EMU’s Asymmetries and Asymmetries in German and French Influence on EMU Governance Reforms

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Abstract

This paper looks at asymmetries in terms of French and German influence on EMU’s governance reforms during the two decades since the start of EMU in 1999. Drawing on the literature dealing with the sources of power and influence in EU decision making, this paper investigates key moments of the evolution and reform of EMU – the establishment and reform of fiscal rules, the creation of fiscal instruments and institutions of risk mutualizing including risk-sharing pillars of the Bank Union. It provides an account of the observable asymmetry of German and French influence and power in EMU governance reforms and their variations over time in different phases of EMU decision-making.

Keywords: France, Germany, Asymmetry, EMU, Governance Euro area.

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1. Introduction

In the past, Franco-German ‘embedded bilateralism’ (Krotz and Schild 2013) in Europe provided crucial political leadership in critical phases of European in monetary cooperation and integration, paving the way towards EMU (Dyson and Featherstone 1999). This co-leadership had inbuilt asymmetries, varying over time. The balance of influence in designing the EMU’s governance framework tilted more often in favour of Germany rather than in favour of France (Mourlon-Druol 2017).

The EMU’s asymmetrical design reflects the asymmetrical bargaining power of its two key promoters, France and Germany. It combines a centralized monetary policy with decentralized responsibilities for fiscal, financial and structural policies. EMU was designed in a way to allow market pressures to correct unsustainable fiscal policies. Its institutional setup mirrors core German preferences, anchored in its stability culture, to a greater extent than French ones. This holds true for the basic pillars of the EMU’s ‘Maastricht 1.0’ economic constitution such as the primacy of price stability, the independence of the ECB, the no-bail-out clause, the prohibition of monetary financing of sovereign debt and national responsibility for fiscal policy.

German leadership took the form of a co-leadership with France (Mazzucelli 1997). However, key French ideas on an ‘economic government’ of the EMU did not prevail (Howarth 2007). Its economic pillar remained less developed and centralized compared to the monetary pillar.

The debate on the asymmetry of the EMU’s architecture came forcefully back during the Eurozone crisis (Howarth and Verdun 2019). The crisis opened a window of opportunity to reduce the asymmetry between monetary and economic integration and led to a series of integrative steps such as the introduction of new rules, instruments and procedures, and institutions of economic governance. Yet the outcome of the Eurozone’s governance reforms does not come close to a comprehensive ‘embedded monetary union’. The latter would comprise a financial, fiscal, banking and political union in addition to monetary union (Hodson 2019; Mathijs and Blyth 2015). Steps towards a fiscal and a political union remained particularly controversial (Schlosser 2019).

Looking back on 20 years of EMU reforms, this contribution looks at the relative influence of Germany and France in shaping the EMU’s governance framework at key moments of change in the EMU’s trajectory. The focus on France and Germany is justified by their central role in all stages of EMU reform. The two countries represent opposing schools of thought – France standing for a fiscal union with centralised fiscal instruments mutualizing risks and liabilities whereas Germany stands for a stability union emphasising national responsibility for economic policy and national liability for its failures. Hence, Franco-German compromises were and are a necessary condition for any substantial EMU reform.

Which are the key causal factors accounting for an asymmetrical influence of Germany and France at different stages of reform? The explanation provided by this contribution has three core elements: a) changing patterns of asymmetric interdependence; b) path dependencies stabilizing the status quo and c) functional
pressures stemming from high levels of economic interdependence and high status quo costs (i.e. costs of not changing the institutional status quo) in moments of crisis.

By concentrating on asymmetries of German and French influence on EMU reforms and by broadening the time horizon to cover a period of 20 years, this article makes a contribution to the literature on the role of France and Germany in EMU affairs and to our understanding of the lasting nature of asymmetry in the EMU.

The following section describes our dependent variable, the relative influence of Germany and France on EMU reforms affecting its asymmetry. Then it sketches core French and German preferences for EMU reform in order to evaluate their success in moving reform outcomes closer to their respective preferences. The next section lays out the theoretical argument, drawing eclectically on strands of liberal intergovernmentalist, historical institutionalist and neofunctionalist theorizing. Against this background, we summarize important turning points and decisions on governance reforms that changed the EMU’s trajectory during the past 20 years and try to assess the relative explanatory power of our three key variables. The final section concludes.

2. The dependent variable

Our dependent variable is the relative influence of Germany and France on EMU reforms, in particular on reducing the degree of asymmetry of the EMU’s governance framework. In order to assess their relative influence, we have, first, to clarify what we mean by the asymmetry of the EMU’s governance framework and, second, what the preferences of France and Germany are in this respect. We start with the former.

