**Quiet Politics and Its Impact on Europe’s Banking Union**

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# Abstract:

# Much has been written about European banking union and Germany’s role in shaping it. Missing, however, is a comprehensive explanation for Germany's contradictory positions on banking union: German policymakers gambled on a single supervisory mechanism, and a single resolution mechanism yet drew the line on European-wide deposit insurance. We explain Germany’s mixed positions on banking union by drawing on prospect theory and theories of policy salience.

Introduction

In 2013, *Der Spiegel* journalist Armin Mahler (2013) predicted, “Germans are right to be worried about their savings because the euro bailouts will make most of them poorer.” At the time, the European banking system was in crisis, sowing fear and instability in the hearts of savers and the boardrooms of financial institutions. Mahler’s statement appeared soon after the European Union (EU) signed into effect its Single Supervisory Mechanism (SSM), the first pillar of a European Banking Union (EBU). However, the supranational organization had yet to create its Single Resolution Mechanism (SRM) and had failed to agree on the 3rd pillar-a European Deposit Insurance Scheme (EDIS). The political battle to further integrate the EU banking system began well before 2013, or even the Great Recession of 2008-2009, but here we focus on the most recent iteration of the ongoing debate over EBU.

Studies of supra-national agreements, particularly in International Relations, typically focus on the process of political bargaining between state actors and the preferences of state actors. While bargaining and preferences are important our focus is limited to explaining Germany’s position toward EBU. Our rationale is three-fold. First, Germany’s role in EBU is unique. Interviews, scholarly accounts and media coverage suggest that Germany was (and remains) the most important player in the development of EBU. The view is captured by a comment from a staff member who served on the EU’s ECON Committee,[[3]](#footnote-3) “It was understood by everyone on the committee and in parliament that Germany sets the agenda for European Banking Union and without Germany there is no banking union. Period.” A second reason to focus attention on Germany’s position is the puzzle the country presents. EBU consists of three separate pillars – supervision, resolution and deposit insurance. Scholars and EU leaders stress banking union requires all three parts. One would, therefore, expect a country to either oppose or accept EBU as a package. Germany, however, agreed to a supranational supervisory and resolution mechanism but refused a similar mechanism for deposit insurance. The case presents an interesting theoretical puzzle with broader applications.

Few decisions are riskier and more wrought with political and economic uncertainty than ceding authority over one's banking and financial system to a supranational authority. Banking and finance provide the capital that sustains and grows an economy. The Great Recession of the 2007/08 and Europe’s debt crisis demonstrated that failing banks can undermine the public's trust in the blink of an eye. Nowhere is the risk better understood better than in Germany, a country built on a bank-based system of capitalism (Deeg 1999)[[4]](#footnote-4). It is therefore particularly surprising that Germany decided to sign on to two of the three pillars of European banking union despite domestic opposition.

Much has been written about European banking union and Germany’s role in shaping it. Indeed, we are well into a second or third generation of scholarship on the topic. Important work on Germany’s position toward European Deposit Insurance points to moral hazard as an explanation for the country’s opposition (Howarth and Qualia 2018; Donnelly 2014). Schäfer’s (2016) analysis demonstrates how economic ideas, in particular ordoliberalism, shaped the preferences and bargaining among German policymakers that, in turn, lead the country to support supervision and resolution pillars. Missing, however, is a comprehensive explanation for Germany's contradictory positions on banking union: German policymakers gambled on a single supervisory mechanism, and a single resolution mechanism yet drew the line on European-wide deposit insurance. Moral hazard partly explains Germany’s opposition to deposit insurance but it begs the question of why Germany supported a European resolution mechanism and fund, which arguably share many of the moral hazard risks (Dermine, 2017). Ordoliberalism likely accounts for Germany’s support of European supervision and resolution but it leaves open the question of why Germany opposes deposition insurance. Moreover, most studies of Germany’s position on banking union neglect or deemphasize the role citizens or voters play in the decision making process. Our research supplements earlier work by asking why political actors pursue some policies and not others, even when the policies are deeply connected. Effective supervision is crucial to curbing abusive and risky bank behavior. It only occurs if banks believe a supervisor has the authority to initiate a resolution. Also, the resolution process is affected by the guarantee to depositors since the degree of depositor protection impacts the distribution of losses among nonguaranteed parties (Verhelst 2012; Elliott 2012). As Mario Draghi stressed, a banking union cannot be achieved without all three pillars (Gros and Belk 2015). And yet while all three are needed for a banking union to function, Germany chose to support two of the reforms, SSM and SRM, and not the third. Germany's mixed positions offer an illustrative case to understand why and how policymakers pursue risky changes.

The following explains Germany’s positions using prospect theory and William Gormley’s salience-complexity typology (Gormley 1986). Prospect theory, a theoretical approach with a rich history in political science[[5]](#footnote-5), explains why policy actors make risky choices under conditions of uncertainty (Kahneman and Tversky 1979; Mercer 2005; Vis 2011). We build on the work of Vis and van Kersbergen (2007) to argue German policymakers’ action (in the case of SSM and SRM) and inaction (in the case of EDIS) on banking union is a function of how policymakers and voters perceive risk and uncertainty. We use a mixed-method approach to identify the reference point from which policymakers and voters assess the risk of the three different banking union policies. Drawing on different sources of data we identify voters’ and policymakers’ perceptions of risk to explain Germany’s position on the three parts of banking union.[[6]](#footnote-6) We complement Vis and van Kersbergen’s (2007) theoretical contribution by introducing the role public saliency plays in the implementation of a policy solution. Following Gormley (1986) and Culpepper (2011), we show German public attention varied across the three banking policies. Low salience levels associated with SSM and SRM compared with EDIS made a compromise on the first two policies possible while hindering compromise on the latter. Moreover, EDIS’s relatively high salience enabled Germany’s public banking interest groups to frame the discussion surrounding EDIS, thus protecting their interest in taking EDIS off the table for the foreseeable future. In short, the concept of salience, when coupled with prospect theory, allows us to explain why Germany opposed EDIS while yielding to compromise and acceptance of SSM/SRM.

