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Leadership in Hard Times:

France, Germany and the Management of the Eurozone Crisis[i]

JOACHIM SCHILD

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Author contact information

Prof. Dr. Joachim Schild

Chair of Comparative Politics

University of Trier, FB-III / Political Science

D-54286 Trier (Germany)

E-Mail: schild@uni-trier.de

Introduction

Since the spring of 2010, the EU and its Member States have faced the risk of seeing the EMU break apart, triggering strong disintegrative tendencies beyond EMU for the wider European integration project. In this situation of acute and deep crisis, the future of the euro area crucially depends on strong European political leadership. As crisis management activities and the redesign of the euro area's governance structures deeply affect national financial resources and national competencies, the kind of leadership needed cannot primarily come from European supranational institutions; it must originate from powerful and resourceful Member States.

Since the very first steps towards European monetary integration in the late 1960s, France and Germany have always had a principal role in European monetary integration and in defining the institutional framework governing monetary policy and fiscal policy coordination.[ii] This article attempts to shed light on the capacity of France and Germany to assume a crucial political leadership role during the current euro area crisis.

We first lay out our understanding of political leadership in the European Union and then focus on the specific Franco-German leadership role during this crisis, in terms of both short term crisis management and their contribution to a redesign of the rules governing the Eurozone.

I. Franco-German Leadership in the EU

According to a definition advanced by Eckhard Lübkemeier, "leadership in the EU is provided by actors who are willing and capable, acting as co-leaders, to prompt other actors to contribute to the achievement of collective goals."[iii] In this sense, Germany and France have repeatedly acted as co-leaders in the field of European integration, not least in monetary integration. Franco-German bilateralism in Europe has involved three basic types of leadership in regional politics: (1) promoting European integration, (2) crisis management, and (3) encouraging closer cooperation in subgroups of Member States. All of these dimensions of European leadership can be found in the management of the current sovereign debt crisis.

The *promoting European integration* type of leadership roughly corresponds to the widespread idea of the "Franco-German engine" for Europe, either in the sense of deepening integration by expanding the EU's functional scope, or via geographical enlargement.[iv] *Crisis management*—namely, attempts to manage, control, or overcome a looming or open crisis inside the EU—is a second type of European leadership. Bilateral leadership, finally, may be exercised in and through *patterns of differentiated integration*. Here, France and Germany (or other Member States) move ahead, creating subgroups of EU Member States. Other Member States may join later, if they consider the group successful or deem non-participation costly politically or otherwise. Thus, this kind of leadership may result in a dynamic enlargement of subgroups, eventually leading to formal insertion of an initially informal integrative scheme into the treaty framework.

These three types of leadership – promoting integration, managing crises, and shaping subgroups of Member States – may be exercised in three ways: (1) agenda-setting; (2) consensus building; and (3) coalition building. Franco-German *agenda-setting* includes the interpretation of a given political situation and the definition of a problem to be addressed by the EU as a whole or a subgroup of Member States. In the past, Franco-German European agenda-setting frequently took the form of submitting common Franco-German proposals to promote both institutional innovations and substantive policy changes.

Consensus building in EU-level negotiations refers to an entrepreneurial function of leadership.[v] Entrepreneurial leaders help to reap all the potential benefits on the negotiating table and work to overcome collective action problems. They provide focal points for negotiations or broker compromises, and they may help to overcome situations of decision-making deadlock. Consensus building in the context of Franco-German bilateralism often includes the shaping of "compromises by proxy,"[vi] in which France and Germany strike bilateral compromises acceptable to other Member States that feel their own interests are properly represented by either France's or Germany's position. In other words, this leadership function does not rest on converging preferences—quite the contrary.

In a different kind of entrepreneurial leadership, France and Germany may succeed in the art of *coalition building*, gathering support behind their own favourite solutions. In such cases, both are part of a powerful winning coalition. Thus, they try to sideline or overrule opposition or, alternatively, establish subgroups of Member States excluding reluctant states.