The EMU’s governance framework can be reformed along two different axes, a supranational-centralised vs. national decentralised governance axis and an axis running from marked based coordination to hierarchical political coordination (see figure 1). Based on these two dimensions, we can distinguish two ideal-types of EMU governance, a supranational, centralised, hierarchical form of political coordination and a decentralised, national governance with room for market based coordination. EMU’s monetary pillar, characterized by supranational-centralized governance, is located in the upper right part of figure 1. EMU’s economic pillar remains located in the lower left part of the figure. Hence, reducing EMU’s asymmetry means moving its economic pillar towards the upper right part of fig. 1, strengthening the supranational-hierarchical and political nature of its governance.

Table 1 summarizes key long-standing French and German EMU related preferences, based on large body of literature (Brunnermeier/James/Landau 2016; Degner/Leuffen 2019; Dyson/Featherstone 1999; Howarth/Schild 2017; Schild 2013). They reflect the revealed preferences of the two countries and their governments at the start of the Eurozone crisis. To be sure, their positions changed to a certain extent over time in response to the crisis (Crespy/Schmidt 2014; Van Esch 2014). However, the basic paradigms underpinning their positions and key preferences arguably did not. We take
these national preferences of France and Germany as given and do not deal with preference formation.

The French preferences are rooted in Keynesian thinking and in the tradition of republican Jacobinism emphasizing the primacy of politics over markets. Different French presidents, most of all Emmanuel Macron, advocated a large Eurozone budget to perform a macroeconomic stabilization function. All presidents during the crisis years favored well-equipped rescue funds to bail out sovereigns and other instruments of risk mutualization, emphasizing different instruments at different moments in time (Eurobonds, a banking licence for rescue funds, European-level deposit insurance, common fiscal backstop for the Banking Union’s single resolution fund.).

The French economic government paradigm entails a strengthening of central institutions to govern from the top, such as Euro summits, and a strengthening of the Eurogroup in macroeconomic policy coordination. As regards fiscal rules, France never subscribed to the idea of hard supranational-hierarchical enforcement of such rules by the Commission or to any automaticity of sanctions against rule-breakers, infringing upon its national sovereignty. Nor did it attach much importance to market discipline via risk premia for sovereign bonds as a correction mechanism against unsound national fiscal policies, fearing irrational market movements entailing contagion risks.

The French ‘fiscal union’ preferences favour a reduction of EMU’s asymmetry. They imply EU-level capacity-building with new instruments and governance institutions. They follow the logic of a reinforced intergovernmental coordination among national executives via the European Council, Euro summits and the Eurogroup rather than a shift towards a supranational-hierarchical mode of governance empowering the Commission.

Table 1 about here

The German preferences are situated at the opposite side of the French ones. The German thinking about EMU reforms is anchored in its stability culture and informed by the dominant sound money paradigm. It also differs from the French approach by emphasizing the economic constitution for the euro area defining the rules of the game, rather than the process dimension of economic policy-making and the related decision-making bodies. This reflects the ordoliberal tradition. Germany did not see the need for a European-level instrument performing macroeconomic stabilization or fiscal equalization functions to cope with asymmetric shocks. Berlin emphasizes national fiscal buffers and national structural reforms. A European-level fiscal capacity finds support only in as far as it provides incentives for domestic structural reforms, dealing with a lack of competitiveness. Proposals for intra-Eurozone solidarity, risk sharing or fiscal transfers meet with strong moral hazard concerns as they might provide incentives to avoid painful domestic reforms and fiscal consolidation efforts. Any move towards a permanent ‘transfer union’ meets with strong domestic opposition (on domestic constraints, see Bulmer and Paterson 2018, ch. 2). Powerful European-level decision-making bodies are seen with suspicion as they might develop into a counterweight to the ECB, undermining its independence. Germany advocates two approaches in order to avoid negative external effects of national economic policies, namely defining hard fiscal
rules combined with strong supranational sanctioning powers; and a credible no bail-out principle, allowing the market (via risk premia on sovereign bonds) to define a price tag for unsustainable national economic and fiscal policies. In order to restore market discipline, it advocates an orderly sovereign default procedure implying credible private sector involvement in cases of sovereign defaults and debt restructuring. Overall, these preferences correspond to a ‘Maastricht 2.0’ model of decentralized, rule-bound national economic policy making constrained by market discipline as correction force. There is, however, one major point on which Berlin prefers an shift of the Eurozone’s governance model on the Y-axis of fig. 1 towards a stronger supranational-hierarchical governance: Berlin repeatedly called for lending an independent body – the Commission or another independent, non-politicized institution – strong powers to enforce the fiscal rules, the idea of a ‘super Commissioner’ with veto rights on national budgets being the clearest expression of this thinking (FAZ 2012; Schoeller 2018b: 10-11).

In order to assess the respective influence of France and Germany on EMU governance reforms, we look at different critical junctures in the evolution of the EMU’s governance after having laid out our hypotheses as regards the causal factors that might explain a stronger or lesser control over outcomes.