The article proceeds as follows: First, we briefly explain the context of the discussion surrounding EBU amid the financial crisis in Europe and throughout the world, as well as the development of the three pillars, focusing primarily on EDIS. Next, we review the state of existing literature on EBU. We then describe our research design and methodology. Finally, we apply prospect theory and salience to explain our case: Germany’s position on EDIS, SSM, and SRM.

Background

EBU originated in the broader concept of the European Monetary Union (EMU), an integral part of the function of the EU from the 1960s. EBU came later, starting in the late 1980s and 1990s with discussions of creating a deposit insurance scheme that would emulate the successful Federal Deposit Insurance Corporation (FDIC) model. It was another two decades later when the idea of a true "banking union," made up of supervision, resolution, and deposit insurance, was brought to the table.

Supervision was the first of the three "pillars" of the formal EBU to pass. The goal of the SSM was to give supervisory authority over all banks to ensure that “banks in the euro area stick to sound financial practices” (European Commission 2012). Michel Barnier, European Commission for Internal Market and Services, stated the "aim [of SSM] is to stop using taxpayers' money to bail out banks," therefore justifying the need for an integrated supervision system which places the European Central Bank as the central supervisor (European Commission 2012). The European Central Bank was designated as this central supervisor, directly overseeing only the largest banks, while ultimately having the authority over all banks in the euro area.

Although an essential first step, SSM alone was not enough—supervision is only effective when the supervisor has the authority to initiate a resolution in the case of a bank failure. This SRM complements the SSM, creating supranational institutions whose role it is to monitor systemic risks, conduct financial supervision, and oversee crisis management (de Larosiere 2009). The SRM, passed in 2014, would be funded through proportional national contributions to a common fund.

European deposit insurance is the third pillar of EBU, although it failed to pass several times. However, there are rules national deposit insurers must follow, a process of harmonization of national schemes which began in 1986. In 2012, an attempt to create a single deposit insurance mechanism, EDIS, failed. Despite this, debates continued well into 2016 regarding the creation of EDIS, with the focus mainly centered on Germany and its institutional critiques of a common deposit insurer. The German banking industry's various interest groups are powerful within both domestic and EU politics, and we posit that Germany's distaste for EDIS is a primary explanation for its failure to pass.

Literature Review & Theoretical Framework

The literature on banking union primarily focuses on the need for and utility of the European Banking Union, as well as explanations for its successes and failures (Schoenmaker and Gros 2012; Ioannidou 2012; Howarth and Quaglia 2014; Epstein and Rhodes 2016; Donnelly 2014). These scholars point to the global recession of 2007 and, later, the sovereign debt crisis, as justifications for the creation of the EBU. The EBU is designed to interrupt the primary cause of the wide-spread contagion of global financial failure: the so-called “doom loop” or “vicious circle” in which banks and sovereigns depend on one another (Pisani-Ferry, 2012). Scholars recognize the need for EBU but disagree on the effectiveness of its current standing, as well as on specific institutional arrangements for it.

Scholars generally agree that establishment of an EBU is a necessary step to maintain the stability of the EU financial market, as well as the single currency (Elliott 2012; Schoenmaker and Gros 2012; Donnelly 2014; Howarth and Quaglia 2013, 2014, 2018). Howarth and Quaglia (2013, 2014) focus on the need for EBU to “address[ing] the fragmentation of the single market in financial services.” They cite banking union successes that had been achieved at the time of writing (2013 and again in 2014) but lament the lack of concrete steps in certain aspects of EBU. The authors claim that banking union would be “the most important step in European integration since the launch of EMU” if it fulfilled all five aforementioned aspects (Howarth and Quaglia 2013, 120). Schoenmaker and Gros (2012) in particular point to the risk of linkages between individual “national fiscal weaknesses” and the implications for both national and EU-level banking system stability. Elliott (2012) goes so far as to say that the solution to the crisis of the euro is to “[weaken] the link between debt-burdened governments and troubled banks.” Goyal et al. (2013) and Ioannidou (2012) also refer to the increasingly integrated system of cross-border banks as a significant reason for the completion of a banking union. They are optimistic about the progress made on EBU but point to concerns over the institutional arrangement. For example, Ioannidou (2012) expresses concerns with the ECB acting as the central supervisor. Donnelly (2014) echoes the sentiment that although EBU is necessary, it had not yet reached a sufficient level of implementation or effectiveness.

Donnelly (2014) takes on a primary argument made by scholars of EBU, rejecting the functionalist argument that further Europeanization of banking and financial services is inevitable. Instead, he points to the "gap between demands made for EBU and the willingness of European national governments to transfer these tasks to the EU." In short, Donnelly is skeptical of the future of EBU given the commitment of national member state governments to their respective banking systems. Epstein and Rhodes (2016) challenge this, arguing that although “national prerogatives prevailed in the first phase” of banking union, there is an increased commitment to supranational institution-building for EBU. Still other scholars view the negotiation over banking union as a function of diverging national views of banking union’s purpose, domestic constraints, and the distribution of cost and benefits (Schild 2018).