Table 1: Types and Ways of Providing European Leadership

<table>
<tr><th>Types of leadership</th><th>Ways of providing leadership</th></tr>
<tr><td>promoting integration
• deepening and enlarging the EU</td><td rowspan="3">agenda setting and common proposals
– institutional blueprints
– policy proposals

consensus building

coalition building</td></tr>
<tr><td>crisis management
• overcoming decision-making deadlock at the EC/EU level and managing economic crises</td></tr>
<tr><td>creating smaller subgroups of Member States
• promoting permanent differentiated integration by establishing subgroups of Member States</td></tr>
</table>

Source: own compilation

Situations of acute political and economic crisis stimulate a strong demand for European leadership that only powerful Member States with corresponding resources of influence can generally provide—for instance, the necessary financial ‘firepower’ in the context of the euro area crisis. Hence, European political and economic crises provide ample opportunities for leadership, not least Franco-German leadership, as Commission leadership is in short supply. Decision-making under severe time constraints with a high degree of uncertainty does not allow for the use of regular and time-consuming procedures in the multi-level fragmented power structure of the EU.[vii] During the sovereign debt crisis, the degree of urgency, high political and economic costs, and far reaching political consequences called for a strong role of the European Council and of resourceful Member States. The lack of strong EU competences in economic policy coordination added to this need.[viii]

France and (even more so) Germany, clearly stand out for their issue-specific leadership resources on EMU matters in terms of their combined GDP and their combined share of ECB capital (48 percent of the euro area, with 27 for Germany and 21 for France). Their standing in international financial markets provides them with another leadership resource, with Germany preserving its AAA rating while Standard & Poor’s downgraded France’s sovereign bond rating on 13 January 2012 to AA+, still among the highest in the euro area. Still, the translation of such resources into actual European leadership depends on a common interpretation of the situation, common or at least complementary preferences, and the willingness as well as the capacity to formulate a common strategy.

However, this type of crisis could also produce deep and lasting splits between France and Germany. The history of European monetary integration is replete with examples of Franco-German divergences with regard to integration strategies, prerequisites for the creation of a monetary union, preferred institutional setup, and choice of policy instruments. Against the background of their often diverging and competing views on crucial issues of monetary integration and fiscal policy coordination, a common Franco-German leadership role in tackling the crisis and in redesigning the economic governance of the Eurozone was by no means self-evident.

Divergent Assessments, Divergent Approaches

In the spring of 2010, when the sovereign debt crisis came to its first climax due to the unsustainable fiscal position of Greece, Paris and Berlin interpreted the situation in quite different ways. French President Sarkozy and his government grasped the destructive dynamic of the speculative attacks on Greece and their spillover potential early on, urging the EU to act. Angela Merkel, however, delayed common European action beyond the date of an important regional state election in North-Rhine Westphalia (9 May 2010), thus adding to the costs of redressing the situation.[ix] And while German actors interpreted the sovereign debt crisis primarily as a consequence of fiscal profligacy, French Minister of Finance Christine Lagarde pointed to underlying problems of competitiveness and macro-economic imbalances. She criticized Germany for its huge current account surpluses, implicitly reproaching it for playing a non-cooperative game inside the euro area.[x]

Nevertheless, France and Germany shared one overriding goal throughout this crisis: preventing the euro area from breaking apart, and keeping Greece in. “If the Euro fails, Europe fails”, as Merkel repeated time and again.[xi] The basic approaches of Berlin and Paris on how to secure the future of the euro area, however, largely reflected differences well known from past controversies on how to organize the EU’s Economic and Monetary Union. France continued to prefer a policy discretion approach, with the European Council and Euro summits of the heads of state and government serving as the economic government of the euro area; whereas Germany still favored a rule based approach. However, “the approach the German side favored – a system of criteria, rules and rule-bound institutions – proved inadequate for preventing the national debt crisis and also for dealing with it."[xii]

In the past, the German EMU approach had relied on three core pillars that should underpin a stable monetary order: an independent central bank pursuing a stability-oriented monetary policy and prohibited to monetize public debt; European-level safeguards against non-sustainable budgetary policies at the national level (the excessive deficit procedure and the SGP); and national responsibility for fiscal and broader economic policies assuring the necessary national adjustments to the constraints of EMU membership, reflected in the no bail-out clause of the treaty. The sovereign debt crisis demolished these pillars in a short period of time.