3. Explaining asymmetrical power over outcomes

What accounts for the relative power of Germany and France in the process of reforming the EMU’s governance framework? Our explanation rests on three causal factors: asymmetrical interdependence; functional pressures and associated status quo costs, and path dependencies/exit costs from a given path. We combine arguments drawn from liberal intergovernmentalism, neofunctionalism and historical institutionalism that have been used to explain the reform outcome of the Eurozone’s crisis (Gocaj/Meunier 2013; Jones/Kelemen/Meunier 2015; Niemann/Ioannou 2015; Schimmelfennig 2014;2015; Verdun 2015).

We take asymmetric interdependence and intergovernmental bargaining theory as our starting point. Member states with a high preference intensity for a cooperative solution, usually in the role of a demandeur in negotiations, and those more vulnerable due to strong interdependence than others have to make important concessions to their partners that are less vulnerable and have less intense preferences and/or attractive unilateral alternatives to negotiated agreement (Moravcsik 1998; Schimmelfennig 2015: 184-188). In bargaining situations characterized by a shared interest for a negotiated Pareto-efficient solution, the perceived utility of a cooperative outcome is negatively correlated to the member states’ bargaining power. And the more dependent a member state is on highly valued resources of another member state when promoting a collective goal, the more concessions it has to make in order to make the resourceful member state cooperate. This basic argument goes a long way in explaining why France or Italy with a strong preference for a common currency had to subscribe Germany’s key demands and

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1 For an argument linking the level of status quo costs to the demand for leadership in the EU, see Schoeller (2014: 8).
its ‘Maastricht 1.0’ template regarding the basic architecture of monetary union (Dyson and Featherstone 1999).

Jones, Kelemen and Meunier (2016) rightly underline that this liberal intergovernmentalist type of argument reaches limits when we adopt a longer time-horizon beyond single negotiations. Path dependencies and lock-in effects gain in importance over time. Increasing returns on a given path raise the exit costs (Pierson 2000). Initial choices at critical junctures can be self-sustaining as the political and economic costs of leaving a chosen path are high or rising over time.

Functional pressures and high status quo costs provide us with the third causal factor in our explanation. High and unbearable status quo costs in moments of crisis can lead to a critical juncture. A window of opportunity to change the EMU’s trajectory can open if the survival of the common currency is at stake and in case the EMU’s current governance framework and toolkit do not provide effective instruments to prevent a breakup of the euro area. This changes the pattern of power distribution among euro area members. Long-standing preferences become more fluid when member states negotiate in deep crisis mode. Important integrative steps are suddenly possible.

During economic, financial and fiscal crises in highly integrated markets, the danger of strong negative externalities of unilateral action and potentially high costs of inaction loom large. In the case of the Eurozone crisis, we can hypothesize that the higher the cost of not reacting to strong tensions in financial markets as reflected by the level of risk premia, the higher the willingness of governments to depart from their EMU-related core preferences in order to avoid a ‘common bad’. Status quo costs are linked to the estimated risk and economic costs of a (partial) breakup of the Eurozone or a collapse of systemically important financial institutions. Rising status quo costs and rising transborder contagion risks diminish the negotiating power of those member states with preferences at odds with functional solutions that reduce tensions in the markets, contagion dangers and the risk of seeing the Eurozone falling apart.

4. (Re-)Designing fiscal rules

Germany’s bargaining power mustered at Maastricht diminished as soon as EMU was in place. Strong path dependence changed its negotiation clout. The option of non-cooperation and the choice of a unilateral strategy, a realistic option for Germany before the start of EMU, clearly lost in attraction due to high and rising economic exit costs, hardly calculable in a reliably way ex ante. The increased functional interdependence inside the euro area provided strong incentives to stick to the initial basic choice.

The history of the Stability and Growth Pact (SGP) provides us with an interesting example of legal path dependency that weakened the German influence and power compared to the Maastricht. Germany asked for a Stability Pact in the mid-1990s to clarify the application of the Maastricht Treaty’s rules on excessive deficits. Its minister of finance, Theo Waigel, made the case for automatic sanctions applied to rule breakers. The French government rejected the idea of automatic sanctions against fiscal ‘sinners.’ Legal path dependency strengthened the French position as the excessive deficit procedure (EDP), as laid down in article 104c of the Maastricht Treaty (Art. 126 TFEU) and the
protocol on the EDP, did not allow for such an automatism. The Council has to decide by qualified majority on the existence of an excessive deficit. Circumventing this legal obstacle by way of establishing the new rules in an international treaty outside Community law was no viable option either (Heipertz and Verdun 2010: 80).

In a clear contrast to the asymmetrical interdependence favouring Germany during the Maastricht negotiations, the German government now acted in the role of a demandeure, being dependent on the consent of its partners, first of all France. Hence, Germany had to make important concessions to France (e.g. on the definition of a ‘severe recession’, allowing member states to run a deficit higher than 3 per cent of GDP and on the automaticity issue). It could not credibly use an exit threat to make reluctant partners subscribe to its demands (Heipertz and Verdun 2010: 26).