Scholars also seek to explain the levels of success for the "pillars" that make up the EBU. Often the discussion centers on the political disagreements between France and Germany, given the institutional differences in their banking systems. Our research contributes to this debate in its focus on the salience of EBU, particularly EDIS, for the German public. Scholars agree that Germany opposed EBU from the outset. They disagree on the real impact that opposition had on the practical outcomes of EBU. Epstein and Rhodes (2016) reject the common claim that outcomes of EBU debates “illustrate the power of Germany to veto policy developments of which it disapproved” (416). They point to concessions Germany made regarding SSM and SRM, despite vehement opposition against further risk-sharing within the banking sector. Ultimately, they attribute the current institutional structure of EBU to the “ability of the European Commission and ECB to manipulate the policy process” even in the face of German opposition (Epstein and Rhodes 2016*,* 431). Others, including Schäfer (2016) and Skuodis (2018) note the specific points of debate on which Germany yielded, including the creation of the Single Resolution Fund (SRF), the ECB's control over all EU banks, and the speed at which the agreements were implemented. Schäfer (2016), in particular, describes how Germany’s ideational frame of ordoliberalism rather than material interests led the country to support European resolution and supervision.

Most recently, Howarth and Quaglia (2018) explain continued German opposition to EDIS, ultimately concluding that German concerns about moral hazard and commitment to their existing national deposit guarantee schemes and institutional protection schemes shape these long-lasting preferences. The authors refer to specific concern “regarding the financial imposition upon banks of healthier national banking systems-first and foremost Germany [which was] politically unpalatable for policymakers” (190).

Together, this literature holds that EBU was a necessary response to financial crises especially given the interconnectedness of European banking. Further, scholars show most actors in Europe—be they politicians, EU institutions, or member states—supported some level of EBU. The literature supports the argument that Germany led the opposition to EBU proposals. And the literature examines the impact that opposition had on the current incarnation of EBU. Despite this wealth of knowledge, one is left with one question: If Germany was just as opposed to SSM and SRM as to EDIS, why did it make concessions on the former but not the latter? Arguments related to moral hazard, ideational frameworks, or domestic constraints can be applied to all three pillars, yet the willingness of Germany to yield sovereignty over its banking system differed across the pillars. We use the theoretical frameworks provided by prospect theory, as well as literature regarding political salience to explain Germany's seemingly contradictory stance on EDIS.

*Prospect Theory*

Prospect theory is a descriptive model of decision making developed by Kahneman and Tversky (1979) that offers an alternative to rational choice theory. Under conditions of uncertainty and risk, people -- populations, voters, policymakers – fail to maximize their expected value or behave rationally in the rational choice sense of the term. Uncertainty and risk lead individuals to weigh potential losses larger than gains when making choices (Vis and van Kersbergen 2007) and weigh outcomes that are certain over probable outcomes (Kahneman and Tversky 1979).

# At issue in prospect theory is how one perceives their current situation, i.e., the reference point. Whether one perceives oneself in a positive "gain" or a negative "loss" domain shapes the likelihood one will opt for reform or stick with the status quo. Prospect theory, however, says little about how one determines the location of the reference point. Citing Levy (1997, 100), Vis and van Kersbergen (2007) note prospect theory is “a reference-dependent theory without a theory of the reference point” (157). It is akin to rational choice theory which is based on preferences yet offers no theory for how preferences are determined.

# In democratic systems, policymakers' and voters' preferences determine policy outcomes. Assuming one can identify policymakers' and voters' reference points, prospect theory tells us that both groups avoid risks when they consider themselves in a gain domain and opt for the risky choice if they perceive themselves in a losing domain. Vis and van Kersbergen (2007, 160) develop a matrix we rely on for our analysis that illustrates conditions that favor the status quo (doing nothing) and those that lead governments to take the risk of adopting a risky reform such as SSM or EDIS.

# We hypothesize that governments undertake a banking reform with risky electoral consequences if they perceive their current situation to be a loss (either cell I or II in Figure 1). If voters are also in a loss domain, banking reform occurs easily. Alternatively, if voters perceive themselves in a gain domain, governments will face public opposition. We expect that policymakers will still opt to gamble but take steps to avoid the political fallout by pursuing what Vis and van Kersbergen (2007, 160) refer to as “blame avoidance strategies."

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | **Government Policymakers** | |
|  |  | Losses Domain  (status quo -/-) | Gains Domain  (status quo +) |
| **Voters** | Gains Domains  (status quo +) | (risk averse, risk seeking  Conflict:  Government wants reform, Voters Oppose Reform  I | (risk averse, risk averse)  No Conflict  III |
| Losses Domain  (status quo -/-) | (risk seeking, risk seeking)  No Conflict  II | (risk seeking, risk averse)  Conflict:  Voters wat reform, Government opposes reform  IV |

**Figure 1. Voters’ and Governments’ Domains (Vis and van Kersbergen 2007)**

# If the government views its current position favorably as a gain (cells III and IV), we hypothesize that policymakers will resist banking reforms and favor the status quo. Again, this can go one of two ways. If the voters perceive their situation as satisfactory, opting for the status quo will be uncontentious. Alternatively, if voters perceive their welfare in jeopardy, we expect policymakers and their interest group allies will take steps to change the public's view. It is in this cell that saliency plays a vital role by giving interest groups the opportunity—when salience is high—to influence voter perspectives.

*Salience*

Saliency measures how much the public cares about an issue. A highly salient issue is  
one that large numbers of people care about in a significant way. An issue’s salience may change over time if, for example, the underlying problem worsens or an issue gets redefined by an interest group’s campaign or policy entrepreneur. Gormley’s (1986) salience-complexity typology, as well as Culpepper’s work (2011) offer a simple diagram that enables one to generate hypotheses about the type of politics one can expect from a policy choice based on an issue’s complexity and saliency.

