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Abstract

This paper explores how three major European nation-states, France, Germany, and the UK, are negotiating financial reform in the wake of the most recent financial crisis. France, Germany, and the UK were affected differently by the 2009 financial crisis, in some ways varying the degrees to which they are willing to negotiate further financial regulation. Also because of these differences financial reform resonates differently with each states' polities. Drawing on statements by finance ministers and heads of state, as well as IMF data measuring the effects of the latest crisis on each national economy, this paper seeks to identify opportunities for consensus amongst the three major actors. The characteristics and outcome of negotiations by these states have the potential to greatly influence the future of financial regulation not only within the EU, but also abroad. On the other hand, promising opportunities for consensus lie in potentially negotiating within the European Union and establishing methods to reduce the costs of market failure in the financial sector.

Introduction

Despite academic debates surrounding the ultimate effectiveness and desirability of international financial regulation, states continue to call for increased regulation. This issue is of particular relevance in the eurozone, where, although states have agreed to coordinate monetary policy, disagreement persists among member states as to when and how to address problems of financial regulation. The rancorous debates about the successive bailouts of Greece and Ireland following the collapse of the international financial system in 2007 have served as a reminder of the interests invested in the European community thus far and the opportunity to shape future responses to financial crises. As the threat of instability continues to plague financial markets in euro zone countries, it becomes increasingly necessary to revisit the various political considerations that drive demand for further financial regulation within the euro zone. Demand has not been uniform throughout the euro zone, with some countries, like France, much more active in calling for reform. States' positions on either liberalizing international financial markets further or, conversely, introducing more regulations is a looming question in the euro zone and beyond.

This paper will develop as follows: 1) A brief background on financial markets and instability emphasizes the importance of state action on the issue. 2) A survey of the literature surrounding international financial regulation reveals that more research is needed into the interests and negotiating behavior of actors to identify areas for possible consensus. 3) State interests, as they represent domestic polities and social purpose, are taken to be the driving force of negotiations. 4) The prospects for agreement among states are drawn from analyzing the economic priorities of states regarding financial regulation, and their positions on European integration. 5) Positioning these interests in the milieu of domestic polities partly reflects the extent that societal purpose recast as state interest permeates bargaining on the issue.

Two central arguments run throughout the paper: France, Germany, and the UK call for further financial regulation to the extent that it reflects state interests and when they can project preferences within the EU and internationally. Further regional integration is an issue that publicly divides the United Kingdom's interests from those of France and Germany, while opportunities to limit the costs to individual states in the event of financial market failure present real options for consensus.

Background

Although the recent financial crisis has highlighted international financial reform as an important issue, the international financial system has witnessed great shocks on the magnitude of the East Asian crises and undergone substantial changes due to rapid technological change, a feature of global economic history that weighs heavily upon regulatory debates. The neoclassical school of economics generally rejects theories that attempt to establish a pattern for crises, characterizing them as historical accidents. Charles Kindleberger, an international political economist, argues that crises are inherent in international capitalism and that the chain of events from which they arise potentially follow some basic patterns.[1] It is useful to draw on both perspectives, the first highlighting the possibility that it may not be possible to predict or preempt financial crises, the second recognizing common characteristics of crises that policy makers can address. At a basic level, debates surrounding regulation of international financial markets reflect a concern with stability. In an international system where the daily turnover in currency exchanges grew from $15 billion to $1.2 trillion from 1973 to 1995, it is important to acknowledge not just the money at stake, but the very real consequences of financial instability.[2] As Robert Gilpin suggests in his well known text, *Global Political Economy*, "It is extraordinary that there is no mechanism to regulate international finance..."[3] A number of scholars, including Charles Kindleberger, Susan Strange, and James Tobin note that the international financial system is the weakest link in the chain of the international economy...".[4] Kindleberger, Strange, and Tobin also argue for the establishment of either international financial regulation or a formal regime, although Gilpin is skeptical of the extent to which this could be achieved.[5] These authors highlight one of the underpinning themes of international financial regulation's story: International finance has become an issue that requires a considerable amount of coordination and negotiation.

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[1] Gilpin, Robert, *Global Political Economy*, (Princeton: Princeton University Press, 2001). Pg. 268.
[2] *Ibid.,* Gilpin. Pg. 261.
[3] *Ibid.,* Gilpin. Pg. 261.
[4] *Ibid.,* Gilpin. Pg. 268.
[5] *Ibid.,* Gilpin. Pg. 268.

This paper is primarily about how France, Germany, and the UK are negotiating financial regulation, a focus that requires a brief background on arrangements that concern international finance. The forums in which the three states discuss this issue are quite diverse, the most significant of which are the European Union, the G20, and communication under the auspices of the International Monetary Fund, a forum that has witnessed a surprisingly frank conversation on regulatory issues. Another arrangement worth mentioning is the Committee of Wise Men on the Regulation of European Securities Markets, a group created by the European Council in 2000 to make recommendations to the Council on issues of legislature. Despite not being directly involved in negotiations, the Committee of Wise Men provide useful suggestions as to which actors should be interested in various decision-making processes. European Union leaders also agreed to a pan-European super-regulator in 2009, whose future significance and clout is yet to be determined and still must be turned into European law.[6] These institutions constitute important settings for negotiation between France, Germany, and the UK. The forum that actors choose will largely dictate whether negotiations on the issue are oriented towards building a larger framework, as in high-level discussions at the G-20, or conversely, address specific policies.

However, state membership in institutions does not guarantee coordination internationally by itself; the European Union imposes some limits on possibilities for regulatory legislation. Dr. Rosa M. Lastra, a senior lecturer in International Financial and Monetary Law at the University of London emphasizes the importance of the principle of subsidiarity citing Article 5 of the European Community Treaty which limits interests in regulation:

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[6] Traynor, Ian, "European Union agrees super-regulator to head off financial crises," *Guardian.co.uk*, December, 2, 2009, accessed http://www.guardian.co.uk/business/2009/dec/02/eu-financial-regulation-deal.

> In areas which do not fall within its exclusive competence, the Community shall take action in accordance with the principle of subsidiarity, only if and insofar as the objective of the proposed actions cannot be sufficiently achieved by the Member States...[7]

This limit is particularly relevant in light of the most recent financial crisis, which poses serious questions as to whether the current loosely organized financial system is sufficient. Although the fragile state of international financial markets has the potential to render regulation an uncontroversial issue, the linkage between regulation and integration in the European Union introduces the politics of competing interests.

Reflecting on what form financial regulation should take does not define the current debate in Europe, where the conversation has failed to focus on a specific set of measures to combat financial market instability. Lastra makes a distinction in her work that few politicians discussing regulation seem to adhere to: "Governance has to do on the one had with the allocation of power and on the other hand the exercise of power. Supervision refers to the oversight of financial firm's behavior... Regulation refers to rule-making."[8] However, for the purposes of this paper, governance, supervision, and regulation are not separate issues where they reflect the pursuit of interests and the dynamics of negotiation surrounding international financial reform. In that sense, the argument below does not make suggestions about how supervision or regulation should look, but rather reflects upon the relevance of interests to conversations on these issues.

Literature Review

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[7] Lastra, Rosa, "The Governance Structure for Financial Regulation and Supervision in Europe," *Columbia Journal of European Law,* 49 (2003), www.law.harvard.edu/faculty/.../Governance_in_EU.Lastra.pdf. Pg. 4.

[8] *Ibid.,* Lastra, Rose. Pg. 2.