A major change of EMU’s fiscal rules came in 2005. From 2002 to 2005, the German budget deficit exceeded the 3 percent threshold, the French one from 2002 until 2004. The Schröder government opted for a rule-breaking fiscal policy in order to guarantee a political support base for its far-reaching Agenda 2010 of labour market reforms (Schröder 2016). This provided France with a unique opportunity to soften the rules with the valuable support of Germany. France and Germany were able to bring together a coalition in the Ecofin Council, which decided to stop the EDP launched by the Commission against France and Germany, thus hollowing out the SGP’s legal framework. In a highly unusual European actor constellation, France and Germany successfully joined forces in order to bring about a reformed SGP in 2005. Supported by Italy and the UK, they pushed for a more flexible interpretation of the deficit criteria and overcame the resistance of smaller Member States led by Austria and the Netherlands—traditionally closely allied to Germany—that tried to prevent a watering down of the SGP (Chang 2006).

After the start of the Eurozone crisis, reform of the SGP came forcefully back on the EU’s agenda. Germany called for a strengthening the SGP framework and for making the sanctioning of rule breakers more automatic, thus depoliticizing the excessive deficit procedure, while France continued to prefer a policy discretion approach with a central role for the European Council (Chang 2013).

In exchange for more solidarity (see below), Germany got commitments to more national fiscal responsibility. Berlin successfully promoted the idea of a ‘fiscal stability union’ with support from France. Together, they endorsed reforming the rules governing the Eurozone along the lines of the Commission’s ‘six-pack’ of legislative proposals, put forward in September 2010, strengthening both the SGP’s preventive and corrective arm, putting more emphasis on the debt criterion and making sanctions more easy to adopt thanks to a ‘reverse qualified majority’ voting procedure. This procedure foresees that a Commission recommendation is adopted unless the Council decides by qualified majority to reject it.

A new ‘fiscal compact’, forcefully advanced by Germany and France ahead of the October and December 2011 European Council meetings, even reinforced the reformed SGP. Germany, again with support from France as part of a mutual exchange of concessions, successfully advocated the introduction of balanced budget rules at the national level, inspired by a similar rule enshrined in 2009 into the German Basic Law. In order to make reluctant euro area members subscribe to its idea of a fiscal stability union,
Germany followed a linkage strategy (initially opposed by France, see Schäfer 2013: 120), making the ESM available only for countries signing the ‘Treaty on stability, coordination and governance in the Economic and Monetary Union’ which contained the Fiscal Compact.

To be sure, this strengthening of the fiscal rules promoted by Germany reflects its bargaining power during the crisis years rooted in a situation of asymmetric interdependence, others being highly dependent on German fiscal resources. Berlin could link its own concessions on rescue funds to concessions by its partners on the tightening of fiscal rules. However, the reinforced fiscal rules should not be interpreted as a decisive shift towards more supranational-hierarchical governance of the EMU along the lines of German preferences, reducing the asymmetry between the EMU’s monetary and the economic pillar. First of all, the full implementation of these rules cannot be taken for granted. There are serious doubts about the Commission’s capacity and willingness to enforce the rules. Based on two decades of experience of SGP rule application, member states hardly face the risks of sanctions thanks to the Commission’s ‘political’ interpretation of its own role.

Furthermore, the German finance minister Wolfgang Schäuble failed in its attempt to promote the idea of a ‘super Commissioner’ with the hierarchical power to veto national draft budgets not complying with European fiscal rules (FAZ 2012). This failure was mainly due to French objections. The institutionalization of a ‘super Commissioner’ would have required a treaty change, hence the French veto power. The same holds true for the idea of making sanctions against rule breakers automatic, a long-standing German preference that likewise met with French objections. Without a credible threat of sanctions and strong supranational-hierarchical enforcement powers, the change in the Eurozone’s fiscal governance framework remains, from a German point of view, quite limited. So is the reduction in the asymmetry between EMU’s monetary and economic pillar along German preferences.

5. Creating fiscal instruments and mutualizing risks

Starting with the Greek debt crisis, the respective influence of France and Germany and the bilateral power distribution went through different stages as regards the setup of rescue funds and other instruments of risk mutualization. We can broadly distinguish four different phases. An initial one in early 2010 was characterized by strong German hesitations to act and to accept major financial commitments. The second, ‘Merkozy’ phase of highly intensive bilateral coordination started in the second half of 2010 and intensified in mid-2011. It was followed by the Hollande years 2012-17 with little common ground between Paris and Berlin; and, finally, a renewed Franco-German bilateralism after the election of the French president Macron that met with skepticism and resistance from smaller creditor countries.

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2 Interview (conducted in Brussels, 11 January 2019) with a former high civil servant in the German ministry of finance, involved in the concertation with the French partner during the Eurozone crisis years.
During the euro area crisis management after 2009, German issue-specific power resources, mainly the ‘power of the purse’ and its triple AAA credit ratings, made its partners dependent on Germany’s cooperation. A growing asymmetry between Germany and France, in terms of economic clout and financial resources, reinforced the asymmetrical nature of the interdependence, hence strengthening, other things being equal, German power in EMU negotiations.