The successive rescue packages for Greece (May 2010), Ireland (December 2010), Portugal (May 2011), and again for Greece (July 2011 and February 2012) – as well as the establishment first of temporary stabilization funds (the intergovernmental European Financial Stability Facility EFSF and the European Financial Stabilisation Mechanism-EFSM, based in Union law) and later of a permanent lending facility, the European Stability Mechanism (ESM) – violated a core principle of the Maastricht Treaty, the no bail-out clause (Art. 125 TFEU). The degree of independence of the ECB is open to debate, as politicians pressured it heavily to act boldly and to flood the markets with liquidity. The ECB crossed a red line when it began to purchase sovereign bonds on secondary markets on 10 May 2010, reportedly leading to the resignation of the German president of the Bundesbank, Axel Weber, and the ECB's German chief economist and executive board member, Jürgen Stark. Both considered these purchases to be an indirect way of monetizing sovereign debt.[xiii] The SGP, first violated, then watered down by France and Germany in 2003-2005,[xiv] could not prevent situations of excessive deficits and in any case did not address underlying factors such as growing divergence of competitiveness inside the euro area. Moreover, international financial markets failed to exert disciplining pressures on the periphery members, as market actors did not perceive the risk of sovereign default early on. Thus, the German success in uploading the German stability model at Maastricht was elusive, first because its European-level elements turned out to be less resilient than assumed, and second, because its "download" by the Southern periphery of the euro area was incomplete, to say the least.

German attempts to remedy this situation and to prevent a recurrence of a similar crisis comprised familiar as well as new elements. A familiar element came with proposals to prevent moral hazard and to rely on market pressures providing strong incentives for Member States to redress unsustainable fiscal positions. Hence, Germany insisted on the participation of private lenders in the restructuring of Greek debt and pushed to enshrine the principle of private sector participation in the restructuring of sovereign debts into the treaty establishing the permanent lending facility ESM (European Stability Mechanism). From the German government's point of view, providing for an orderly sovereign default procedure and thus making sovereign default a credible option inside the EMU was necessary to prevent both reckless borrowing and reckless lending.

A second familiar German element came with proposals to strengthen the SGP and to make sanctioning of euro area members with unsustainable deficits more automatic, thus depoliticizing the excessive deficit procedure. We can see a new element of the German approach in Berlin's proactive role in strengthening economic policy coordination beyond the SGP framework. In the past, Berlin had insisted on the non-binding nature of economic policy coordination in the Lisbon process and its follow-up, the Europe 2020 strategy. Now, it subscribed not only to tighter European fiscal policy surveillance through assessments of national draft budgetary plans ("European semester"), but also to the idea of extending multilateral surveillance to macro-economic imbalances, based on a scoreboard of indicators. The new "excessive imbalance procedure", adopted in a so-called "six pack" of legislation on the economic governance of the euro area, even includes the option of sanctioning non-compliant behavior of Member States. In addition, Berlin put forward, together with France, the idea of a "competitiveness pact", which would later become the Euro-Plus Pact agreed upon by the European Council in March 2011. Germany and France designed this agreement in order to strengthen the economic pillar of EMU by politically (not legally) binding national commitments to foster competitiveness, employment, and the sustainability of public finance.[xv] Finally, Berlin staunchly refused the idea of Eurobonds implying a common liability of Eurozone members for each other's debts.

