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## Comment on Paola Palminiello/2. Playing Europe. Critical Remarks on Palminiello's Non-Circular Explanation of the European Monetary System

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## Comment on Paola Palminiello/2

Playing Europe.

### Critical Remarks on Palminiello's Non-Circular Explanation of the European Monetary System

by Antonino Palumbo

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Although dissatisfied with rational choice explanations of institutional change, Palminiello [2016] is keen to retain their underlying methodological individualism and arrive at a non-circular alternative. To this end, she retrieves an evergreen of heterodox game theory, Schelling's *The Strategy of Conflict* [1960], and proposes a revised version of the bargaining games analysed there. The outcome is a threefold typology of bargaining situations that she uses to analyse the evolution of the European Monetary System (EMS) and assess competing readings of that process. This is in a nutshell the structure of the paper I'm going to comment upon, a task I undertake very sympathetically because I am myself interested in a similar theoretical enterprise, though in my case the object has been the set of institutional and political changes which brought about new modes of governance [Palumbo 2015]. My comments will, however, be very tentative, because I found parts of the discussion unclear, even after many readings (which have made my dissatisfaction with the paper increasingly greater).

The first section of the paper highlights both the epistemic virtues of individualistic and subjective explanations (compared to holistic and functionalist alternatives), and the shortcomings of rational choice explanations of institutional change. In the latter case, the discussion concerns the rationality of pre-commitments (threats and promises), which are often used inconsistently with the methodological tenets required by sound individualistic explanations. In Palminiello's words:

Agents who have no incentive to behave in a specific way, don't have any incentive to give themselves that incentive either. Indeed, the idea that they might succeed in pre-committing derives from the illegitimate introduction of a kind of rationality that is quite different from the subjective one of rational-choice theory [Palminiello 2016, 8].

In other words, cooperative equilibria or efficientist solutions are often selected because the analyst surreptitiously attributes to the players an inbuilt bias towards Pareto optimal solutions, making them akin to impartial observers rather than individual agents vying against each other. The paradoxes of interdependent strategic decisions are, therefore, avoided at the cost of incoherence. Gauthier's [1986] constrained maximisation strategy is the most well-know and discussed example.

While personally sharing the same misgivings of the author, I'm not at all convinced by her attempt to apply this criticism to a set of works that employ the two-level game logic first suggested by Putnam [1988]. Among Palminiello's targets is in particular Vreeland, whose work on the good governance programme of the IMF I find very compelling, especially the version contained in his 2003 book (reproposed again in 2007) not referred to in Palminiello's essay. Vreeland's work is an empirical attempt to evaluate the effectiveness of the good governance approach for economic development. The main aim of the study is to find out the statistical relevance that unobserved factors could have in affecting the economic growth of the countries taking part in IMF's structural adjustment schemes. Among the unobserved factors that contribute to the success/failure of those schemes, one of the most important is, according to Vreeland, the willingness of a government that enters into them to stick to the conditions imposed. The identification of this unobserved variable leads Vreeland to focus on the question of selection: why do governments and IMF enter into agreements? And even more puzzling, why do they do so when it is clear that IMF schemes hurt economic growth?

The political decision to call in the IMF takes place within a domestic context populated by a plurality of sub-national state actors having their own sets of interests. In addition, this context is characterized by constitutional rules establishing adversarial relations among them. Particularly relevant is the relationship between legislative and executive bodies mandated by the liberal conception of the separation of powers and the attendant system of checks and balances. In this context, transnational bodies like the IMF and their programs represent an opportunity for some sub-national state actors to alter the domestic balance of power in their favour. By calling in the IMF, the executive has the power to either shift the burden for the looming crisis on the legislative, or enhance its authority *vis-a-vis* the legislative, or even both (and likewise can be said about the ministers seating around the govern-

mental table). Moreover, the burdens of the structural adjustments imposed by the IMF are born by some domestic constituencies rather others. Hence the support those policies manage to get among the constituencies unaffected or which expect to benefit from them either directly or indirectly. This strategic dimension means that at the bottom of the selection process there is a degree of domestic discretionality that makes the decision to call in the IMF very seldom compulsory; that is, due to hegemonic imposition by an external superpower or systemic competitive dynamics promoted by globalising markets. According to Vreeland's findings, in the sample analysed in his work, domestic political considerations systematically trump coercive pressures from without.