Various authors comment on the difficulty that seems to characterize financial negotiations in the European Union and the international community. This section surveys 1) The global challenges to international financial regulation and related implications for economic governance; 2) Debates surrounding EU economic integration; 3) Specifics of EU financial and monetary theory; 4) Negotiating and bargaining tactics. In reviewing the literature across these areas, the recurring theme of state interests and a reluctance to cede national political control to supranational economic institutions sets the stage for the coordination problem posed by the issue-linkage between integration and financial regulation. Writing on negotiating and bargaining provides a frame of analysis for interpreting state preferences for regulation and posits state interests as reflections of domestic polities.

Analyzing the future of financial regulation during a panel for the CESifo, an institute for economic research, entitled "Globalization and the Crisis," Barry Eichengreen, an international economist at the University of California, emphasizes that although the United States and Europe agree that there must be a third possibility to approach the problem of troubled banks -- besides uncontrolled bankruptcy and bailouts -- he contends such a viable third option is yet to emerge.[9] Eichengreen's commentary touches on the viability of policies, a fundamental question in the negotiation of financial market regulation. A workable framework for international finance depends on political agreement.

It may be that there is no longer a level of consensus among states that would spur a unified approach to financial regulation. Previously, a commitment to a liberal economic order manifested itself in the area of finance in states' reluctance to become too involved in regulating markets; regulation represented for the Chicago school of economists a perverse policy that they charac-

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[9] Eichengreen, Barry, "Globalization and Crisis," *Ifo Institute for Economic Research at the University of Munich*, 11 (2010): 20-24, accessed http://ideas.repec.org/a/ces/ifofor/v11y2010i3p20-24.html. Pg. 21.

terized as "financial repression".[10] To proclaim the impending doom of the liberal economic order would be dramatic, but as Professor of Political Economy and Development at the London School of Economics Robert Wade suggests in his article, "Financial regime change?" we may be entering "a period marked more by a lack of agreement than any new consensus."[11] However, precisely because the world of economic governance has faced such an enormous test in recent years, calling into question how actors will negotiate a new economic order, it is instructive to return to the basic driving force of states -- interests. Yet the ways states express their objectives in international negotiations is not always clear.

As Jeffry A. Frieden, Professor of Government at Harvard University, suggests in his article, "Invested interests: the politics of national economic policies in a world of global finance," there are two major areas in which states are concerned about financial regulation. The first, the process by which the international financial system becomes more fully integrated, is the general concern of recent high-level negotiations, because it pertains to states' preferences for the future of the global economic order.[12] The second, sectoral policy within financial services, is of interest as well, because it is an area in which a national government has more freedom to dictate outcomes regardless of competing interests.[13] A division of financial policy into these categories affords a simple framework by which state interests can be differentiated between preferences for the character of the global economy and preferences for how global financial movements play out within their own borders. The problem of projecting a given set of interests is a central concern of observers focusing on relations within the European Union.

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[10] *Ibid.,* Wade. Pg. 2.
[11] Wade, Robert, "Financial regime change?" *Forlaget Manifest*, 2008, accessed www.manifest.no. Pg. 2.

[12] Frieden, Jeffrey, "Invested Interests: the politics of national economic policies in a world of global finance," *International Organization*, 45 (1991): 425-451. Pg. 3.
[13] *Ibid.,* Frieden. Pg. 4.

The exercise of interest in the European Union and the euro zone is a hotly debated issue owing to the larger theoretical questions it raises. Literature relating to ways in which state interests play out in Europe paints a picture of the limits different areas of European integration have placed on state sovereignty, in some ways driving the discussion towards models explaining cooperation. Andrew Moravcsik, the Director of the European Union program at Princeton University, approaches the problem of interests through the lens of liberal intergovernmentalism. Moravcsik contends in "Explaining the Treaty of Amsterdam: Interests, Influence, Institutions," that demand for cooperation, as opposed to supply, constrains further steps towards European integration.[14] Indeed, financial regulation is an interesting issue because it represents a test of how great the European appetite is for further integration. In their book, *European Integration and Political Conflict*, Gary Marks and Marco R. Steenbergen identify further theoretical obstacles to cooperation between states in the European Union, focusing on three major perspectives.[15] Identifying path dependence, the authors suggest it is costly for political parties to deviate from a given course of action. Referencing rational choice theory, they posit a stable balance of interests is less likely in more complicated political arenas. A third perspective, cognitive political psychology, argues the more complex a political space becomes, the more actors are limited by their ability to think through a problem.

States are hardly the only actors for these authors; in their essay, "European Integration from the 1980s: State-Centric v. Multi-level Governance," Gary Marks et al. advance the position that the sovereignty of individual states is limited by collective decision making and supranational institutions, while states' ability to mediate representation of domestic interests in the interna-

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[14] Andrew Moravcsik and Kalypso Nicolaïdis, "Explaining the Treaty of Amsterdam: Interests, Influence, Institutions," *Journal of Common Market Studies,* 37 (1999): 59-85. Pg. 83.
[15] Gary Marks and Marco R. Steenbergen, *European Integration and Political Conflict,* Cambridge: Cambridge University Press, 2004. Pgs 2-3.

tional arena also suffers.[16] Making sense out of messy theoretical debate is challenging, although attempts to refine analytical work surrounding the European Union presents interesting findings in the case of monetary and financial policy.

Previous analysis of monetary and financial policy in the European casts the state in a conflicted role facing a compromise between integration and retaining domestic political controls. The integration of 17 EU member states into monetary union raises the specter of further consolidation of areas that are traditionally governed by the state into European institutions.

Xavier Vives, in an insightful piece for the Barcelona's *Institut d'Anàlisi Econòmica*, addresses the structural problems of financial regulation in the European Monetary Union. Although Vives is more interested in addressing institutional shortcomings in the present eurozone financial regulation framework, the author identifies one of the major problems facing negotiators:

> However, the idea that the present supervisory arrangements of banking and financial markets in Europe are adequate because of the existing segmentation of business by countries seems fallacious on the face of the fast integration of capital markets and the potential and actual developments in electronic banking. At the heart of the problem is the tension between economic integration and the lack of willingness to relinquish national political control.[17]

Certainly states could persuade themselves that enough structure in the financial markets already exists. The rate at which financial markets develop, as Vives points out, belies this argument, and states themselves seem to believe that financial regulation is an issue that needs to be addressed. Therefore the problem of political will in regulating financial markets in the European Union is one not just of control, but of the sort of controls that states are interested in giving up.

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[16] Gary Marks, Liesbet Hooghe, Kermit Blank, "European Integration from the 1980s: State-Centric v. Multi-level Governance," *Journal of Common Market Studies,* 34 (1996): 341-378. Pgs. 345-347.

[17] Vives, Xavier. "Restructuring Financial Regulation in the European Monetary Union," *Journal of Financial Services Research*, 19 (2001), accessed ideas.repec.org/a/kap/jfsres/v19y2001i1p57-82.html. Pg.2.