Based on these issue-specific German power resources needed for any short-term solution to the worsening crisis, Angela Merkel had a strong hand. She had, at least for a while, ‘the ability to afford not to learn’ – Karl W. Deutsch’s famous definition of power (Deutsch 1966, p. 111) –, delaying common European action beyond the date of an important regional state election in North-Rhine Westphalia (9 May 2010). However, inaction came at high and escalating costs (Jones 2010). The 2010 Greek crisis provides us with an example of rapidly rising status quo costs. German and French banks were highly invested in Greece, making them – and indirectly their governments – highly vulnerable. A Grexit would have implied providing huge sums of taxpayers’ money to rescue ailing German and French banks (Hübner 2012). Therefore, president Sarkozy urged the EU to act, grasping the destructive dynamic and spillover potential of speculative attacks on Greece early on. The German government came to this conclusion only after weeks of hesitation.

‘If the Euro fails, Europe fails,” as Merkel put it in the German Bundestag on 19 May 2010 (Merkel 2010). From the very moment Chancellor Merkel made this basic choice – the result of high interdependencies inside the tightly integrated euro area, exerting powerful functional pressures on Germany to act – the French influence on key issues risk mutualisation grew. Germany’s positions moved closer to the French ones and allowed for mutual exchanges of concessions. After the bilateral lending programme to Greece, Germany accepted the establishment first of two temporary rescue funds (EFSF and EFSM) in May 2010 and later promoted the permanent European Stability Mechanism (ESM). Apart from the case of the smaller EFSM, Germany proved successful in keeping the governance of these funds intergovernmental, outside the Union law, and limited its financial commitments.

On the German side, the pragmatic search for ways to stabilize the euro area in moments of escalating market tensions and risk premia on sovereign bonds trumped ordoliberal ideas of avoiding moral hazard (Feld et al. 2015). France and Germany shared the overriding goal of preventing the euro area from breaking apart. This tilted the internal balance in the Franco-German relationship to a certain extent towards France on issues of rescue operations and risk mutualisation, as long as German red lines due to domestic constraints were not crossed.

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3 For a similar argument on contraints on Germany’s influence on EMU reform by increased sunk costs of monetary union and strong negative spillover risks, see Steinberg and Vermeiren 2016.

4 This reflects the German government’s official position, mainly shaped by Chancellor Merkel. Wolfgang Schäuble pursued a Grexit strategy after the Syriza government came into power, see Varoufakis 2017.
The Merkozy phase

France and Germany proved able to play a common proactive and often decisive role at different moments during this ‘Merkozy’ phase (Degner and Leuffen 2018; Schild 2013; Schoeller 2018a). Paris and Berlin were able to reach compromises through a series of mutual concessions at crucial moments. A first important moment came with the Franco-German deal struck at Deauville at the occasion of an informal bilateral meeting between Merkel and Sarkozy in October 2010. Germany made a concession on the automaticity of sanctions against ‘fiscal sinners’ in exchange for French support for treaty reform to provide a legal basis for a permanent lending facility ESM. Another French concession came with Paris —reluctantly— subscribing to a private sector involvement (PSI) in sovereign debt restructuring.

A second crucial phase of crisis management started in mid-2011. After the intense bilateral preparation of the July 2011 European Council, Merkel and Sarkozy called the shots in European-level decision-making in the second half of the year. France and Germany could once again define a common approach through an exchange of mutual concessions. First, in a bilateral compromise, Merkel and Sarkozy agreed to give the European Council a central role as an ‘economic government’ of the euro area, a major German concession to France. Merkel also accepted Euro summits to be held at least twice a year. Furthermore, Germany reluctantly conceded higher firewalls against the risk of contagion—and German guarantees to underpin them. Berlin subscribed to enlarged competences for the EFSF (decided at the Eurozone summit on 21 July 2011) and to an increase of its lending capacity (decided at the Eurozone summit on 26 October 2011). Sarkozy even asked for giving the temporary stabilization fund EFSF (European Financial Stability Facility) a banking license and hence unlimited access to ECB money (Le Monde 2011). However, subscribing to potentially unlimited liabilities proved to be clearly beyond German red lines.

In exchange for his support of the German-sponsored Fiscal Compact, Sarkozy got reassuring signals to the financial markets. Contrary to the common approach adopted at Deauville, Germany accepted in December 2011 that private sector involvement in debt restructuring would be limited to the Greece, an ‘exceptional and unique case’ (Eurogroup 2012: 2). The highly nervous reaction of financial markets to the prospect of PSI explain this German backtracking. And Berlin did not go very far in defining an orderly sovereign default procedure it had suggested in 2010 (Merkel 2010). The Merkel government deliberately toned down this issue when this idea met with strong French skepticism in bilateral high level talks.5 Paris, on its part, lent its support to the tough German line to prevent the introduction of Eurobonds.