The French approach differed markedly from the German one. First, France displayed a clear preference for more vigorous and decisive crisis management action, such as rescue schemes for Greece and, later, Ireland and Portugal—as well as high firewalls (emergency funds and permanent lending capacities) to prevent contagion to Spain and Italy.[xvi] Sarkozy even supported the idea of giving the European Financial Stability Facility (EFSF), established in May 2010, a banking licence and hence unlimited access to ECB funds.[xvii] Second, President Sarkozy, much more than German decision makers, put pressure on the ECB to act boldly. In his view, exceptional circumstances required exceptional measures, including unlimited purchases of sovereign debt on secondary markets to bring down skyrocketing risk premiums on sovereign bonds. Third, Paris emphasized solidarity values. According to the former State Secretary for European Affairs, Pierre Lellouche, "[t]he €440bn mechanism [of the EFSF, JS] is nothing less than the importation of Nato's Article 5 mutual defence clause applied to the eurozone. When one member is under attack the others are obliged to come to its defence"[xviii] – the exact opposite of the no bail-out logic advocated by Germany. Fourth, France forcefully used the window of opportunity of this sovereign debt crisis to promote major changes to the economic governance structure of the euro area along the lines of its long-standing preferences. Finally, France perceived the risk of a financial market panic in case of private sector involvement (PSI) in debt restructuring. Raising the specter of PSI in the context of highly nervous financial markets makes the purchase of sovereign bonds an unattractive option for private investors, thus pushing up the risk premiums for highly indebted euro area members, an assessment shared by the ECB. French officials also saw the danger that PSI in debt restructuring operations in the Southern periphery states implied substantial losses for French banks, heavily exposed in Greece, Ireland, Portugal, and Spain.

The Road to Bilateral Leadership

Considering the crisis' extremely high stakes and the conceptual differences between France and Germany, this situation clearly entailed the risk of a deep and lasting rift between France and Germany. Differing interpretations of the situation, different risk assessments, and diverging preferences indeed help to explain the slow and bumpy start to Franco-German cooperation during the early phase of the sovereign debt crisis in spring 2010.[xix] From May 2010 onwards, however, France and Germany intensified their cooperation and proved able to play a common, proactive, and often decisive role at various moments. This holds especially true since May-June 2011, when Italy and Spain came into the line of fire and when the breakup of the Eurozone, beyond the special case of Greece, became a credible scenario.

The Franco-German bilateralism performed leadership roles of all three types mentioned above. Berlin and Paris promoted deeper integration by pushing for changes to the economic governance rules and structures of the euro area; they strongly contributed to the flurry of crisis management activities; and they made use of the option to establish a subgroup of Member States to overcome the opposition against their common proposal of a fiscal compact. The two core states of the euro area provided leadership by agenda-setting, submitting important bilaterally concerted proposals to their partners; they acted as entrepreneurial leaders, hammering out bilateral compromises suited to building bridges between opposing camps and providing focal points for negotiations; and they were able to build coalitions to overcome the resistance of individual member states.

As regards agenda-setting, France and Germany used the familiar instrument of common statements and contributions in order to submit a number of concrete proposals to their partners throughout the crisis. The amount of input from the two governments since May 2010 was exceptional, even by the high Franco-German standards.[xx] These common contributions served as an important point of reference for other actors, both for EU institutions and key personnel and for the other Member States' governments. When France and Germany intensified the rhythm of their bilateral consultations in mid-2011, their partners even refrained from submitting their own contributions to the crucial debates on the strengthening of the rescue funds and on the fiscal compact, taking a reactive stance towards the proposals emanating from Franco-German consultations.[xxi]

Whenever the European Council, the Ecofin Council, or the Eurogroup summits decided on rescue packages, bilateral credits, credit guarantees, or permanent lending facilities, the power of the purse made Germany and France (albeit to a lesser extent) key actors at the bargaining table right from the beginning—little wonder, as together they had to foot almost half of the bill. This holds true for all major decisions on bilateral credits for Greece and the establishment and boosting of temporary support funds (the intergovernmental EFSF and the Union's European Financial Stabilisation Mechanism EFSM, launched in May 2010), as well as the institution of a permanent lending facility (European Stability Mechanism-ESM).

An important moment for Franco-German relations and leadership in this EMU crisis came with the bilateral informal summit meeting at Deauville in October 2010. In the negotiations on new governance rules for the euro area, Germany might have been tempted to build a coalition with like-minded countries such as the Netherlands, Finland, or Sweden supporting a tough line on strengthening fiscal rules; while France might have led a counter coalition of Southern countries in favor of stronger emergency measures in terms of well-equipped rescue funds and more "European solidarity" through the introduction of Eurobonds. Berlin and Paris, however, took the decision to strike compromises with their partners across the Rhine, thus building bridges between opposing camps of Northern and Southern Member States. Neither had a credible alternative winning coalition. A counter coalition against France and Germany did not exist, nor could any other Member State claim to exert leadership in EMU matters, the UK being outside the euro area and both Italy and Spain under heavy pressure from the markets.