I find this political explanation particularly illuminating and fully consistent with the subjective types of explanations sought by Palminiello. Also, by disaggregating the state and attributing to distinct subsets of state actors conflicting preferences, Vreeland reverses the logic of the two-level game used by Putnam and makes the actions of each subset purely self-seeking. I have read the passages of the essay in which Palminiello charges Vreeland with inconsistency countless times and repeatedly failed to understand her reasoning [2016, 10].

The point is important because Palminiello's bargaining model seems, in the end, to be based on a two-level game pretty much like the one described by Vreeland, but not as well defined and therefore far less convincing. Indeed, it is not clear why the author insists in labelling them bargaining games when in reality she is using a different type of non-cooperative situations identified as mixed-motive games – strategic contests that produce a blend of coordination and cooperative problems. At one point, Palminiello notes the difference and spells out that, of the two main aspects of her bargaining games, only the second is “made explicit by Schelling” [*Ibidem*, 13]. In reality, Schelling [1960] explains quite clearly why he is concerned with bargaining games (discussed in chapter two) rather than mixed-motive games (which he discusses in chapter three). Unlike the traditional bargaining games considered by Schelling, the mixed-motive games chosen by Palminiello are not concerned with the splitting of given amounts of money, but with the establishing of cooperative schemes. This in effect means linking efficientist and distributive questions; elements that Schelling tries to keep separate to concentrate his attention only on the logic underpinning distributive issues – i.e. how we can divide a cake none of us contributed to make but received as a gift.

Since Palminiello blames rational choice explanations of institutional change for using efficientist arguments inconsistently with their own methodological tenets, I would have thought that the main reason for retrieving Schelling's approach to bargaining was indeed that. Evidently not. In addition, the situation discussed by

Palminiello turns out to be repeated  $n$  person games, with  $n > 2$ , where moves are not made simultaneously. The strategic settings identified by these conditions are, in my opinion, qualitatively different from those discussed by Schelling, and I'm therefore not convinced that his considerations about the strategic role of threats and promises apply to this class of games. In fact, the type of interactions analysed in the third section of the essay refers only to binary encounters, where  $n = 2$ , and the discussion concerning threats and promises to be found there is pretty superficial. But on this later.

In section two, Palminiello presents a typology of "bargaining" situations whose analytical structure I found puzzling. The author first distinguishes between i) "devising and adopting a cooperative scheme" and ii) "choosing between alternative cooperative schemes" [Palminiello 2016, 14]. To start with, I'm not convinced about the relevance of this distinction. To me this distinction would make sense, analytically speaking, if she wanted to distinguish between 1) the act of "founding" a new cooperative scheme from 2) the act of "joining" an already established cooperative venture. Otherwise I don't see the point of making it; and in fact in the rest of the paper this distinction doesn't play any role at all, insofar I can understand it.

Situation *ii*, "choosing between alternative cooperative schemes," is divided into two main occurrences: *a*) cooperative schemes where there is agreement on their ultimate goals but serious disagreement about the means required to achieve them and, vice versa, *b*) cooperative schemes where there is agreement on the means to employ but disagreement about the goals to pursue. I found this distinction sound, even if not analytically complete. To make it analytically complete, I would have added two further alternatives: *c*) cooperative schemes where there is agreement on both means and goals and *d*) cooperative schemes where there is disagreement about both means and goals. Thus, to me the correct general scheme should either have a total eight typologies (if the first distinction between situations *i* and *ii* is retained), or only four of them (in case this [redundant] distinction is dropped).

I found the rest of section two (that is, the description of the analytical features that characterise the three types of bargaining games identified by the author) quite confusing and remain uncertain about its actual relevance for understanding section three. Given the nature of the games discussed, all considerations made about search for truth, the real or apparent veracity of the reasons given to the counterparts and the need of voting mechanisms are, insofar I can see, not that relevant for the account of the negotiation process proposed next.