Most observers agree that Berlin strongly influenced the Eurozone crisis management process during this phase (Bulmer and Paterson 2018, ch.6; Webber 2019, ch. 3). Deubner, however, diagnosed a German a conceptual defeat as the crisis years eroded major building blocks of the ‘Maastricht 1.0’ economic constitution cherished by Germany such as no bail-out clause, the non-monetization of sovereign debt by the ECB

5 Interview at the German Ministry of Finance, 14 March 2012.
as it indirectly financed national public debt purchasing sovereign bonds on secondary markets (through its Securities Markets Programme announced in May 2010), risking to compromise its independence. France, meanwhile, seized window of opportunity of the sovereign debt crisis to promote its own approach of governing the euro area from the top, promoting major changes to the economic governance structure of the euro area along the lines of its long-standing preferences (Deubner 2011). This can mainly be explained by the deep crisis environment exerting strong functional pressures on Germany and increasing the status quo costs.

The Hollande years

During the time in office of François Hollande, we could once again observe a close relationship between the level of functional pressures and related status quo costs on the one hand and German willingness to accept institutional changes along the lines of French preferences that implied risk sharing on the other.

The establishment of the European Banking Union (BU) provides the most important institutional change of the euro area’s governance during the Hollande years. BU’s first pillar came with the historical decision to move towards a European-level bank supervision. The Spanish banking crisis in 2012 served as a focusing event, drawing attention to the link between banks and sovereigns and opening a policy window when it became clear that Spain would request external financial assistance. Once again, strong functional pressures, as indicated by rising risk spreads on sovereign bond, were at work.

The European Council meeting of June 2012 launched the work on BU. Germany faced a large coalition of like-minded member states (e.g. France, Italy and Spain) and European institutions advocating the direct recapitalisation of banks via the ESM. Against the backdrop of the Spanish banking crisis and potential transnational contagion effects, Merkel accepted the idea of a direct recapitalisation of banks through the ESM. In exchange for this concession, Germany pushed for a centralised European banking supervision, the ‘Single Supervisory Mechanism’ (SSM) under the responsibility of the ECB. Germany’s rhetorical commitment to break the vicious circle between the banks and sovereigns could then be used by France, Southern European states, the Commission and the ECB to advance the Banking Union agenda and get concessions from Germany (Schäfer 2016). Once started, the work on BU gained a dynamic of its own and was driven forward by way of a collaborative leadership of European institutions. Franco-German cooperation had only a very minor part in this (Nielsen and Smeets 2018; Schild 2018).

Nevertheless, in intergovernmental negotiations on BU following this initial political agreement on the principle of the SSM, ‘the main players were France and Germany’ (Howarth and Quaglia 2013: 111). But most of the time, they played against each other. Time was on Germany’s side, strengthening its bargaining power. After ECB president Draghi’s famous statement that ‘the ECB is ready to do whatever it takes to preserve the euro’ in July and the announcement of the ECB’s OMT (Outright Monetary Transaction) programme by the ECB’s governing Council in August 2012, financial markets calmed down, risk spreads declined and functional pressures on governments to act quickly and boldly diminished. This tilted the balance in the negotiations in favour of
Germany and against the fervent advocates of a comprehensive BU such as France, Italy and Spain.

France and Germany sharply diverged on the timetable for setting up BU. Strong domestic constraints translated into a successful German negotiation strategy of delaying important issues and of defining conditions for moving forward. German preferences also largely prevailed as regards the use of ESM funds for direct bank capitalisation. The Germany, Finnish and the Dutch ministers of finance joined ranks to exclude the use of ESM funds to deal with current bad assets of banks (‘legacy assets’), as favoured by France, Spain and Italy, limiting their use to deal with future banking crises. Germany finally conceded the possibility of using the ESM’s direct recapitalisation instrument for dealing with ‘legacy assets’ ‘decided on a case-by-case basis and by mutual agreement’, giving Germany a veto right (Eurogroup 2013). The instrument of direct bank recapitalisation using ESM funds, never used so far, will be replaced by a public backstop agreed upon at the EuroSummit meeting in June 2018 and providing funds for bank resolutions at the latest in 2024 (Euro Summit 2018). This decision was also delayed by Germany and the details are still to be defined.

As regards the funding of banking resolution, the vast majority of EU member states, including France, advocated a single resolution fund whereas Germany favoured a network of national funds. The final compromise foresees a fund with national compartments that will only gradually be merged into a single fund over an eight year period until 2023, to be filled with an estimated €55 billion. This provides us with another example of Germany delaying the introduction of European-level risk mutualisation schemes, but making concessions to France and like-minded partners.