In the Franco-German deal struck at Deauville, Germany made a concession on the automaticity of sanctions against "fiscal sinners" in exchange for French support for treaty reform. Before this date, Germany found itself almost isolated in its demand to head for yet another politically risky treaty change in order to provide a legal basis for a permanent lending facility (European Stablity Mechanism-ESM). A second French concession came with Paris—very reluctantly—subscribing to private sector participation in sovereign debt restructuring.

This Deauville deal earned France and Germany strong criticism from participants in an Ecofin and Eurogroup meeting in Luxembourg on the same day, working on the same subject in the framework of the Van Rompuy Task Force on the reform of the EMU's economic governance. They had notice of this bilateral Deauville deal only through news agency reports, giving rise to criticisms of a "Franco-German diktat".[xxii]

At the European level, however, Germany later got only part of what it had asked for in Deauville. The Member States indeed altered the Lisbon Treaty in March 2011, adding a second paragraph to article 136 TFEU. The new paragraph states that "Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole." This change, of course, seriously conflicts with the substance of the treaty's no bail-out clause (art. 125 TFEU). The private sector involvement in future operations of sovereign debt restructuring, however, remains highly uncertain beyond the Greek case. Germany could anchor this principle in the intergovernmental ESM treaty. But the Eurogroup made repeatedly clear that it considered the Greek debt restructuring, with private lenders agreeing to write off huge parts of their debt claims ("haircut"), as an "exceptional and unique case".[xxiii]

At least, Germany was able to prevent the introduction of Eurobonds, that is, a common liability of Euro Members for each other's debts (or parts of them). A proposal emanating from the President of the Eurogroup, Luxembourg's Prime Minister Jean-Claude Juncker, along with the Italian Minster of Finance Guilio Tremonti, to create a European debt agency issuing common Eurobonds met with fierce resistance from Germany.[xxiv] Under President Sarkozy, France lent its valuable support to this tough German line.

When the situation worsened in Ireland and Portugal, France and Germany successfully put pressure on Dublin and Lisbon to make use of the EFSF funds—which they indeed did in November 2010 and May 2011, respectively—in order to calm the markets and prevent contagion.

A crucial moment came in June and July 2011, when the risk of contagion to Spain and Italy drew the Eurozone near to the abyss. France and Germany recognized the importance of preserving the strong bilateral bond under conditions of extremely severe economic and political strain, and of assuming a common responsibility for the Eurozone's survival.[xxv] Against the backdrop of highly nervous international financial markets, Paris and Berlin defined a closely coordinated common line. For top-level political actors, the idea of Merkel and Sarkozy displaying divergent approaches and fissures at the end of a bilateral summit meeting was completely out of the question, as this risked sending shockwaves through the markets. In order to avoid Franco-German clashes on the European scene, they reached an understanding to bilaterally coordinate their positions ahead of all important European Council or Eurozone summit meetings dealing with the crisis.[xxvi] The frequency of top-level Franco-German meetings in various formats prior to European summit meetings in order to come up with common positions and proposals clearly increased starting in June 2011 (see Table 2).

This bilateral pattern of cooperation was embedded in the broader framework of intense summit diplomacy at the level of the European Council and Euro Summit meetings. Franco-

German bilateralism provided the inner link of wider Eurogroup and EU-27 negotiations. Important consultations took place on several occasions inside a kind of inner circle of crisis communication and management, the so called "Frankfurt Group" composed of Merkel, Sarkozy, and the presidents of the European Council, the ECB, the Eurogroup, and the Commission, with the occasional participation of the IMF's managing director.[xxvii]