The first strategic contest identified here, bargaining over a cooperative scheme (which in my revised four-fold classification would overlap with *c*, agreement on both means and goals), describes a genuine bargaining game in which redistributive

questions are all that matters. The other two (corresponding to types *a* and *b* are mixed-motive games, which in the third case (corresponding to *a*) looks like a Chicken Game. I reach this conclusion because Palminiello states that, in this strategic contest:

There are at least two possible solutions: each side definitely prefers its own to the other side's one; however, since it also prefers cooperating in the way chosen by the other party rather than not cooperating at all, it is also willing to give up. Which solution will be chosen is decided by the party that is better able to communicate its own choice to the other in a credible manner [*Ibidem*, 20].

I have discussed the structure of this class of games and their interests for philosophically minded game theorists at length elsewhere [Palumbo 2000, chapter 4], and do not have enough space here for summarising that discussion.<sup>1</sup> My conclusion is that the cooperative schemes generated by Chicken Games are evolutionary stable if, and only if, they satisfy strict conditions (Locke's provisos) which are very improbable to be met within human ecologies (as opposed to wildlife ecologies where interaction is between and within animal species). Technically, Chicken Games have three Nash equilibria, two in pure strategies (the ones mentioned by Palminiello) and one in mixed strategies (not considered by the author). But it is only the latter the equilibrium solution for any game played symmetrically and anonymously. This means that any interaction structured as such will, alas, produce something resembling Hobbes' state of nature: a strategic contest where cooperation is just a matter of chance and remains, therefore, very fragile when the game is repeated overtime. This theoretical result has epistemic implications for any attempt wishing to avoid such a dismal conclusion by modifying the conditions of symmetry and anonymity (Palminiello included), for those attempts can always be blamed for using *ad hoc* solutions.

As mentioned earlier, in discussing the establishment of the EMS, Palminiello employs a two-level-game and uses the logic underpinning this game to cast doubts on alternative accounts. Here is the textual evidence:

Gradual convergence on low inflation rates [...] on the part of the less stable countries was a result [...] of two subsequent negotiations: of the external one on the exchange rate system, [...] but also a negotiation internal to each of the high inflation countries [...]. From this perspective, the 1987 Basel-Nyborg agreement could be viewed as a sort of promise made by Southern countries to Germany to comply

<sup>1</sup> In that work I discuss a variety of mixed-motive games and find all of them problematic whenever used to explain the evolution of cooperation in the Humean settings, as proposed by evolutionary game theory. This means that even if I'm wrong in identifying what Palminiello's has in mind with a Chicken Game, the strategic problems discussed here concern the wide class of mixed-motive games and will not easily disappear by using another member of that class. In that same work, I show that Hume's theory is based on a rule-utilitarian approach and not a direct utilitarian model, as claimed by Palminiello [2016, 17, footnote 35].

with the cooperation rules always preferred by the latter, in return for an increase in exchange opportunities [Palminiello 2016, 21].

As to the strengthening of the EMS in 1987, one should then see it [...] as the outcome of twofold bargaining: the above-described bargaining (of the third type) within each of the countries previously characterized by high inflation rates, and a European negotiation between parties moved by then by the same objectives (a bargaining therefore of the first type) [*Ibidem*, 25].

As in Putnam, we are dealing with a game played at two distinct levels: at the transnational level, wherein state members are called to choose between two alternative financial reforms (one proposed by France and the other by Germany), and at the domestic level, wherein national governments are supposed to decide which camp to side with (where the game involves trade unions and entrepreneurs). The presentation of the alternatives proposed by Palminiello tells us that the French plan was premised on the priority of full-employment policies above inflation reduction, while the German plan supported a reversed set of priorities. We are also told that the French plan would have benefited the high inflation countries, whereas the German plan was more congenial to high productivity countries. Since the structure of interaction at both levels is a Chicken Game, the question is then why in the end it was the German plan that won the day, and why high inflation countries like Italy chose to support it against their national interest.