For Vives and other authors, negotiating the regulation of aspects of the international economy within the EU challenges whether state interests are furthered by retaining control of their financial and monetary policy. In the case of the European Union, the model of monetary union is a glaring example of states relinquishing political control to achieve specific objectives. A piece by Eichengreen, entitled "European Monetary Unification: A Tour D'Horizon," surveys a number of unanswered questions posed just after the European monetary unification process, suggesting in one passage that one of the important controversies resulting from the union was the effects of the sacrifice made by states in surrendering monetary policy as a tool to reinforce economic stability.[18]

Regulating financial markets is a similar and yet different problem, again raising the issue of political control, along with specific regulatory concerns. Hans-Jurgen Bieling lists a series of areas related to the regulation of financial markets in the European Union in which policies may become entangled in vested domestic interests, including accounting practices, shareholder rights, and regulation of mergers, influences that change the way states perceive the purpose of regulatory measures.[19] Complications are ubiquitous beyond domestic interests. Vives explores some important questions that financial institutions in the European Union have yet to face, the chain of command and the sharing of losses resulting from transnational institutions that may become insolvent being especially relevant.[20] By its very nature, the chain of command in the event of financial instability reinforces a hierarchy of actors, a process by which states will either try to consolidate or cede control depending on their interests in the matter. Notwithstanding this

[18] Eichengreen, Barry, "European Monetary Unification: A Tour d'Horizon," *Oxford Review of Economic Policy*, 14 (1998), accessed people.exeter.ac.uk/tkirsano/eichengreen.pdf. Pg. 25.
[19] Bieling, Hans-Jürgen, "Social Forces in the Marking of the new European Economy: the case of Financial Market Integration," Paper prepared for the Seventh Workshop on Alternative Economic Policy in Europe at the Free University of Brussels, 28th-30th September, 2009, accessed www.epoc.uni-bremen.de/publications/pup2001/.../bieling.pdf. Pg. 2.
[20] *Ibid.,* Vives. Pg. 2.

competition for influence, the sharing of losses emphasizes one of the most important divisive outcomes of financial market failures in the European Union: cost. These concerns are a reminder that financial market regulation is not simply a matter of institutional characteristics; regulation also interests states.

Ascribing a theoretical framework to financial market regulation in the European Union proves a challenging task. Lucy Quaglia attempts a variation on this in her study, "The politics of financial services regulation and supervision reform in the European Union," arguing that various theoretical approaches best explain contrasting phases of the policy making process.[21] Noting that the financial sector is one of the least developed in terms of policy making in the European Union, Quaglia takes this to mean it must become one of the centers of European activity in the future, maintaining that the theories of interdependence, supranational governance, and liberal intergovernmentalism all had explanatory value at different stages of policy making.[22] For Quaglia, increased interdependence due to the Single Market and European Monetary Union set the background for an agenda that was largely defined by supranational agents like the European Commission.[23] The author evokes liberal intergovernmentalism in at the decision-making stage, emphasizing that at this point, national executives are the only actors of importance, and that an agreement must be within the limits of a state's preferences.[24] Quaglia's analysis is a step in the right direction as it recognizes the fundamental importance of state interests, but the reforms treated in the survey, which range from 1999 and 2004, are somewhat removed from today's political climate.

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[21] Quaglia, Lucia, "The politics of financial services regulation and supervision reform in the European Union," *European Journal of Political Research*, 46 (2007): 269-290. Pg.269.
[22] *Ibid.,* Quaglia. Pg. 269.
[23] *Ibid.,* Quaglia. Pg. 274.
[24] *Ibid.,* Quaglia. Pg. 274.

Reconciling state interests on an international level with domestic political sentiment necessitates first an understanding of the dimensions of negotiation on the international level, and second, how these dimensions are influenced by politics.

Since researches to not always have direct access to executives, determining patterns of negotiating interests is complex. States use multiple strategies to negotiate agreements in their interests. Fisher and Ury provide a useful categorization in labeling various strategies as examples of hard bargaining and soft bargaining, the former a contest of wills, the latter an exercise in giving away concessions easily to reach an amicable solution.[25] For the authors, both have negative connotations as they do not necessarily result in a wise agreement for either party.[26] Instead, the authors recommend a method of principled negotiation, which suggests deciding issues on the merits, and takes an interest based approach to establishing negotiating positions.[27] Andreas Dür and Gemma Mateo test the extent hard or soft bargaining techniques play out in the European Union using the negotiations surrounding the 2007-2013 EU Financial Perspective as a case study, arguing, "...Large member states, countries with a good alternative to negotiated agreement, and governments facing domestic constraints are more likely to resort to hard bargaining tactics," laying out several dimensions where states are especially likely to press their interests.[28]

Tallberg, a professor at Stockholm University, prioritizes dimensions of power that allow states to adopt either hard or soft bargaining tactics. In interviews with Tallberg for an article entitled "Bargaining Power in the European Council," European leaders seemed to reject the notion

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25 Roger Fisher and William Ury, *Getting to yes: Negotiating Agreement Without Giving In*, New York: Penguin Group, 1981.
26 *Ibid.,* Fisher and Ury.
27 *Ibid.,* Fisher and Ury.

28 Andreas Dür and Gemma Mateo, "Bargaining Power and Negotiation Tactics: The Negotiations on the EU's Financial Perspective, 2007-2013," UCD Dublin European Institute Working Paper 08-2, May 2008. Pg. 1.

of benefiting from domestic political constraints, instead claiming that negotiators who are fettered by domestic pressures are considered weak and become marginalized.[29] The author further cites testimonies from the council's elite to suggest that the state dimension of power is most fundamental to influencing negotiations.[30] Characteristics of lesser importance to European leaders include institutional[31] and individual dimensions of power and influence.[32] Tallberg's analysis thus provides a useful framework for how power and interests might play out in the European Union on the most important issues. However, France, Germany, and the UK do not have vastly different dimensions of power. It is therefore necessary to conceive of state interests as more than a will to impose a preference upon another. Literature linking state interests to domestic polities poses the problem of coordinating international and domestic interests.

Not surprisingly, when considering economic governance, states have a variety of interests on the international and domestic levels that they must prioritize according to purpose. Robert Gilpin argues that states generally prioritize three different economic goals: national security, individual welfare, and social welfare.[33] He further argues, "The question of purpose is at the core of political economy, and the answer is a political matter that society must determine," establishing a direct connection between the purposes of states and the political clout of domestic society.[34] Also adherent to this view, Stephen D. Krasner specifies in his article, "State Power and the Structure of International Trade," four basic state interests that determine the degree of

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29 Tallberg, Jonas, "Bargaining Power in the European Council," *Journal of Common Market Studies,* 46 (2008): 685-708. Pg. 698.
30 *Ibid.,* Tallberg. Pg. 689-690.
31 *Ibid.,* Tallberg. Pg. 694-696.

32 *Ibid.,* Tallberg. Pg. 698-702.
33 *Ibid.,* Gilpin. Pg. 24.

34 *Ibid.,* Gilpin. Pg. 24.

openness for the movement of goods: aggregate national income, social stability, political power, and economic growth. [35]While we can take these concerns to be the main driving interests of EU member states, one must also recognize that, even though they position themselves as state-centric realists, Gilpin and Krasner take a somewhat different approach in attempting to reconcile state interest and domestic politics.