Starting with their bilateral meeting on 17 June 2011 and the intense bilateral preparation of the July 2011 European Council,[xxviii] Merkel and Sarkozy called the shots in European-level decision-making, earning them the nickname of "Merkozy". In November 2011, during a highly critical situation in which the Greek government announced plans to hold a referendum on the Greek rescue plan, "Merkozy", together with Barroso, Lagarde, Van Rompuy, and Juncker, threatened to immediately discontinue financial support for Greece. Moreover, breaking a taboo, they made clear that this vote would not only be about accepting or rejecting the rescue plan, but rather about the future of Greece in the Eurozone. This open and concerted pressure made Greek Prime Minister Papandreou think twice and dismiss his plan.[xxix]

Table 2: Schedule of bilateral and European top-level meetings in the context of the euro area crisis since 2010

Date	Place	Participants	Institutional Context
23 August 12	Berlin	Hollande, Merkel	Informal meeting
28-29 June 12	Brussels	EU-27 / EU-17	European Council and Euro area summit
27 June 12	Paris	Hollande, Merkel	Informal meeting ahead of European Council and Euro area summit
22 June 12	Rome	Hollande, Merkel, Monti, Rajoy	Informal meeting with Italian and Spanish prime ministers, Mario Monti and Mariano Rajoy
16 Mai 12	Berlin	Merkel, Hollande	Informal meeting, inaugural visit
6 February 12	Paris	Merkel, Sarkozy, French and German ministers	Franco-German Council of Ministers
30 January 12	Brussels	EU-27 / EU-17	Informal European Council / Euro area summit
9 January 12	Berlin	Merkel, Sarkozy	Informal meeting
8-9 December 11	Brussels	EU-27 / EU-17	European Council / Euro area summit
5 December 11	Paris	Merkel, Sarkozy	Informal meeting
24 November 11	Strasbourg	Merkel, Sarkozy, Monti	Informal meeting with the Italian Prime Minister Mario Monti
2 November 11	Cannes	Merkel, Sarkozy, Barroso, Van Rompuy, Juncker, and Lagarde (IWF managing director)	Informal meeting („Frankfurt Round“) ahead of G20 summit
26 October 11	Brussels	EU-17	Euro area summit
23 October 11	Brussels	EU-27	European Council
20 October 11	Frankfurt	Merkel, Sarkozy, Trichet and his successor Draghi, Barroso, Van Rompuy, Lagarde, Schäuble, Baroin	Informal meeting of the "Frankfurt Round" at the farewell ceremony for Jean-Claude Trichet as president of the ECB
9 October 11	Berlin	Merkel, Sarkozy	Informal meeting
16 August 11	Paris	Merkel, Sarkozy	Informal meeting
21 July 11	Brussels	EU-17	Euro area summit
20 July 11	Berlin	Merkel, Sarkozy, Trichet; Van Rompuy (by phone)	Informal meeting
23-24 June 11	Brussels	EU-27	European Council
17 June 11	Berlin	Merkel, Sarkozy	Informal meeting
24-25 March 11	Brussels	EU-27	European Council
11 March 11	Brussels	EU-17	Euro area summit
4 February 11	Brussels	EU-27 / E17	European Council / Euro area summit
16-17 December 10	Brussels	EU-27	European Council
10 December 10	Freiburg	Merkel, Sarkozy, French and German ministers	Franco-German Council of Ministers
28-29 October 10	Brussels	EU-27	European Council
18 October 10	Deauville	Merkel, Sarkozy	Informal meeting
16 September 10	Brussels	EU-27	European Council
17 June 10	Brussels	EU-27	European Council
14 June 10	Berlin	Merkel, Sarkozy	Informal meeting
25-26 March 10	Brussels	EU-27 / EU-17	European Council / Euro area summit
11 February 10	Brussels	EU-27	Informal European Council
4 February 10	Paris	Merkel, Sarkozy, French and German ministers	Franco-German Council of Ministers

Entries are formal (Franco-German Council of Ministers) and informal meetings of Angela Merkel and Nicolas Sarkozy / François Hollande, including meetings of the "Frankfurt Round" with the presidents of the European Council, Van Rumpuy, the Commission, Barroso, the ECB, Trichet and his successor Draghi, the Eurogroup, Juncker, and the IMF's managing director Lagarde. Formal and informal European Council and Euro Summits.