The criticisms moved against the notion of pre-commitment in section one notwithstanding, the explanation advanced by Palminiello relies on the adoption of pre-commitments. In disagreement with rational choice readings which attribute to the Italian government the adoption of a pre-commitment to resist the pressures coming from the trade unions, her account attributes the crucial pre-commitment to Germany, which communicated effectively to the French counterparts her unwillingness to even consider their own plan. However, Germany was willing to make the implementation of that plan flexible by leaving any decision about its application to national governments. In Palminiello's account, France accepted the revised German plan because she preferred cooperation with Germany above else, and viewed the revision offered as a sufficient guarantee for retaining national autonomy. Similar reasoning was replicated within high inflation countries like Italy, where the entrepreneurs sided with the revised German plan, and the trade unions acquiesced to it for reasons analogous to those of the French government. Hence the success of the revised German plan concerning the EMS.<sup>2</sup>

<sup>2</sup> Omitted from this reconstruction are Palminiello's qualifications of the two interlinked games by using the typology presented in section two. According to the author, the transnational game between France and Germany is a bargaining game of type *i*), whereas the domestic game is of type *iii*). I'm

As Schelling's 1960 discussion shows, given their basic symmetry a pre-commitment of the type adopted by Germany could have been neutralised by an identical pre-commitment assumed by France. Why did France decide against assuming a similar pre-commitment and accept to believe that the German threat was credible? The answer given by Palminiello seems to be: "Because Germany managed to communicate that threat better than France." How are we going to prove that this explanation is the correct one, rather than a *post hoc* rationalisation? I don't think Palminiello's account has the resource for rejecting any such accusation. This is, in part, because she presents the game played at the domestic level as reactive to the game played at the transnational level between France and Germany. Once it is clear that the Germans will not be moved and the French are willing to accept the revised plan, the structure of their preferences dictates that (Italian) trade unions play Chicken as well, rather than being excluded from new cooperative scheme altogether. I don't find the symmetry between French government and (Italian) trade unions convincing, for, unlike the former, acceptance of the German plan by the latter is inconsistent with their self-interest no matter what. What explains the willingness of the French government to play chicken?

My impression is that if we try to answer this question consistently with game theoretical tenets, we need to retrieve the version of the two-level-game used by Vreeland. From this perspective, accepting the revised version of the German plan results acceptable to the new centre-right French government because this gives it the opportunity to reinforce its positional power *vis-a-vis* its domestic competitors: Parliament, trade unions and even the business community. By accepting the revised German plan, the French government would acquire full discretion about whether to apply it in practice and could play trade unions and entrepreneurs against each other. At the same time, responsibility for the economic consequences of its choice could be easily shifted on to antagonistic internal coalitions (for pressing in a contrary direction) or on supranational institutions (for imposing restrictive measures in the first place). Obviously, this reasoning can be replicated by all other governments of high inflation member states facing similar internal challenges. The German pre-commitment has in this way causal force not because of its credibility, but for the opportunity

omitting them because I found the discussion on the point very confusing. Given the information supplied by the author, in my opinion both games are of type *iii*): there is a general agreement about the goal (financial stability) and a serious disagreement about the means for achieving it. For, the French plan suggested "that fluctuation margins be set according to the average trend of the Community currencies given their weights as fixed by the Ecu basket, instead of in terms of bilateral parities." And the same applies to the domestic debate in Italy.



it offers to all potential backers of the French plan; trade unions, instead, do not get any benefit by going along with it.

The same cannot be said about the French plan, because it is based on criteria that are opposed by high productivity countries and do not boost the power of their governments *vis-a-vis* their internal competitors. To make the situation with Germany fully symmetrical, France should have pre-committed itself in the same fashion as Germany and offered its counterparts (high productivity countries) similar flexible clauses. In that case the outcome could have been a stalemate, due to the fact that in this situation the mixed-equilibria strategy becomes the only rational course of action.

Besides the rescue of Vreeland's explanation from the charge of being inconsistent, the point I want to make is that, as it is, it is Palminiello's account that risks falling into the inconsistencies she imputes to others.

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## Comment on Paola Palminiello/2

Playing Europe.

### Critical Remarks on Palminiello's Non-Circular Explanation of the European Monetary System

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Abstract: Palminiello claims it is possible to overcome the shortcomings of rational choice accounts of European integration and arrive at a better and more coherent alternative. To this end she proposes a spectrum of bargaining games derived from Thomas Schelling's pioneering studies. This commentary takes issue with some aspects of the bargaining games used by Palminiello to arrive at a non-circular explanation of the European Monetary System. First, it claims that her description of the negotiation process resembles a two-level chicken game rather than a bargaining game. Second, it points out that, as it is, it is Palminiello's account that risks falling into the inconsistencies she imputes to others.

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*Keywords: Bargaining Games; European Integration; Game Theory; Rational Choice; Transnational Governance.*

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