The relationship between the interests projected by states into the international arena and their origin at the state level poses an analytical problem. As Peter Katzenstein put it, “The main purpose of all strategies of foreign economic policy is to make domestic policies compatible with the international political economy,” situating the context of negotiation in the framework of domestic political considerations.[36] John G. Ruggie explains in “International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order” that many states are on the one hand committed to an economic liberal order, while on the other must face trying international economic conditions and the temptation to renege on its commitments to liberal economic arrangements.[37] Although referring to economic and political conditions in 1982, Ruggie poses a final question that, if anything, seems more salient today:

> How enduring is embedded liberalism? Specifically, will it survive the current domestic and international economic malaise? A central ingredient in the success of embedded liberalism to date has been its ability to accommodate and even facilitate the externalizing of adjustment costs.[38]

After the shock of the 2008 financial crisis, as Ruggie suggests, embedded liberalism is tested by strong domestic political sentiments prompted by rapid economic decline. From this perspective,

[35] Krasner, Stephen, “State Power and the Structure of International Trade,” *World Politics,* 28 (1976): 317-347. Pg. 318.
[36] Katzenstein, Peter, ed., *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States*, Madison: University of Wisconsin Press, 1978. Pg. 4.
[37] Ruggie, John, “International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic System,” *International Organization,* 36 (1982): pg. 379-415.
[38] *Ibid.,* Ruggie. Pg. 36.

an analytical framework taking into account the international and domestic levels of international economic bargaining should provide a more nuanced account of how states' interests play out in negotiating international financial regulation.

Robert D. Putnam, a political scientist and professor of public policy at Harvard University, proposes such a framework when he writes in "Diplomacy and Domestic Politics: The Logic of Two-Level Games," that international negotiators face very real constraints from domestic politics.[39] Thus a negotiator must play a two-level game, responding to domestic interests and constraints, while minimizing the negative effects on the international level.[40] Putnam also identifies that states are most likely to find consensus where their win-sets, or the range of outcomes that satisfy the interests of a state and its constituents, overlap.[41] The two-level game approach provides an underlying framework for analysis that appropriately addresses the interests of states in the international arena and the basis of interests domestically.

Out of the literature surrounding the process of negotiating international financial regulation in the European Union, a common theme emerges in the shape of the central importance of state interests. While the 2008 financial crisis constituted a shock to the global system of economic governance, even on a regional level the issue of financial regulation faces challenges, particularly where it is linked to the issue of European integration. Literature analyzing European monetary and financial policy developments paint part of the picture in terms of the constraints state interests face internationally, but do not suggest an analytical framework for state bargaining, nor do they present possibilities for consensus. Putnam's two-level games analysis stands out from the literature because it proposes a model that reconciles the realist perception of state

[39] Putnam, Robert, "Diplomacy and Domestic Politics: The Logic of Two-Level Games," *International Organization*, 42 (1988): 427-460. Pg. 433-434.
[40] *Ibid.,* Putnam, Robert. Pg. 434.
[41] *Ibid.,* Putnam, Robert. Pg. 435-436.

interests with domestic politics and emphasizes that where these interests overlap, consensus can be found.

Methodology

With the intent of filling some gaps in the literature analyzing the intersection of state interests, negotiation, and domestic politics in the case of European financial regulation, this research asks two major questions: How are three major European actors, France, Germany, and the UK, negotiating further financial regulation? What are potential areas for consensus?

The framework guiding the analysis below generally adheres to Putnam's conception of two-level games. State interests, defined by their domestic polities, are associated with a set of outcomes that are acceptable to the executives negotiating financial regulation.

To explore the negotiation of interests further, this paper draws on the statements of finance ministers and heads of state to flesh out a better qualitative understanding of the politics of financial regulation in the European Union. Where possible, the analysis also considers the forums states use to negotiate to elaborate interests and the additional complexity of bargaining in an institutional framework. The research explores the *interests* of states and how these bear out in the character of negotiations. Therefore, as much as this is a paper about international relations, domestic factors are also important, and will be referenced when necessary. It is tempting to treat the outcome of financial regulation negotiations as a foregone conclusion; certainly conceptions of embedded liberalism and the liberal capitalist global economic order would suggest that the opening of markets is inevitable. Even if this is the case, an interest based approach to analyzing the politics of financial regulation is important because it is designed to draw lessons from the process of negotiating, not just the outcome. The intent of this research is to reach beyond conclusions of a descriptive nature, and, ultimately, to highlight useful characteristics of state demand for financial regulation that serve to clarify the process of negotiation.

The thesis tested below submits that France, Germany, and the UK's respective positions concerning potential financial regulation should reflect state interests and their ability to project preferences in the European Union and beyond. Furthermore, European integration is an issue that publicly divides the United Kingdom's interests from those of France and Germany, while opportunities to limit the costs to individual states in the event of financial market failure present real options for consensus.

Accordingly, this study's dependent variable is consensus between France, Germany, and the UK on the issue of financial regulation within the European Union. The measure of the level of consensus reached is illustrated by the extent to which France, Germany, and the UK's win-sets overlap. State interests on a spectrum from being more concerned with social welfare to more concerned with individual welfare and state preference for more or less integration comprise the independent or explanatory variables. Operationalizing the independent variables is slightly more difficult as this study does not use quantitative measures.

However, the state's tendency to promote stable economic growth and to regulate the worst outcomes of market failure suggests an orientation towards societal welfare, while encouraging private sector demand to stabilize the economy indicates more emphasis on individual welfare. Robert Gilpin makes a similar distinction in differentiating the orientations of national economies, arguing that nations may be concerned with wealth creation and much less so with its distribution, or they may choose to balance efficiency and distributional concerns.[42] Gilpin's framing of the matter, associating a greater emphasis on wealth creation with the United States and balance of wealth and societal concerns with Germany, recalls the connection between state interest and societal purpose of economy.[43]

A state's preference for further integration is qualified by its belief that significant policy actions should be taken through the European Union rather than at the domestic level, a measure that reflects Vive's argument that the issue of financial regulation is linked to European integration, and therefore is subject to debates about relinquishing domestic political control.[44] The state interests expressed on the international level are compared against domestic sentiments, quantified in a Eurobarometre conducted under the auspices of the European Commission surveying public opinion on economic governance in the European Union.[45] This extra step is calculated to underscore the extent to which state interests and domestic sentiment are intertwined, and test if bargaining between France, Germany, and the UK mirrors domestic politics.

Analysis

The analysis of state interests is divided into three sections that generally positions France, Germany, and the UK individually with respect to their positions first on the purpose of financial regulation in the context of economic priorities, and second on European integration. France, Germany, and the UK's positions are then oriented towards potential areas of consensus. Finally,

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42 *Ibid.,* Gilpin, Robert. Pgs. 150, 168.
43 *Ibid.,* Gilpin, Robert. Pgs. 150, 168.
44 *Ibid.,* Vives, Xavier. Pg. 2.

45 "Economic Governance in the European Union," *Eurobarometer 74: Public Opinion in the European Union*, January 12, 2011, accessed http://europa.eu.int/comm/public_opinion/index_en.htm.

comparing domestic sentiment to the bargaining positions expressed by France, Germany, and the UK estimates the influence of domestic politics on financial regulation negotiations.

France

A highly vocal presence in the debate surrounding financial market regulation, France's concern with stable growth, an even recovery, and taxation of the financial sector suggests that they largely prioritize social welfare. Their commitment to pursue these aims through the European Union underscores a preference for further integration. In a country whose debt as a percentage of GDP was reported at 77.6% by *The Economist*, a rate which well exceeds the standards set out in the Stability and Growth Pact (requires 60%), and that witnessed only .4% growth in the third quarter of 2010,[46] it is not surprising that France is prioritizing policy action in financial regulation that it believes will stabilize European markets and its economic growth.

In April, 2010, Mrs. Christine Lagarde, the Minister of Economic Affairs, Industry and Employment made a telling statement to the International Monetary fund, claiming that although France was making a gradual but uneven recovery, two significant risks remain, namely a jobless recovery and the damage to growth from crucial fiscal consolidation.[47] Lagarde suggests this is of even more concern if policies are not well coordinated and lack credibility.[48] France's concerns in the regulatory process are focused less on a rapid recovery from the 2008 crisis and more promoting stability. This emphasis is apparent in Lagarde's argument for implementing strong financial regulation, noting, "It is necessary to restore sustained confidence among partic-

[46] "Europe's Economies: Spreading infection," The Economist 6 April, 2011, accessed 6 April, 2011, http://www.chicagomanualofstyle.org/tools_citationguide.html.

[47] "Statement by Christine Lagarde," International Monetary Fund, accessed February 5, 2011, www.imf.org/External/spring/2010/imfc/statement/eng/fra.pdf.

[48] *Ibid.,* International Monetary Fund. Pg. 1.

ipants and lay the foundation for more robust, more stable growth."[49] In an interview with Ben Hall of *Financial Times*, Lagarde was even more specific, stating that if financial regulatory issues were not addressed head on, stimulating the economy would amount to "reshuffling deck chairs."[50] Lagarde warns the failure to institute safety nets for people to resume lending will lead to further economic stagnation. If anything, Lagarde believes that the orientation towards societal welfare in France has generated a more stable financial system, commenting, "The welfare system that we have, on which we spend a lot more public money than the UK, that's an economic model that is slightly different; that has been a bit of a shock absorber," crediting the French national economic model for inspiring a more involved response to the 2008 crisis[51]. Not only does the French response suggest the state believes financial regulation is in its interest, this interest is explicitly tied to a concern with social welfare.

Where France believes that a direct approach to financial regulation that targets stable financial markets will benefit the domestic economy, it is open to further European integration on regulatory issues if it is politically feasible and efficient. Lagarde argues that political will limits France's ambitions, indicating that despite the impetus of the 2008 financial crisis, Europeans do not want a single regulator. Hinting at the UK being one such reluctant state, Lagarde commented, "...If we have something that only applies to x per cent of the market without, for example, including the sterling market or London as a financial center...we are a little bit short."[52] The

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[49] *Ibid.,* International Monetary Fund. Pg. 2.

[50] Hall, Ben, "Transcript: Christine Lagarde," *Financial Times*, February 12, 2009, accessed, http://www.ft.com/cms/s/0/8a8dbed2-f93c-11dd-90c1-000077b07658.html#axzz1J64znuDR.

[51] Ashley Seager and Heather Stewart, "Christine Lagarde: French model on the world stage," *Guardian.co.uk*, November 6, 2009, accessed http://www.guardian.co.uk/business/2009/nov/06/france-christine-lagarde-model-stage.

[52] *Ibid.,* Hall, Ben.

French state's interest in integrating Europe under a single regulatory body suggests it believes domestic social welfare and international financial regulation to be issues that would benefit from European consensus. From this perspective, France's win-set is sizable. Although financial regulation benefits the state's priorities, further European integration would also be welcomed, providing it is politically feasible and economically sound.

Germany

Set alongside the French case, Germany provides an example where contrasting economic and social dynamics have created a similar, if narrower, set of interests. Germany supports financial regulation and its quickness to implement measures domestically reflects a prioritization of stable growth and financial discipline. The increasingly smaller groups of states it chooses to negotiate with underscores that the state is not willing to sacrifice domestic control over regulatory responses. For Germany, integration, European or global, in financial regulation constitutes a potential distraction from stabilizing the domestic economy.

Emerging as the healthiest economy in Europe, Mr. Wolfgange Schäuble, Minister of Finance for Germany, reminded the IMF that real GDP was up 2.2 percent in the second quarter of 2010, the greatest quarterly increase in GDP since German reunification, a gain that is not enough to offset the negative effects of the 2008 financial crisis.[53] Even as Germany welcomes global commitments to financial regulation, it recognizes that policy action is a domestic responsibility, and remains concerns with the negative externalities of undisciplined financial markets. Schäuble notes the imposition of a "banking fee," designed specifically to "reflect the systemic risk a financial institution poses, thus helping to internalize some of the negative externalities

[53] "Statement by Wolfgang Schäuble," International Monetary Fund, accessed February 5, 2011, www.imf.org/External/AM/2010/imfc/statement/eng/deu.pdf. Pg. 1.

embedded in its activities," an elaborate way of claiming the new regulatory feature minimizes the societal cost of institutional failure.[54] However, financial regulation will do little to address the short term sacrifices Germany intends to make in fiscal terms after the financial crisis.

The significance of Germany's intent to cut social welfare programs in the short-run is not lost upon Schäuble, who acknowledges a larger political narrative in the country: "This is little choice but to cut federal welfare spending...but this sort of fiscal consolidation can only be achieved if a majority of people perceive it as socially equitable."[55] While Germany's inability to prioritize societal welfare in the short-run presents Schäuble with a difficult political situation, it is clearly an issue that weighs heavily upon his calculations for Germany's future. So too does European integration in financial regulation, a proposition that provokes conflicted sentiments in Germany.

A German MEP Wolf Klinz summarized his country's misgivings at the ninth annual European financial services conference in 2011, musing:

> When I look at every regulatory proposal on its own, it makes sense, but when I put all of these proposals together I ask myself if we are doing the right thing... The American philosophy is boom and bust, let the horses run. In Europe, we tend to take a mid to long-term view. We are miles away from convergence, and I don't think we will ever get there.[56]

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54 *Ibid.,* Schäuble, International Monetary Fund. Pg. 3.

55 Schäuble, Wolfgang, "A plan to tackle Europe's debt mountain," *Europe'sWorld*, Autumn 2010, accessed http://www.europesworld.org/NewEnglish/Home_old/Article/tabid/191/ArticleType/ArticleView/ArticleID/21726/AplantotackleEuropesdebtmountain.aspx.

56 *Ibid.,* Turner, Matt. "Barnier reaffirms regulatory road map," http://www.efinancialnews.com/story/2011-02-10/barnier-regulation-roadmap-eu-g20.

Klinz's statement reveals deep fissures between the German conception of financial regulation and that of the American neoliberal perspective, and more generally underscores Germany's obstinate views surrounding integration.

European integration of financial regulation is attractive to Germany where it is politically expedient. Otherwise, Germany seems determined to implement regulation independently. Schäuble's promise of progress on common plans for governance of the euro zone in September 2010 only referenced discussions with France.[57] Donald Tusk, the Polish prime minister summarized a growing resentment towards Germany and France's economic leadership in the EU, asking at the unveiling of the recent "competitiveness pact" between eurozone members, "Why are you trying to show divisions? Are we getting in your way? You are humiliating us."[58] However, the leaders of eurozone signaled their intent to move forward, with the 17 eurozone leaders staying behind to discuss competitiveness while Prime Minister David Cameron of the UK went home.[59] Mrs. Lagarde's observation on Germany that, "You can't ask one player, as big as it is, to pull the whole group. But clearly there needs to be a sense of common destiny that we have together with our partners," epitomizes the country's conflicted status in the European Union.[60] As much as Germany's recent economic leadership has had positive effects for the region, there is a sense that the rest of Europe is being pulled along, regardless of their particular interests.

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57 Peel, Quentin, "Berlin stands by budget cut plans," *Financial Times*, September 14, 2010, accessed http://www.ft.com/cms/s/0/19848806-bff1-11df-9628-00144feab49a.html#axzz1J64znuDR.

58 "The Divisiveness Pact," Charlemagne's Notebook, *The Economist*, http://www.economist.com/node/18330371.

59 *Ibid.,* Charlemagne's Notebook.