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | **Issue Complexity** | |
| **Issue Salience** |  | **Low** | **High** |
| **High** | Hearing Room Politics | Operating Room Politics |
| **Low** | Street-level Politics | Board Room Politics |

**Figure 2. Complexity/Saliency Diagram (Gormley 1986, 607)**

In the case of highly salient issues that are relatively easy for the public to understand politicians and interest groups have an incentive to take their message to the public through media and advertising campaigns. We hypothesize that this type of “Operating Room Politics” is contentious and rarely leads to substantive solutions. In contrast, complex issues with relatively low salience lead to what Gormley calls “Board Room Politics” or Culpepper terms “Quiet Politics;" the condition in which a lack of public awareness or interest enables policies to be more easily crafted by bureaucrats and interest groups. Boardroom or quiet politics is also contentious. However, conflicts occur behind closed doors, and generally not between politicians trying to score electoral points which leads us to hypothesize a greater likelihood of compromise. Whereas prospect theory explains the likelihood policymakers will support risky policy changes on banking union, saliency theory explains the likelihood of achieving compromise necessary to implement the policy changes.

The high level of salience associated with deposit insurance – particularly in the wake of Cyprus’ bank failures -- presented interest groups and policymakers the opportunity to shape the debate and ensure voters' reference point was in a “gain” position, that a policy change would be too risky, and that the status quo was the best option.

Research Design and Methodology

We employ a within-case comparison or an embedded multi-case design (Yin 2003, 40) of a single country (Germany) and a single regulatory sector (banking). Our design draws on Przeworski and Tuene’s (1970) "most similar systems" in that we select cases with different values on the dependent variable and similar values on all but one of the possible causal variables. The dependent variable is Germany's position on the EU's three banking union proposals. Institutional- and interest-group factors that affect Germany's position on banking union, including the federalist systems, the domestic governing coalition, the EU governing structures, and societal issue networks are similar across all three proposals. What is different across the three cases is how lawmakers and voters perceive their reference position vis-à-vis the risks associated with each policy proposal. Secondarily, the level of public saliency differs across the three proposals affecting the likelihood of a compromised solution.

Our analysis uses quantitative and qualitative data including 1) Eurobarometer public opinion data from 2012 and 2013; 2) transcripts of German parliamentary debates over the EU proposals in the country's lower house, the *Bundestag*; 3) German press accounts; 4) a quantitative examination of the media coverage devoted to different part of banking union in the four highest-ranked online news publications and 5) semi-structured interviews with German and European elites directly involved in the proposal and adoption of the three banking policies.

# Prospect Theory and Germany’s Position on Banking Union

# Prospect theory requires one to identify the reference point (Mercer 2005). It is not enough to show that reform is framed as a loss or a gain. What matters is whether – before deciding to adopt a policy -- policymakers and voters view their position as a "gain" or a "loss." To identify voters' reference point we draw on surveys conducted by the European Commission, Directorate-General for Communications in 2012 and 2013 (European Commission 2012, 2013). To identify policymakers' reference point, we draw on interviews in the press and textual analysis of German parliamentary debates[[7]](#footnote-7) before turning to the evidence some historical context is presented to appreciate how voters and policymakers experienced the crisis as it was happening.

# In the lead up to the European Commissions’ three proposals on banking union, Germany’s banking system was in crisis. When the financial crisis began in the US in 2006, German lawmakers and policy elites reacted with *Schadenfreude*; expressing concern but also self-satisfaction that such examples of Casino-capitalism could not occur in the risk-averse Rhine Model of capitalism (“Lessons from a crisis,” 2008, “The World From Berlin,” 2008). *Schadenfreude* quickly turned into a domestic crisis when Germany’s banks suffered losses from the same bets that brought down US banks. By 2009 the 18 largest German banks carried 305 billion Euros in toxic assets on their balance sheets (Reiermann and Reuter 2009). Especially shocking to the public and policymakers were the losses suffered by Germany’s public state banks, *Landesbanken*.

# Although they comprised 21 percent of German banking assets before the crisis, *Landesbanken* accounted for 41 percent of the losses (Cassell 2016; Bofinger *et al*. 2008, 137). Commercial banks like Deutsche Bank and Commerz Bank also suffered significant losses, but *Landesbanken* suffered the most severe combined losses. *Landesbanken* losses were so significant that a report published by Germany's Federal Bureau of Statistics in 2008 called for privatization of all *Landesbanken* (Bofinger *et al*. 2008, 2)*.*

# Losses resulted in a wave of capital injections and guarantees by federal, state and private actors. The Special Fund for Financial Market Stabilization (Soffin) became ground zero for Germany’s 480 billion Euro bailout program (Spiegel Online 2008). *Landesbanken* losses undermined the public’s trust in one of their public institutions and in the state policymakers who served on the supervisory boards of the *Landesbanken.* As co-owners of Landesbanken, *Sparkassen* bore significant responsibility for the losses. The public savings banks’ involvement in the *Landesbanken* collapse damaged the public’s positive image of *Sparkassen* (Balzli, Pauly, and Reuter 2009). Finally, press accounts of how public and private banks were resolved with taxpayer Euros dominated the press through 2011 and 2012. In was in this environment that the European Commission surveyed Europeans including Germans on their views toward the economy and the impact of the financial crisis.

# The surveys reveal the public’s reference points on banking union at the moment that all three proposals were considered. In 2012, 59 per cent of Germans believed the worst impact of the financial crisis was still to come (European Commission 2012). This is slightly lower than the EU27 average (62 per cent) but underscores the prospective unease German voters felt toward the economy. German voters were in a "loss" domain. Pessimism in Germany was on the rise. Between the spring and autumn of 2012, the number of Germans who expressed the view that the worst of the economic crisis was still to come increased by five percentage points. Only 27 per cent believed the impact of the crisis on jobs had peaked.

# German voters' foreboding about their economic future does not automatically imply a connection to the country's banking woes. Fortunately, the European Commission commissioned several surveys the following year that asked Germans their views on policy areas that parallel the three pillars of a banking union (see Figure 3). A survey conducted in May 2013, found 83 per cent of Germans believe a central supervisor of the banking system at the EU level would be useful in tackling the financial and economic crisis. A month later a separate Eurobarometer survey asked respondents to reveal whether supervising and monitoring banks should occur at the national or EU level (European Commission 2013).

**Figure 4: German support for EU-level solutions to banking union by political party**

# More than two-thirds of Germans believed banking supervision should occur at the EU level. The finding was consistent across all political parties. Green Party voters were the most likely to favor an EU solution (77 per cent). However, CDU/CSU voters (74 per cent) and Left Party voters (73 per cent) favored an EU solution at higher rates than the SPD voters (70 per cent).

# The Eurobarometer survey also revealed a supermajority of Germans (62 per cent) believe resolving banks should be left to the EU. Again, the finding was consistent across political parties with Green (73 per cent) and FDP (74 per cent) voters expressing the most support for an EU solution and Left Party voters the least support (59 per cent). Sixty-five per cent of SPD and CDU/CSU voters supported an EU solution to the problem of resolution.

# Finally, the survey asked respondents whether they thought their national government or the EU should be the entity that guarantees deposits. A majority of Germans (55 per cent) expressed a preference for an EU solution. Surprisingly, the most robust support for an EU solution was from CDU/CSU voters (58 per cent), and the lowest support was expressed by SPD voters (54 per cent). Fifty-five per cent of Green, FDP, and Left Party voters believe the EU is a more effective government than the German government in guaranteeing deposits.

# German voters in 2012 believed the economic crisis was worsening even after the government had taken costly measures to resolve failing banks. In surveys conducted six months later German voters expressed a strong preference to reform Germany’s banking regulatory and resolution system. And finally, the surveys show variation across the three banking policies: the strongest support for an EU supervisor, moderate support for an EU resolution authority, and the least support for an EU guarantor of bank deposits. Somewhat surprising is that in the spring of 2013 the majority of Germans supported ceding authority to the EU across all three banking policy area including deposit insurance. German voters understood themselves to be in a "loss" domain when the Commission first proposed banking union policies. But how about German policymakers?

We selected two *Bundestag* sessions where the banking union was the focus of debate and analyzed how politicians framed the three pillars of banking. During the first session, held January 17, 2013, members of parliament debated the EU proposal for a single resolution scheme and a single supervisor. During the second session, February 25, 2016, parliamentarians debated the EU's proposal for EDIS.

Following Berelson (1952) we use an inductive approach to analyze the content of the parliamentary debates. We conduct a descriptive content analysis, identifying and coding each justification given by policymakers for their position on SSM, SRM, and EDIS. Our unit of data analysis are parliamentary statements. Moreover, while we limit our data collection to the debates, we also use interviews with parliamentarians as a check on our analysis. Appendix 1 compares frames used by policymakers.

During January 2013 debate each political party emphasized a different understanding of the problem, there was agreement that Germany was in the loss reference point, and that supranational solutions to supervision and resolution were needed to prevent a further slide (Deutscher Bundestag 2013). Peer Steinbruck, leader of the SPD, expressed the problem as loss of trust in Germany’s economic order. Steinbruck argued an EU system to resolve and supervise banks would slow Germany’s increasing dependence on profit-seeking banks and prevent further losses to taxpayers. Wolfgang Schäuble, CDU Finance Minister, also referenced a *Vertrauenskrise* or crisis of trust/confidence in the Euro (Deutscher Bundestag 2013, 26777). For Schäuble, without SSM and SRM the stability of the Euro was in jeopardy. This was echoed by Klaus-Peter Flosbach (CDU/CSU) who said: "only when everybody follows the rules do we achieve a stable Europe” (Deutscher Bundestag 2013, 26786). Volker Wissing (FDP) saw resolution and supervision as necessary to keep Germany from losing its economic competitiveness (Deutscher Bundestag 2013, 26782). Finally, the Green Party and the Left Party also saw SSM and SRM as necessary to stop the economic slide, but ministers felt both proposals were too weak. Before the financial crisis, German policymakers opposed EU banking, however by 2012 & 2013 they had changed course; although risky, policymakers viewed the policy changes as necessary to prevent a continued loss of trust and stability. Based on their testimony, when it came to ceding authority to an EU supervisor and resolution authority, German policymakers' reference point was in a "loss" position.

Germany’s *Bundestag* reviewed the question of EDIS on February 25, 2016, three months after the EU Commission’s latest proposal for pan-European deposit insurance (European Commission 2017). As they did three years earlier, party leaders debated the EU proposal. The two most common frames from CDU/CSU and SPD representatives were “*Vergemeinschaftung*” and “*Zwangshaftung.*” Although imperfect, the terms “socialization,” “communalization,” or the phrase “broadening the community” come close to the meaning of *Vergemeinschaftung*. In the context of EDIS, policymakers used the term to describe watering down Germany’s subjective sense of its community by acquiring the risks and financial burdens of other countries. In other words, policymakers argue their current economic situation, with which they were happy, was under threat.

Consider Alexander Radwan’s (CDU/CSU) description of EDIS as the “*Vergemeinschaftung* of debt and risk on to Germany's regional banks and small banks that is the source of a high level of stability” (Deutscher Bundestag 2016, 15571). Manfred Zöllmer (SPD) used the term to describe EDIS stating, “A *vergmeinschafte* deposit insurance can only occur when the existing risks in the banks have been reduced” (Deutscher Bundestag 2016, 15551) The reaction of policymakers to EDIS implied that they were happy with their current deposit insurance system. In contrast to German banks, no German depositor had lost any deposits; the countries’ deposit insurance systems were sound particularly public savings bank deposits.