Sources: www.france-allemagne.fr; http://www.european-council.europa.eu/council-meetings/conclusions/; press articles from Frankfurter Allgemeine Zeitung, Le Monde, and Der Spiegel.

In terms of common Franco-German contributions to euro area crisis management and to the reform of its governance framework, two lines of action stand out. First, in a bilateral compromise found in June 2011, Merkel and Sarkozy agreed to give the European Council a central role. Merkel publicly subscribed to the idea of the European Council acting as an "economic government" of the euro area, a very negatively loaded expression in the German debate since Maastricht.[xxx] She also accepted Euro area summits, even though she had repeatedly underlined the need to avoid creating fault lines between the "ins" and "out" of the euro area. With these concessions to France, Merkel gave up the German position, held since the Maastricht IGC, of preventing the European Council from taking center stage, as well as the stance of limiting the Eurogroup's role to an informal framework at the level of ministers of finance. On 16 August 2011, Merkel and Sarkozy suggested holding Euro area summits twice a year and advanced the name of Herman Van Rompuy to chair these meetings. This important reform of the euro area's economic governance structure, first suggested by France and then advocated together by France and Germany, made its way to the European level. On 26 October 2011, a Euro Summit agreed upon regular Euro Summit meetings to be convened at least twice a year; another Euro Summit on 2 March 2012 appointed Van Rompuy as its president.[xxxi] All of this was fully in line with long-standing French preferences.

In exchange for more financial solidarity—that is expanding the remit of the EFSF and providing for the possibility of leveraging this fund—Germany received commitments to more national fiscal responsibility. Berlin very actively promoted the idea of a "fiscal stability union" and found valuable support from France. Together, they endorsed reforming the rules governing the Eurozone along the lines of the Commission's "sixpack" of legislative proposals, put forward in September 2010.[xxxii] Berlin and Paris indeed agreed on major points: strengthening of the SGP's "preventive arm"; new emphasis given to the debt criterion which, better than deficits, reflects the sustainability of fiscal positions; stricter budgetary ex ante surveillance with the so-called "European semester"; and the introduction of an excessive imbalance procedure to put pressure on Member States in a position of major macroeconomic imbalances (mainly current account imbalances). France also subscribed to decision-making procedures designed to facilitate sanctioning of non-compliant member states, but only after Germany gave up the idea of any automaticity of sanctions at the Deauville meeting.

The new "fiscal compact", forcefully advanced by France and Germany ahead of the October and December 2011 European Council meetings,[xxxiii] even reinforces the recently reformed rules governing the excessive deficit procedure. Foreseeing "automatic consequences unless a qualified majority of euro area Member States is opposed"[xxxiv] for Member States recognized by the Commission to be in breach of the 3 percent deficit ceiling, it also specified a highly demanding debt reduction rule for overindebted Member States which, at the insistence of France and Italy, needs a qualified majority vote to be enforced through sanctions. In order to make reluctant euro area members subscribe to their concept of fiscal stability union, Germany and France followed a linkage strategy, making the ESM funds available only for countries signing the "Treaty on stability, coordination and governance in the Economic and Monetary Union" (fiscal compact).[xxxv]

In the light of previous experiences with the old SGP in 2003, the binding nature of European-level rules is surely not beyond doubt. Another, possibly more important ingredient of the Franco-German "fiscal compact" package attacked the problem of compliance with fiscal rules from a different angle: the national level. At their bilateral meeting in Paris on 16 August 2011, Merkel and Sarkozy joined forces to advocate the introduction of balanced budget rules in national constitutions, inspired by a similar rule enshrined in 2009 into the German Basic Law (art. 109 GG).[xxxvi] This, of course, represents an important departure from the French policy discretion approach. When Spanish prime minister Zapatero promoted the enshrinement of such a "golden rule" into the Spanish constitution ahead of the November 2011 parliamentary elections, he admitted that this move was the result of the pressure exerted on him by Merkel and Sarkozy.[xxxvii]