France regarded a common bank deposit guarantee scheme as an integral part of BU. The Commission considered submitting a legislative proposal to this end. However, meeting with staunch German opposition, it refrained from tabling a proposal until November 2015 (Schild 2018: 109-110). Later, when it finally tabled its proposal in November 2015 on a European Deposit Insurance Scheme (EDIS), it met with very strong and almost unanimous German resistance across the political board. Germany succeeded in getting the Ecofin Council to define a number of conditions that have to be fulfilled before the political decision-making on EDIS could seriously be started. Thus, Germany could impose its preferred sequence of steps – bank risk reduction first, and more risk sharing being considered only once very strict conditions have been met. The work on EDIS has been put on the backburner, as the Council will only ‘continue constructive work on the technical level’ until there is ‘sufficient progress (…) on the measures on risk reduction’ (Council 2016).

Macron’s reform agenda – Germany on the defensive?

French president Emmanuel Macron, elected in May 2017, laid out a comprehensive reform agenda for the Eurozone reform (and the EU more broadly). The idea of a Eurozone budget with an order of magnitude of several percentage points of the euro area’s GDP – that is several hundred billions of Euros – stands out. Additionally, he made the case for a European finance minister and a Eurozone parliament controlling this
minister and the use of the budget (Macron 2016; Le Point 2017). These proposals along the lines of a 'fiscal union' implied an important reduction of the asymmetry in the EMU's governance.

This new French dynamism, however, did not shift the balance of influence on EMU decisions towards France. A serious debate on the core of Macron's agenda for EMU reform, the Eurozone budget, had to wait until after the German election in September 2017 and after another grand coalition government took office in March 2018. The new German government felt obliged to send signals of goodwill to Paris, promising to 'strengthen the principle of mutual solidarity' in Europe (Coalition Treaty 2018: 6). A more concrete support came with the Franco-German Meseberg declaration of 19 June 2018 and the 'French German roadmap for the Euro Area' (French and German Governments 2018a; 2018b). It specifies the goal of setting up a 'Eurozone budget within the framework of the European Union to promote competitiveness, convergence and stabilization in the euro area, starting in 2021' (French and German Government 2018b). By subscribing to the French idea of a Eurozone budget and defining stabilization as one of its core functions, the German government proved willing to add a new fiscal instrument to the euro area's toolbox. However, the budget figure that Chancellor Merkel had in mind did not come anywhere close to the several percentage points of euro area GDP. Merkel's saw it rather to be in the lower two digit range (Merkel 2018). And Germany continued to oppose the creation of a permanent transfer system. Additionally, Germany found French support for the idea of reforming the rules for debt restructuring in cases of sovereign defaults to make it easier and more predictable.

So far, the main proposals put forward by Macron didn't fly. The idea of a European minister of finance did not make its way on the EU's political agenda, nor did the associated proposal of a separate Eurozone parliament. And the Franco-German compromise on a Eurozone budget didn't carry the day at the European level. A group of northern creditor states, referred to as the 'new Hanseatic league' (HL), expressed their common outright opposition against this new instrument and against any kind of exclusive Franco-German bilateralism pretending to speak on behalf of the euro area countries (Government Offices of Sweden 2018). The HL countries were successful in preventing the idea of the Eurozone budget performing a stabilisation function from making its way into the Euro Summit declaration of 14 December 2018 (Euro Summit 2018).

This most recent experience of EMU reform attempts corroborates the neofunctionalist hypothesis ex negativo. The absence of crisis-related functional pressures, of strong negative spillover dynamics and contagion risks reduce the status quo costs from a German point of view. Hence, Berlin made only some rather symbolic concessions to France on the Eurozone budget but did not subscribe to the idea of adding a powerful fiscal instrument to the Eurozone' toolbox in order to strengthen its economic pillar.
Conclusion

This contribution identified the causal factors accounting for an asymmetrical influence of Germany and France during the last 20 years at different stages of EMU reforms. The explanation provided has three core elements: a) changing patterns of asymmetric interdependence; b) path dependencies stabilizing the status quo and c) functional pressures associated with high levels of economic interdependence providing incentives to change the status quo in moments of crisis.

The degree of symmetry/asymmetry in influence of the EMU’s two core members, our dependent variable, indeed changed over time. Liberal intergovernmentalisms’ core concept of asymmetric interdependence can provide powerful explanations for cases in which Germany could translate crucial issue-specific power resources – mainly its ‘deep pockets’ – into negotiation clout, using linkage strategies to promote its agenda of strengthening the fiscal rules. Functional pressures, negative spill-over dynamics and prohibitive status quo costs, on the other hand, explain why Germany found itself on the defensive when crisis tensions came to a climax and why France (and like-minded countries) could use these pressures to successfully push for instruments of risk mutualization, the bail-out of insolvent member states and for institutions to govern the Eurozone from above such as Euro summits, a clear ‘conceptual defeat’ and major departure from the German ideal-type EMU economic constitution (Deubner 2011).