Similarly, *Zwangshaftung* means forced liability or responsibility against one's will. The modifier *Zwang* generally connotes something negative. Manfred *Zöllmer* (SPD) stated about the EU's proposal, "We do not want this type of *Zwangshaftung*. We expect the Commission to enforce the applicable European laws in all member-states” (Deutscher Bundestag 2016*,* 15551) *Zöllmer*’s use of the term is not accidental. An Internet search reveals *Zwangshaftung*’s most common use is by the German Savings Bank Association (DSGV). Georg Fahrenschon (2016), DSGV President wrote in a February 2016 press release: “We don’t need a European *Zwangshaftung*. Effective protection of depositors begins with a responsible corporate policy and nations responsible for their own deposit insurance system.”

Policymakers viewed change as constraining a system with which they were satisfied. Their reference point was in a “gain” position. Thomas Dörflinger (CDU/CSU) made the strongest case: “We are unified in the belief that it is our responsibility to protect our well-functioning regional banking system… Fight with us [so] that at the European level no decision is made that would weaken our regional banks” (Deutscher Bundestag 2016*,* 15555).

According to Vis and van Kersbergen’s (2007) matrix when voters and policymakers are in a loss position change is likely. This explains Germany’s position on supervision and resolution. In the context of the global financial crisis and a run of German bank failures, particularly *Landesbanken* failures, German voters were pessimistic about the future; their reference point was in a “loss” domain. Not surprisingly, voters supported EU solutions to all three pillars of a banking union. Analysis of parliamentary debates reveals policymakers were in a “loss” position on the question of supervision and resolution. However, two years later, in debates over EU deposit insurance, German policymakers operated from a "gain" position and were therefore unwilling to gamble on EDIS. A question that emerges is what occurs when policymakers operate in a “gain” reference point while voters are in a “loss” reference point? The challenge for policymakers and interest groups is to shift voters’ reference point. To do that, salience matters.

Saliency and Germany’s Position on EDIS

Based on Gormley and Culpepper’s work we argue saliency contributes to Germany’s mixed positions on banking union. EDIS was significantly more salient among the German public than SSM and SRM between 2012 and 2014. Furthermore, the effect of saliency on Germany’s position was two-fold. First, EDIS' relatively high level of saliency created an opportunity for interest groups opposed to the policy, particularly Germany’s cooperatives and public banks, to frame the public's view on EU deposit insurance. And second, SSM and SRM's relatively low level of saliency created a "quiet politics" policy environment in which EU policymakers and bureaucrats could compromise. Our conclusions are based on examining the saliency levels for banking union policies and interviews with policy elites.

No surveys compare German public interest in the three pillars of a banking union. However, there are reasons to believe deposit insurance is and remains more salient to the German public than banking resolution or supervision.

According to public and private banking officials, before the financial crisis, most German account holders thought little about deposit insurance (*Einlagensicherung)*. Following the Euro crisis, a survey of German adults found that 52 percent believed Germany's deposit insurance was important or very important. Nearly 40 percent of Germans said they actively pay attention to Germany's deposit insurance system (TNS Infrastest 2015). A 2011 survey revealed two-thirds of Germans consider *Sicherheit* or safety to be the most important factor in choosing a bank; far more than the 15 percent who chose based on the rate of return (Bundesverband Deutscher Banken 2011). The risk-averse bubble of Germany’s banking system was interrupted in 2008 with the failure of Iceland’s largest banks: Glitnir, Straumur, Landsbanki and Kaupthing (Neubacher 2008). Bank failures in non-EU countries would typically not cause concern in Germany. However, 300 million euros in deposit accounts of 30,000 Germans were threatened by the Icelandic banking collapse (Spiegel Online 2008). Kaupthing was not a member of Germany's DGS, and therefore German deposit holders were dependent upon Iceland's insurance scheme. Iceland's experience raised the possibility that depositors were not safe.

Five years after Iceland's collapse, the Bank of Cyprus and Cyprus Popular Bank were on the brink of collapse and threatened to take down the country's economy. A bank collapse in Cyprus – a small European country – should not have been a particular worry to a German public that had experienced its share of highly-publicized bank failures. What raised the salience of deposit insurance for the German public was the European solution leaders agreed on to bail out the banks. European leaders insisted deposit holders contribute to the bailout; accounts with more than 100,000 euros would pay a one-time tax of 9.9 percent of their savings. Those with less than 100,000 euros would make a 6.75 percent payment. Taxing small savers’ deposits triggered such an outcry throughout Europe that the agreement was changed to only impose a tax (albeit much higher) on deposit holders with more than 100,000 euros. Although the agreement was altered, the damage was done. According to Volkery (2013), a writer for *Spiegel Online*, “The initial assault on small savers has done lasting damage to confidence in Europe’s crisis management.”

The Cyprus solution further raised the salience of deposit insurance. As Armin Mahler (2013) commented in *Der Spiegel*, “Germans are right to be worried about their savings because the euro bailouts will make most of them poorer…not even savings accounts are safe, as was recently seen in Cyprus.” *Die Bild Zeitung,* the largest and most popular tabloid in Germany with a circulation of 3 million readers, published daily articles for a week during the Cyprus banking crisis with the large hyperbolic headlines: “How safe are our deposits?”[[8]](#footnote-8) or “The money is gone – can it happen to us?”[[9]](#footnote-9) Articles focused on threats to German deposit holders. A survey of the German public conducted a month after the Cyprus bailout for the business newspaper *Handelsblatt,* found that less than a third of Germans felt their deposits were safe and 59 percent of Germans did not believe Chancellor Angela Merkel’s claim that they were[[10]](#footnote-10).

We analyzed 1902 articles published on banking supervision, resolution and deposit insurance between January 1, 2012, and December 31, 2014, in four most visited news websites in Germany[[11]](#footnote-11): *Focus, Bild, Die Welt, and Der Spiegel*. To collect the data, we relied the news aggregator, *Factiva*, which assembles news texts from around the world and makes them available to researchers. Using the statistical software R, we calculated the number of words devoted to each topic, each week, and for each of the four publications. News coverage is a proxy for salience. Our analysis supports the narrative that deposit insurance is more salient than supervision and resolution. Supervision occasionally receives more coverage than deposit insurance. Resolution gets the least attention. However, overall deposit insurance garners the most attention. What also stands out from the analysis is that deposit insurance coverage spikes in March and April 2013 during the Cyprus crisis.

**Figure 3: Weekly total word count devoted to deposit insurance, banking supervision, and banking resolution 2012-2014.** 

To determine how salience mattered we interviewed banking lobbyists in Brussels, staff to MEPs who served on the European Parliament's CommitteeonEconomicand Monetary Affairs(ECON) during the banking union debates, and representatives of DSGV and the Association of German Banks (*Bundesverband deutscher Banken*). Interviewees identified several ways in which saliency mattered. First, saliency enabled the public campaign against EDIS to gain traction. The DSGV, in particular, launched a massive advertising campaign against EDIS; running full-page advertisements in all of Germany's major news publications. Banking lobbyists and representatives from public banks’ interest groups noted the campaign was particularly effective in the wake of the Cyprus crisis. They argued that their public campaign against EDIS turned the voting public’s reference point from a loss to a gain.

And second, as Culpepper’s work predicts, interviewees noted the lack of public attention devoted to supervision and resolution created space to find compromises on SSM and SRM. For example, proponents of a banking union with a small number of large banks led by France advocated for a banking union that covered all banks with the Eurozone. Countries with a large number of smaller banks, led by Germany, opposed banking union. Ultimately, policymaker compromised: applying the new policies only to “significant institutions,” those with holdings greater than 30 billion euros or 20% of the GDP of the state where they are based, and those directly funded by the European Stability Mechanism or European Financial Stability Facility. One MEP staff person stressed that a similar compromise could have been reached on deposit insurance but that there was a clear message from the German delegation that deposit insurance was a none starter.[[12]](#footnote-12) A representative from the Association of German Banks noted, “Nobody cares or understands resolution or supervision. What people understand and what they are very concerned about is the safety of their deposits…all they care about is the 5000 euros in their account.”[[13]](#footnote-13)

In sum, saliency surrounding deposit insurance likely moved voters from a "loss" to a "gain" domain and put voters in sync with the reference point of policymakers. Interviews also revealed the relatively low level of saliency around supervision and resolution enabled those countries initially opposed to banking union to find compromise solutions.

Future of Banking Union

Scholarship on a banking union has evolved considerably since the establishment of the European Monetary Union. The earliest work made a case for greater fiscal integration. The Great Recession triggered an outpouring of research that made the case for why economic stability in the EU demanded a European-wide solution to supervision, resolution and deposit insurance. Since the recession, scholars have turned attention to explaining different parts of the banking union, the challenges of enforcement, and why particular countries like Germany reject EDIS. Our work builds on earlier work by using the experience of the banking union in Germany to ask a more fundamental question: Why do policy actors make risky choices under conditions of uncertainty? Germany’s mixed position on three pillars of banking union offers the ideal case to explore the question since the country gambled on two the policies but not on the third.

In line with liberal intergovernmentalist expectations, we find domestic banking interests in Germany influenced the country’s position on EDIS. The country’s ordo-liberal understandings of political economy also influenced Germany’s positions. However, neither interests nor ideology was determinative. Domestic banking interests also opposed SRM and SSM and were ultimately compelled to accept a compromise. And economic ideology remained the same across all three pillars.

Prospect theory and saliency offer an answer as to why German lawmakers made the risky choice to support SSM and SRM and not EDIS. Fundamentally, policy change is a function of how voters and policymakers understand their current position in light of significant uncertainty. In line with Vis and van Kersbergen (2007), we find that when it came to supervision and resolution policymakers and voters were a loss domain – they believed the economic situation would get worse and therefore the risk was worth it. When it came to deposit insurance, policymakers were in a gain domain while voters were initially in a loss domain. Heightened public attention surrounding deposit insurance – triggered in part by the bank failures in Cyprus – created an “Operating Room” policy environment whereby interest groups engaged the public through mass advertising campaigns and policymakers engaged in almost irrational public posturing going so far as to compare EDIS with placing a vampire in charge of a blood bank. As Gormley and Culpepper predicted, the heightened level of salience reinforced the status quo and ultimately reduced the space for compromise.

Our work suggests that psychology also matters. For Germany to change its position on European-wide deposit insurance requires a shift the reference point of voters and policymakers. Both groups need to perceive their current situation as a loss, as likely to worsen in the future. Without such a shift in their respective domains, the status quo is likely to prevail.

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Appendix 1

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| --- | --- | --- |
| **Sample of frames used to describe the Single Supervisory Mechanism and Resolution Mechanism** (January 17, 2013, Berlin Germany) | | |
| **Speaker** | **Frame** | **Examples** |
| Peer Steinbruck (SPD) | Loss of Trust and Stability | This crisis does not just cost us money and trust. Rather it can cost us trust in the economic order.  *Diese Krise nicht nur Geld und Vertrauen kosten kann, sondern eventuell auch das Vertrauen in unsere wirtschaftliche Ordnung,* |
| Wolfgang Schäuble (CDU/CSU) | Reestablish Lost Trust | We’re not over the mountain yet. But we’re on the right path toward addressing step by step the crisis in confidence with respect to the euro.  *Wir sind nicht über den Berg, aber wir sind auf dem richtigen Weg, die Vertrauenskrise in Bezug auf den Euro – denn aus all dem ist eine Vertrauenskrise entstanden – Schritt für Schritt zu lösen.* |
| Richard Pitterle (Linken) | The situation is worse than the government portrays. Proposal does not go far enough | The government decorates itself with foreign feathers and fog candles. You propose improving things with tougher and more effective regulations of the financial markets. What is “improving”? Why don’t you actually start?  *Die Bundesregierung schmückt sich mit fremden Federn und zündet Nebelkerzen. Ihr Antrag ist mit„Schärfere und effektivere Regulierung der Finanzmärkte fortsetzen“ überschrieben. Was heißt hier „fortsetzen“? Fangen Sie doch erst einmal richtig an!* |
| Volker Wissing (FDP) | Loss of Stability | We want to stabilize the financial sector of Europe  *Wir wollen die Stabilisierung des Finanzsektors in Europa* |
| Gehard Schick (Greens) | The system has failed. Proposal is insufficient | For you the financial crisis is business failure that requires a couple of screws. For us the financial crisis was a system failure that demands more than a couple of screws.  *Für Sie ist diese Finanzkrise ein Betriebsunfall, nach dem man ein paar Schrauben anziehen muss, für uns ist diese Finanzkrise die Folge einer systematischen Fehlentwicklung, die wir korrigieren müssen. Da reichen ein paar Schrauben nicht aus* |