In exchange for his support of the German-sponsored fiscal compact, Sarkozy got two strong reassuring signals to financial markets thanks to German concessions. Contrary to the common approach adopted at Deauville, Germany seems to have accepted in bilateral talks in Paris on 5 December 2011 that the private sector involvement in debt restructuring would remain limited to the Greek case. Furthermore, Berlin subscribed to the idea of starting the ESM in July 2012, one year earlier than initially planned.[xxxviii]

At the European level, Germany and France basically got their way. The December 2011 Euro area summit statement contains a commitment that general government budgets must be balanced or in surplus, a commitment later laid down in the "Treaty on Stability, Coordination and Governance in the Economic and Monetary Union" signed on 2 March 2012.[xxxix] The parties to this new international Treaty must introduce this rule into their national legal systems "at constitutional or equivalent level", provide for an automatic correction mechanism in case of deviation, and "recognise the jurisdiction of the Court of Justice to verify the transposition of this rule at national level".[xl]

Germany, supported by France, would have preferred to anchor this fiscal compact in European primary law. Both put reluctant partners under pressure by threatening to go ahead outside the treaty framework if a consensus on treaty reform could not be found. This indeed happened when British Prime Minister David Cameron, isolated by France and Germany, refused to accept this treaty reform. France and Germany then accepted the risk of lasting fault lines inside the EU when taking the decision to conclude an international treaty outside Community law in a "17 plus" format, that is, between all euro area members and other Member States willing to subscribe to these obligations. Eventually, 25 of 27 Member States signed this treaty, with only Britain and the Czech Republic keeping aloof. Here, we find an instance of Franco-German leadership by promoting a two-speed Europe or durable forms of differentiation inside the EU, quite characteristic for monetary cooperation and integration from the Snake and EMS to EMU.

The Hollande effect: breaking with Franco-German bilateralism?

A common and bilaterally closely concerted Franco-German leadership role during the sovereign debt crisis was a deliberate choice of German Chancellor Merkel and French President Sarkozy. Against the background of different assessments on the character of this crisis and diverging national preferences as regards the choice of remedies to cope with it, a common Franco-German approach was anything but self-evident.

With the French presidential elections of 2012, the crucial question arose whether the new French President Hollande would make a strategic choice different from his predecessor's. The incoming Socialist president and government indeed had criticized Sarkozy for staying to close to the course charted by chancellor Merkel and had called for a more balanced Franco-German relationship, perceiving a growing Franco-German power asymmetry in favor of Germany during the management of this crisis.[xli]

During his election campaign and after entering into office, François Hollande stressed the need for a European growth strategy; called for a renegotiation of the "Treaty on stability, coordination and governance in the Economic and Monetary Union," (TSCG, or "fiscal compact treaty"); made the case for the rapid introduction of Eurobonds; advocated the monetization of debt by the European Central Bank; wanted to give the EFSF permission to directly finance banks in trouble; and saw a European guarantee for bank deposits as an appropriate way to deal with the shaky foundations of national banks, especially in Greece and Spain.[xlii] Germany subscribed to this agenda only as far as the first point of adding a growth component to the fiscal stability policy is concerned, but without adding new debts to old by way of a deficit-financed and short-lived reflation policy. On all the other major points that Hollande raised, he met with staunch German opposition. Immediately after the second ballot of the French presidential elections, Chancellor Merkel made clear that the renegotiation of the recently concluded international treaty on the fiscal compact, signed by 25 EU Member States including France, was out of the question, as this working method would systematically subject past European agreements to national government changes and hence prevent the EU from keeping a steady course.[xliii] And Berlin clearly sees the introduction of Eurobonds—even though not completely excluded by the German government for the (distant) future—and the direct lending by the ECB to crisis-ridden euro area members as no go areas.

Hollande had little to gain from a showdown with Germany. First, France has very high financing requirements to cover its deficits and its medium and long-term debt redemptions (177 billion euro in 2012 according to the state financing program of 2012).[xliv] Hence, having lost its Standard & Poor's AAA-rating and having its sovereign debt financed overwhelmingly by foreign investors, France is vulnerable to international financial market pressures. Second, Member States at the Southern periphery do not automatically follow the French lead on contentious issues such as Eurobonds, the Spanish Rajoy government being an example. Third, