the negotiations was determined by two-level game dynamics. The German government profited from the fact that its domestic win set -- and the intersection between the preferred-to set of the German negotiators and the domestic win set -- was relatively small (and was perceived as such by negotiators on Level I). In addition, the contours of its domestic win set may have decisively determined Germany's strategy to support issue-linkage on the intergovernmental level.

We cannot conclusively support any of these three possible explanations on the basis of the analysis presented in this article, but we do find some evidence in support of them. Explanation (i) is trivial. It seems somewhat unlikely that the data could be biased to such an extent, considering respective efforts by the researchers to avoid such errors. More information on the methods of data collection would have helped to estimate whether the assumption of bias could be correct. Both statement (ii) and (iii) find some support on the basis of the analysis conducted in this paper (assuming that the data reflect what they were assumed to measure). The German government was a "center player" with respect to a crucial dimension of the EMU negotiation agenda, "kind of banking arrangement", a category for which actor preferences were collected at an early stage. But Germany's preferences were located more towards the extreme ends of the scale on the remaining issues of the negotiations. For these remaining categories, assumption (iii), on two-level game dynamics, may provide some convincing supplementary explanations for Germany's relative bargaining strength.

Thus, according to this paper, it is likely that for Germany two factors are especially relevant in explaining its performance in the intergovernmental EMU negotiations. First, the distribution of preferences was such that it made the German delegation a "center player" (along with Italy and several middle-sized EC states) in the first and most central category of the
negotiation agenda. Subsequently, in negotiations on the remaining issues, a strategic exploitation of cleavages in domestic politics -- considering the uncertainty of Level I negotiators about the contours of domestic win sets -- may have strengthened Germany's leverage in the intergovernmental negotiations and critically determined its support for issue-linkage. There is little indication, however, that issue-linkage in the intergovernmental bargaining process was resorted to in order to reach agreement on Level I.

V. Conclusions

Can we understand how an agreement was reached among EC states on moving forward towards the EMU as contained in the respective TEU provisions? In order to understand the background to the EMU negotiations, this paper first provides some information on the history and functioning of the EMS. It proceeds by providing data on the preferences that EC governments held with respect to issues such as the institutional structure and timing of the EMU and the range of policy powers to be attributed to the new ECB. Subsequently, some simple bargaining models are applied to assess the outcomes, mainly focusing on the roles and interests of the governments of France, Germany and the UK.

Comparing the relative performance of all twelve EC states that were involved in the negotiations, the smaller and middle-sized states (with the exception of Denmark) fared well in the intergovernmental negotiation process. Among the three large actors that are usually viewed as most influential in the framework of these negotiations -- Germany, France and the UK -- the German government is found to have performed best, i.e., to have obtained bargaining outcomes closest to its own initial preferences. Based on an analysis of the distribution of government preferences with respect to the EMU, this contribution finds that the German delegations did not have to sacrifice essential interests in the intergovernmental bargaining process. Although there was some protest in German public opinion against the EMU -- and on what were perceived to be only modest steps taken towards EPU -- negotiation outcomes on the EMU are close to the initial policy preferences of the German government. By comparison, bargaining outcomes were not favorable for Denmark (which, however, obtained an opt-out clause on the EMU at a later stage). It is sometimes assumed that France profited from the establishment of the EMU, mainly by

\[32\] I am grateful to Peter Lange for pointing out this possible sequence of events to me.

\[33\] This does not necessarily imply, however, that the TEU as a whole was beneficial to Germany. Establishing a respective cost-benefit analysis for Germany would be nice, but is a rather complex endeavor (as domestic preferences and evaluations of the various TEU elements would vary among different societal actors).
gaining a more symmetric form of access to monetary cooperation in Europe. However, according to the analysis conducted here, the actual negotiation outcomes were at quite a distance from the initial preferences of the French government. A similar distance is found for the UK\textsuperscript{54}; however, it also obtained an opt-out clause with respect to participation in the EMU.

These bargaining outcomes may partially be explained by the fact that Denmark, France and the UK were actors holding non-central preferences on one of the most crucial policy dimensions in the EMU negotiations. By comparison, Germany was a “center player”, as was Italy, holding preferences close to the median position among the EC governments. In addition, based on the analysis conducted here, it is likely that agenda-setting – especially by the Delors committee – may have influenced the bargaining outcomes on the EMU.

When analyzing the settlement of the other issues in the negotiations, however, it seems probable that two-level game dynamics were essential factors that influenced the bargaining process. Since intergovernmental agreements in the EU require ratification of Treaty revisions on the domestic level (“Level II”) in all member states, smaller and medium-sized states may have been relatively crucial in the summit meetings. In addition, negotiators on Level I may have had justified doubts about the prospects for domestic support of an EMU agreement in Germany. This partially explains Germany’s bargaining leverage in the intergovernmental framework and its interest in the strategy of issue-linkage. Broadening the scope of the negotiation agenda -- mainly by adding the EPU -- as strongly advocated by the German government, may primarily have been aimed at decreasing the risk of involuntary defection on an international agreement in Germany, rather than generating a zone of agreement (or to influence the distribution of gains) on Level I. However, looking at the process of TEU ratification ex post, the size of the domestic win sets was most likely overestimated by the negotiators on Level I for some EC states, in particular Denmark and France.

\textsuperscript{54} Note, however, that in the years preceding the 1989 summit meeting in Madrid (and the publication of the influential Delors report in mid-1989), the government of the UK was probably more clearly opposed to the EMU than it was, for example, during the decisive Maastricht meeting of 1991.
VI. References


Table 1: Policy Positions Regarding an Integrated European Monetary and Banking System (salience in brackets)

<table>
<thead>
<tr>
<th>EU Member State</th>
<th>Harmonization</th>
<th>ECU/National Currency</th>
<th>Responsibility</th>
<th>Power over Policies</th>
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Table 2: Individual Value Scores (EMU Regulations: Twelve EC Member States)
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Table 3: Total Value Scores (EMU Negotiations, Twelve EC Member States)
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Table 4: Predicted Outcomes Regarding Elements of the EMU (On the Basis of Government Preferences and Salience)
Figure 1: Special Arrangement of Preferences on "Kind of Banking Arrangement: EMI Negotiations (Twelve EC States)"