|  |  |  |
| --- | --- | --- |
| **Sample of frames used to describe the European Deposit Insurance System**  (February 25, 2016, Berlin Germany) | | |
| **Speaker** | **Frame** | **Examples** |
| Antje Tillmann (CDU/CSU): | Increased risk to the system. | We want to minimize the risk of the system. We don’t just want to transfer national risks to the entire European union.  *Wir wollen in diesem System Risiken minimieren . Wir wollen nicht einfach Risiken aus Einzelstaaten auf die Allgemeinheit der Europäischen Union übertragen.* |
| Manfred Zöllmer (SPD) | The current system is stable. EDIS leads to greater instability | We do not want this forced liability...The Commission’s proposal will not lead to more stability but great instability in Europe.  Wir wollen eine solche Zwangshaftung jedenfalls nicht…Das Vorhaben der Kommission führt nicht zu mehr Stabilität, sondern letztendlich zu mehr Instabilität in Europa . |
| Alexander Radwan (CDU/CSU) | Regional banks work. EDIS threaten to weaken ‘our’ regional banks. | Now is the time to fight with us to protect our regional banks from the European decision.  *Kämpfen Sie mit uns…wenn die Zeit dafür gekommen ist – jetzt ist die Zeit dafür –, dass auf europäischer Ebene keine Entscheidungen getroffen werden, die unsere Regionalbanken schwächen* |
| Christian Petry (SPD) | German savers are doing well. EDIS threatens them. | We are replacing German savers with Germany taxpayers who will have to step in to bailout others.  Wir ersetzen „deutscher Sparer“ aber im Moment durch „deutscher Steuerzahler“, da der im Ernstfall für andere einspringen muss . |
| **Lisa Paus** (BÜNDNIS 90/DIE GRÜNEN | German deposit insurance may be sound but the safety of deposits varies across Europe. | The one thing the financial crisis taught is that banking deposits much be safe…everywhere in Europe.  *Denn eines hat uns die Euro-Krise doch gelehrt: Kundeneinlagen bei Banken müssen sicher sein – überall in Europa .* |

1. Professor of Political Science, Kent State University [↑](#footnote-ref-1)
2. Doctoral student in Political Science, Kent State University [↑](#footnote-ref-2)
3. The ECON Committee is charged with debating and issuing recommendations to the European Parliament on proposals for each of the three pillars of banking union. In explaining Germany’s centrality to the process, the staff member pointed out that prior to 2015 the Rapporteur (Peter Simon) for the ECON and the shadow Rapporteurs for all the political groups except one were German. [↑](#footnote-ref-3)
4. The political risks for German policymakers is and remains considerable. Industry groups in Germany representing public banks and cooperatives initially opposed all three pillars of banking union. Leading German economists opposed banking union. And while the German public generally supports greater EU integration, the rise of political parties like Alternative für Deutschland (AfD) points to voter opposition to policies perceived to weaken Germany’s sovereignty. Economic risks are also significant. It is unclear whether the EBU significantly reduces the risk of another banking crisis. EU leaders note that without all three pillars in place, the stability of the system is at risk because some European banks are safer than others. And some EU economists question the efficacy of the resolution mechanism to prevent another global recession (Dermine, 2017)

   [↑](#footnote-ref-4)
5. See Jonathon Mercer. 2005 “Prospect Theory and Political Science.” *Annual Review of Political Science* 8:1-21. [↑](#footnote-ref-5)
6. Causal factors that affect perceptions of risk such as preferences or values of voters and policymakers is beyond the scope of this study and beyond the available data. Moreover, identifying why a voter or policymaker believes the status quo is acceptable or that a policy change is necessary may be important for studying bargaining. However, Vis and van Kersbergen's (2007) work suggests it is not necessary for a single country’s position on banking union. [↑](#footnote-ref-6)
7. Others have utilized German parliamentary debates as well in discussing legislative change. See Rainer Eising and Florian Spohr. 2017. “The More the Merrier? Interest Groups and Legislative Change in the Public Hearings of the German Parliamentary Committees.” *German Politics* 26(2): 314-333. [↑](#footnote-ref-7)
8. “Wie sicher sind unsere Spraguthaben?” *Die Bild Zeitung* (3/31/2013). [↑](#footnote-ref-8)
9. “Geld futsch – kann das auch bei uns passieren?” *Die Bild Zeitung* (3/26/2013) [↑](#footnote-ref-9)
10. Handelsblatt, ‘Die Deutschen verlieren das Vertrauen ins Sparbuch,’ *Handelsblatt* (2013). [↑](#footnote-ref-10)
11. Based on rankings from alex.com, which measures website popularity. [↑](#footnote-ref-11)
12. Interview conducted October 10, 2018. [↑](#footnote-ref-12)
13. Interview conducted February 23, 2017. [↑](#footnote-ref-13)