The initial basic German choice in 2010 to prevent a breakup of the Eurozone created a strong path dependency. It reinforced the impact of functional pressures on German willingness to make concessions to its partners in terms of risk sharing as long as a breakup of the Eurozone was a real threat. As soon as market tensions and functional pressures receded, however, Germany regained influence. This gave Germany the power to veto proposals, to delay risk mutualizing decisions, linking progress on them to previous progress on risk reduction as in the case of a common deposit insurance scheme, or to water down proposals such as Macron’s pet project of a Eurozone budget. Berlin has, as long as economic status quo costs are not considered to be unbearable, a higher capacity to mark European-level outcomes with its spell compared to France and is able to limit liabilities for itself and its taxpayers, hence a Franco-German asymmetry.

The French capacity to move the EMU’s governance framework closer to its core preferences is a kind of mirror image of the German one. Only in moments of highest tensions in the markets, such as in May 2010 and from the second half of 2011 until June 2012 was it successful when advocating risk and liability sharing instruments, moving EMU into the direction of a fiscal union (rescue funds such as the EFSF and ESM) and a supranational banking union (single rulebook, bank supervision and bank resolution). And legal path dependencies as well as its veto power on treaty change proved helpful to fight off German demands, for instance on automatic of sanctions against fiscal rule breakers or on a ‘super Commissioner’.

The extent to which EMU reforms reduced its asymmetrical features is quite limited, however. This is due to another asymmetry. Both France and Germany were better able to use negative blocking or veto power rather than positive shaping power. Key French proposals for fighting the crisis such as Eurobonds, a banking license for the
EFSF or ESM, a Eurozone budget able to absorb asymmetric shocks and perform stabilization functions and a European deposit insurance scheme were either vetoed, substantially watered down or delayed by Germany. In a similar way, Germany also proved much more successful in preventing decisions to be taken running against its interests and economic policy paradigm – especially by setting clear limits to risk mutualization in the euro area – than in positively shaping the EMU’s economic constitution along the lines of its long-held preferences. German key proposals to reestablish the basic logic of the Maastricht Treaty in a reformed Maastricht 2.0 framework did not fly either. This is true for the German idea to increase supranational-hierarchical control over national fiscal policy by lending strong powers to a ‘super commissioner’ and for its idea of automatic sanctions against fiscal ‘sinners’. The super commissioner was vetoed by France, the automaticity proved impossible due to legal path dependencies. Some progress is about to be made, however, towards an orderly sovereign default procedure.

Overall, this means that EMU’s two core states basically vetoed exactly those proposals from the other side of the Rhine that would have moved the EMU’s governance into a supranational direction, strengthening its economic pillar and reducing its asymmetry, Banking Union being an important exception. Further reducing the EMU’s asymmetry, promoting core proposals from both sides on which consensus proved impossible so far seems realistic only as a part of a big bargain, first and foremost between France and Germany. However, the odds of such a big bargain being struck seems highest in the context of a looming storm threatening to shipwreck the euro, but much less so in calm waters.

References


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Merkel, A. 2018. Interview of Chancellor Angela Merkel with the Frankfurter Allgemeine Sonntagszeitung, 3 June 2018.


Annex: Figures and tables

Figure 1: Two Dimensions of Eurozone Governance Models

<table>
<thead>
<tr>
<th>supranational, centralised governance</th>
<th>Supranational, centralised, hierarchical governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decentralised, national, market based governance</td>
<td>Market based coordination</td>
</tr>
<tr>
<td>market based coordination</td>
<td>hierarchical political coordination</td>
</tr>
</tbody>
</table>

Table 1: French and German preferences on EMU governance issues

<table>
<thead>
<tr>
<th></th>
<th>France</th>
<th>Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ideational Roots</strong></td>
<td>Keynesian paradigm; republican Jacobinism</td>
<td>Ordoliberal 'Freiburg School', Monetarism, sound money paradigm</td>
</tr>
<tr>
<td><strong>Centralization of Economic/Fiscal Instruments</strong></td>
<td>Yes, macroeconomic stabilization function: large Eurozone budget</td>
<td>No instrument for macroeconomic stabilization or fiscal equalization, but fiscal capacity providing incentives for structural reforms</td>
</tr>
<tr>
<td><strong>Common liability / solidarity</strong></td>
<td>Yes: huge rescue funds, Eurobonds, European Deposit Insurance</td>
<td>Fearing wrong incentives/moral hazard</td>
</tr>
<tr>
<td><strong>European-level coordination</strong></td>
<td>Eurosummits ; strengthened Eurogroup</td>
<td>----</td>
</tr>
<tr>
<td><strong>Supranational control of national fiscal policies</strong></td>
<td>Common rules with room for discretionary decisions, no hard supranational enforcement, no automatic sanctions</td>
<td>Yes, unambiguous rules, strong supranational enforcement, high automaticity of sanctions</td>
</tr>
<tr>
<td><strong>Importance of market discipline for correcting unsound policies</strong></td>
<td>Low: Correcting market forces to avoid contagion</td>
<td>High: risk premiums for bonds as correction mechanism; back to no-bail out logic, state insolvency procedure and private sector involvement</td>
</tr>
</tbody>
</table>

*Source: own compilation*