60 Hall, Ben. "Lagarde criticises Berlin policy," *The Financial Times,* March 14, 2010, accessed March 14th, 2010, http://www.ft.com/cms/s/0/225bbcc4-2f82-11df-9153-00144feabdc0,s01=1.html#axzz1FxL7qS4Y.

In this sense, Germany's win-set appears to be substantially smaller than that of France's, as the state is interested in negotiating only to the extent it seems fairly sure of imposing its preferences on others. The cost of the international financial crisis was felt bitterly in Germany. Now the state is responding by prioritizing stable economic growth even if it means leaving some European partners behind.

The United Kingdom

The UK's interests in financial regulation are somewhat limited. Policies instituted thus far suggest that the state does not believe the structure of international finance is in need of reform. Emphasis is placed on the role of the private sector in ensuring the economic growth of the UK, underscoring the state's reluctance to entangle itself more than absolutely necessary in the financial recovery, which it believes was largely the result of poor individual decision-making rather than unsatisfactory economic governance. To that end, the UK has little interest in further integrating with the European Union on the issue of financial regulation, preferring to take domestic policy action to maintain London's status as an international financial center and distancing itself from potential policy limitations it associates with coordination with the European Union.

As the UK works towards restoring confidence in its financial system, it is keen to dissociate the British financial system with the root causes of crises, arguing that individual mistakes worsened financial market failure. Alistair Darling, Chancellor of the Exchequer, was skeptical of the utility of structural change, postulating, "Changing the architecture will not make any difference unless you people with the right skills in place."[61] This position puts Darling at odds with Lagarde, who says of the UK philosophy of financial regulation, "My sense is that you cannot kick-start the economy if you do not fix the financial sector. The economy needs credit to flow," citing this reason and the UK's lesser focus on social welfare programs as major reasons why the country's financial recovery fell behind France's.[62] Darling, however, voiced his greatest fears for the British economy in an editorial for *The Times*:

> As Michel Barnier, the new EU single Market Commissioner takes over the reins of financial regulation, the stakes are high... If we get it right, we have the potential to be the safest and strongest marketplace in the world...Get it wrong and we risk losing business to less regulated jurisdictions. Nothing would be more self-defeating.[63]

The chancellor's observation is succinct. Financial regulation represents a means of making the European marketplace more attractive. However, if regulation is instituted in a way that stifles London's role as an international financial center, as Darling fears, investors may flee Europe.

Thus the central concern for the UK if the EU integrates further on the basis of financial regulation is that policies are not overly restrictive, an outcome the UK cannot be sure of because its role in the EU is shrinking even as its economic priorities differ substantially from those of France and Germany. The categorization by one observer in *The Economist's* "Charlemagne's Notebook" of the UK as one of the "out" countries in Europe, a category shared by Sweden, Poland, and Denmark, refers not just to its status outside the eurozone, but its general passivity in the organization.[64] As the author notes, this would really be of concern if not for the history of policies adapted by smaller groups in Europe being projected on a larger scale. At a press con-

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[61] "Q&A: Osborne's financial regulation reforms," *BBC News*, June 17, 2010, accessed http://www.bbc.co.uk/news/10343900.
[62] *Ibid.,* Ashley Seager and Heather Stewart.
[63] Darling, Alistair, "A strong City is not just in Britain's interests," *The Times*, December 2, 2009, accessed http://www.timesonline.co.uk/tol/comment/columnists/guest_contributors/article6939781.ece.
[64] "Can Angela Merkel Hold Europe Together?" Charlemagne's Notebook, *The Economist*, http://www.economist.com/node/18330371.

ference at the end of the G20 summit in Seoul on 12 November 2010, a reporter asked of British Prime Minister David Cameron:

> You were talking about Britain's role in the world, and I appreciate that at the last G20 Britain held the chairmanship, so they made a difference, but your role here seems to have been more peripheral than Gordan Brown's role. Britain doesn't seem to be at the centre of things in quite the same way. You've been to China, picked up some trade, but nothing like as much as France just did. You go back to country where there are cuts in everything, including defense. Are we watching Britain's international role shrink before our eyes?[65]

Indeed, the ability of the UK to influence international proceedings seems to be deteriorating in spite of its stature as a center of international finance, a reality that decreases its interest in integrating itself further with Europe.

The British executive perceives its newfound insignificance in the international economic governance debate as a boon for domestic policy making. When pressed on the spillover effects of the economic crisis in Ireland, Mr. Cameron responded:

> What I'd say about the Irish situation as opposed to the United Kingdom's position is obviously there is one key difference, which is that we are not members of the Eurozone. And...one of the reasons I never wanted to join the Euro is I believe that one currency for Europe is very inflexible; it means one interest rate for Europe, and actually I think there are times when different countries need different monetary policies, different interest rate policies.[66]

It is not just the eurozone and European monetary policy with which Britain wants to distance itself. Although the Prime Minister was responding to questions about the G20 process, one question lingered on a possible EU budget freeze, an outcome that Mr. Cameron suggested would be perfectly acceptable.[67] This sort of disillusionment with increased European economic

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[65] "PM's press conference at G20," accessed http://www.number10.gov.uk/news/speeches-and-transcripts/2010/11/pm-press-conference-at-g20-56955.

[66] *Ibid.,* "PM's press conference at G20."

[67] *Ibid.,* "PM's press conference at G20."

union underlies a very real concern that the rest of Europe is not closely aligned enough with British interests for further integration to be politically acceptable.

Of France, Germany, and the UK, the British win-set is smallest, because unlike France and Germany, they do not associate the problem of financial regulation with a need for structural change nor further European integration. The UK also seems less concerned with the negative externalities of financial market failure, identifying the inability to adequately respond to such failures as a problem of finding suitable individuals to direct finance, as opposed to a larger threat to social welfare.

The interests of France, Germany, and the UK surrounding international financial regulation are somewhat diverse because they reflect a diverse range of perceptions of the consequences of international financial market failure in the domestic economy and varying enthusiasm for the issue of international financial regulation to be part of the conversation on further European integration of economic governance. Despite a range of interests, European leaders continue to return to the subject of financial regulation in public forums, suggesting there is some belief that consensus can be reached. To identify potential areas for consensus it is necessary to orient state interests with one another suggesting where win-sets overlap.

Orienting Interests

The following section orients state interests to the extent the reflect the two factors analyzed above: towards social welfare or towards individual welfare, and towards more, or less, integration. Identifying how closely interests align in these terms is of importance because it points to where areas of consensus can be found and how politically acceptable an agreement is within the framework of domestic politics.

Sorting out interests in regulatory policies has the potential to be a messy business, however, the Hix-Lord model and the Hooghe-Marks model for integration provide a basic framework that can be elaborated to orient the interests of France, Germany, and the UK towards potentially larger social purposes.[68] The analysis in this section serves to associate the expression of state interests in negotiation with broader societal goals. Although states may move along the spectrums below depending on the particular issue, orienting the state interests discussed above within several models adds some clarity to the regulatory debate.

Marks and Steenbergen propose a powerful analytical question in their book, *European integration and political conflict*, "To what extent, we ask, do the issues arising from European integration hang together as a single dimension, and to what extent is this dimension (or dimensions) connected to existing structures of conflict," one which is worth reprising here in order to nuance understanding of European positions on financial regulation.[69] The first model, the international relations model, places actors along a horizontal axis, positing a spectrum from less integration, and thereby defending national sovereignty, to more integration, promoting supranational governance. However, more complex dimensional models provide more analytical insights. The Hix-Lord model represented below, refers to how political actors define themselves within the domestic arena, shifting integration to the vertical axis and representing "right" and "left", or the organization of resources into functional political groups, on the horizontal axis.[70]

68 This section draws a great deal of inspiration from the state priorities laid out by Robert Gilpin in *Global Political Economy*, where he suggests that states prioritize three larger societal aims: national security, social welfare, and individual welfare.

69 *Ibid.,* Gary Marks and Marco R. Steenbergen, *European Integration and Political Conflict*, Pg. 3.

70 *Ibid.,* Gary Marks and Marco R. Steenbergen, *European Integration and Political Conflict*, Pg. 7.

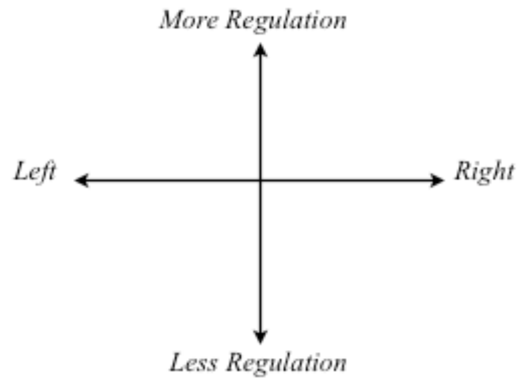

Figure 1.1

After modifications from George Tsebelis and Geoffrey Garrett, the left and right in figure 1.1 also represent regulatory preferences that follow the structure of domestic politics, with left associated with high regulation, while the right associated with low regulation.[71] Hooghe and Marks utilize this regulatory model to suggest regulated capitalism should appear in the upper left quadrant, while neoliberalism should appear in the lower right quadrant.[72] [73] For the purposes of this research however, regulated capitalism and neoliberalism reflect larger narratives expressed on the state level in preferences for varying forms of regulation, and ultimately, economic governance. In fact, a broader model as expressed in Figure 1.2 might better suit analytical purposes on the state level, associating priorities that more or less correspond to the political structures of right and left. Adopting simple Venn diagrams visually stresses the size of win-sets and more clearly shows where state interests have the most possibility of intersecting.

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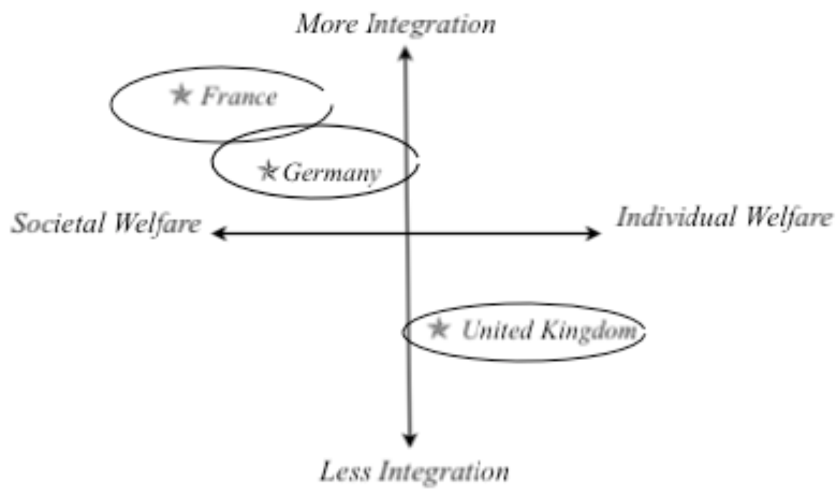
71 *Ibid.,* Gary Marks and Marco R. Steenbergen, *European Integration and Political Conflict*, Pg. 7-8.
72 The structure of domestic political politics is elaborated more fully in Marks and Steenbergen's book, cited above.
73 *Ibid.,* Gary Marks and Marco R. Steenbergen, *European Integration and Political Conflict*, Pg. 9.

Figure 1.2



The model proposed above attempts to follow the specific analysis of state interests presented in the country specific portion of this essay, identifying the multidimensional directions that interests may take. For example, Germany’s moves towards financial regulation with or without the European community as a whole suggests a position that is oriented first towards societal welfare through stabilizing markets and working towards stable economic growth, although as German ministers have iterated, greater integration would also be preferable. France, more openly interested in social welfare, has shown greater resolve in instituting regulation through the European Union, moving it further towards the more integration dimension than Germany. The UK can be associated with a more individual welfare and less integration concerned position, as it seeks to distance itself both from the types of regulation proposed by France and Germany and the constraints of further European integration. There is no overlap portrayed by Venn diagram on the UK’s part in this diagram, largely because it differs from its partners on the form and intent of regulation as well as the degree of integration that is acceptable. Nevertheless, these states are not so stratified along these axes that consensus is impossible. Certainly the positions of France and German indicate promise for consensus, just as their behavior in the international arena indicates. A negotiator taking the step to compromise could shift the constraints of a given actor's win-set outward.

Where interests can be identified, negotiations take on a deeper character as they hint at societal preferences informing states' positions. Orienting the interests ascribed to France, Germany, and the UK by this research is not only useful in this regard; the discussion of the models above presages the question of domestic interests and public perception, an aspect of the financial regulation debate that provides its own intricacies.

Domestic politics and public perception

Establishing a connection between the positions espoused by states at the executive level and domestic sentiment surrounding the same issues illustrates a close relationship between state interest and societal purpose. Where states position themselves in the international financial regulation debate tends to reflect domestic sentiment, measured in this study by the survey of public opinion in the 2010 Eurobarometer. Certainly the results below are not definitive, but they are an essay into better exploring the entanglement between international bargaining and domestic politics on the issue of financial regulation in the European Union.

The November 2010 survey coordinated by the Directorate-General for Communication for the European Commission gauging public opinion in the European Union on the subject of economic governance reveals that the divisions present at the state level exist domestically as well.[74] The report is specifically targeted towards the EU's governance following the onset of economic crisis, consisting of "a selection of questions relating to the present financial and economic crisis, governance measures to exit the crisis, measures to improve governance of the financial markets and the perceived role of the various global actors," essentially gauging European opinion on governance at a time when, as the report remarks, member states find themselves in very different economic situations.[75] Viviane Reding, the Vice-President of the European Commission commented on the overall significance of the survey, claiming, "...We now have a chance to shape European economic governance, as favoured by EU citizens, so that Europe can help address their concerns," reflecting document's overall design to ensure societal preferences are represented at the supranational level.[76] The numbers drawn from the poll are an interesting attempt to quantify interest in financial regulation in the European Union.

Survey data first supports the argument that the UK prefers different financial regulation than the structural measures set forth by France and Germany. UK residents were the least impressed with proposed regulatory measures to combat future crises, with only 51% deeming these to be effective, compared with 75% in the euro area.[77] These figures mirror the UK's greater confidence in domestically conceived regulatory measures compared to France and Germany. Ultimately, 82% Europeans surveyed wanted the European Union to play a larger role in financial

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74 "Economic Governance in the European Union," *Eurobarometer 74: Public Opinion in the European Union*, January 12, 2011, accessed http://europa.eu.int/comm/public_opinion/index_en.htm.
75 *Ibid.,* "Economic Governance in the European Union," Pg. 4.

76 Press release for the Europa, the official website of the European Union, Brussels, August 26, 2010, accessed http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/1071.
77 *Ibid.,* "Economic Governance in the European Union," Pg. 12.

market regulation, with the UK again defying larger European trends with 65% in support.[78] These numbers correspond fairly well to the divisions playing out at the national level. One might expect fewer Britons to be in support of a larger EU role in financial market regulation when confronted with specific regulatory measures, although this could hold true across Europe.

The data also suggests that the UK is divided from France and Germany in terms of the extent to which it is willing to integrate economic governance. When faced with the question of which entity is best placed to take action against the effects of the crisis out of the EU, national governments, the International Monetary Fund, the G20, the United States, or other, respondents in France and Germany ranked the EU as being the most capable institution.[79] However, respondents outside the euro area tended to prefer their national governments, particularly in the United Kingdom, a tendency that was strongest out of any member state surveyed at 40%.[80] These trends are parallel to the corresponding state preferences for international financial regulation, with France and Germany leaning towards the European Union as the most appropriate institution for responding the crisis, while the UK prefers greater domestic control.

As a brief aside, the survey raises the possibility that economic governance could be pursued through the G20 or the International Monetary Fund, options that attracted a nearly insignificant number of respondents and are politically unrealistic. Indeed, even as states negotiate in the context of these forums, it is questionable whether they can be stages for political action. The finance ministers of France, Germany, and the UK cast the IMF in a surveillance and lending role

78 *Ibid.,* "Economic Governance in the European Union," Pg. 12.

79 *Ibid.,* "Economic Governance in the European Union," Pg. 10.

80 *Ibid.,* "Economic Governance in the European Union," Pg. 11.

in their previous statements to that institution.[818283] The capacity of the G20 for actual policy action is questioned elsewhere. As David Gordon of the Eurasia Group remarked to National Public Radio's "Planet Money" podcast, the world faces the risk of a G0, or an interim world in which there is not sufficient leadership for useful collective action after too many players inconsequential players are invited to negotiate, and dominant state's economic dominance recedes.[84] The movement from the G7 all the way to the G20 back to the G2 between China and the United States seems to evidence this. At this juncture, the G20 appears much more as a platform for states to make positive, but largely substance-free, exchanges concerning the future of economic governance.

Survey results mirror to a surprising extent the positions projected by France, Germany, and the UK in the international arena. British sentiment in particular aligns largely with the state's positioning in international negotiations, an outcome that might be at least partly due to the Cameron government's recent election four months before the completion of the survey, leaving a party in power that, at least for now, represents the majority opinion in the UK. However, public sentiment in France and Germany also mirrors state positions, suggesting that a government hardly needs to be new or popular for domestic opinion to sympathize with its policy objectives in the financial markets, particularly in the case of Mr. Sarkozy, who is quite unpopular.[85] State

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81 *Ibid.,* Lagarde, "International Monetary Fund," Pg. 3.

82 *Ibid.,* Darling, "International Monetary Fund," Pg. 2.

83 *Ibid.,* Schäuble, "International Monetary Fund," Pg. 3.

84 "The Friday Podcast: G-Zero," narrated by Adam Davidson, Planet Money, *NPR*, January 7, 2011, http://www.npr.org/blogs/money/2011/01/28/132742511/the-friday-podcast-g-zero.

85 Recent polls of local elections in France project Mr. Sarkozy's center-right UMP to garner 16% of the vote according to *Al Jazeera,* March 21, 2011, (accessed http://english.aljazeera.net/news/europe/2011/03/2011320201422453610.html). Martine Aubry, the leader

interests, therefore, appear less malleable than the make up of the state's government, hinting that state interests are related to a more basic societal direction of purpose that short term changes in the balance of domestic politics do not necessarily affect.

The embodiment of social purpose through state interest at the international bargaining level provides some insight for the difficultly with which states negotiate financial regulation. In the context of different social priorities for economies, and varying interpretations of what it means for a state to regulate and possibly even integrate financial markets, the international relations of France, Germany, and the UK take on added character and complexity.

Conclusion

Bargaining between France, Germany, and the UK on the issue of financial regulation in the European Union is a case through which this paper explores the intersection between state interests, international negotiations, and domestic politics. The 2008 financial crisis opened an international debate on the future of economic governance, recognizing that current systems, whatever their form, are still prone to unpredictable and damaging failures. Financial regulation in the European Union stands out from a plethora of other issues because it presents a case of a group of states, who have agreed to economic and some political integration, that have made little progress in coming to terms on the purpose and extent of financial regulation or the resulting implications for European integration. On the other hand, consensus on the issue of financial regulation presents Europe the unique opportunity to project an image of stability and prosperity globally.

of the Socialist Party and projected winner of the local polls, had this to say, "Tell Nicolas Sarkozy that we no longer support the impasse down which he's taking the country, which is an economic and social impasse..."

This paper proposed that states will negotiate based on their interests, and to the extent that they are able to project their preferences within the European Union and internationally. The position that European integration is an issue that publicly divides the United Kingdom's interests from those of France and Germany, while opportunities to limit the costs to individual states in the event of financial market failure present real options for consensus is also advanced. Taking a perspective that privileges state interests and situates them in the two-level game framework proposed by Putnam, these predictions largely bear out in analysis. France, Germany, and the UK have expressed strong interests to each other within the context of the European Union and institutions like the International Monetary Fund. A significant amount of disagreement between the states is derived from differing perceptions of what international financial regulation in the European Union means for European integration. The UK especially diverges from French and German interests, remaining wary not only of further integration, but also the potentially negative effects pan-European regulation might have on its prominent financial sector. Germany's narrow focus on economic recovery also presents challenges to negotiation. Nevertheless, each state has expressed concern with the various costs that financial market instability has the potential to incur, and out of this mutual apprehension one can draw more encouraging prospects for consensus.

Orienting state interests in terms of domestic political structure and social priorities for economies in the case of financial regulation attempts to elaborate the entanglement between international bargaining and domestic politics espoused by Putnam and other influential voices in the field of international relations. The relationship between state interests and domestic political sentiment is further explored through a Eurobarometer poll of public opinion in the European Union. Analysis of the survey's results reinforces the positions of France, Germany, and the UK in the financial regulation debate proposed in the first section of analysis, and lends credence to the suggestion that these interests are steeped in their respective society's purpose for economic activity.

Drawing on the relationship between state interest and domestic considerations, this research enters into conversation with the field of international relations where the entanglement between international and domestic politics is subject to further debate, and where it needs clarification. Indeed, further research and analysis in this area is much needed in the field of international relations, because such entanglements come to the basic issue of how states bargain with one another. While this paper presents a case in which the domestic polity appears to weigh substantially upon international negotiations, it is not a definitive study. Even as further research is required more broadly into the behavior of states, this research raises some further questions concerning the specific relations of states in the European Union.

Even within discussions limited to financial regulation, the extent to which France, Germany, and the UK's perspectives on the utility, purpose, and implications of financial regulation varied was surprising. In particular, the UK's peripheral influence on bargaining and Germany's willingness to exclude such an important actor in negotiations raises the question of whether Europe's division between states in the monetary union and those outside has fundamentally altered the interests that once brought European states to the negotiating table. Forecasts of the dissolution of the monetary union following the 2008 financial crisis seem dramatic if we examine how closely France and Germany, the two major actors in the arrangement, have proved willing to work on economic governance. Yet a growing sense of disillusionment is visible in fits and starts between the central European monetary union and its periphery, a souring in relations that deserves serious attention. The negative association that the UK manifests in its linkage between a

European brand of regulation and further European integration is a further symptom of this malaise.

Further understanding of state interests, bargaining, and domestic politics works towards improving relations between states, and as a consequence, betters global realities. The intricacies of the relations between states and the niggling question of domestic politics should continue to inspire and inform work in the field of international relations.

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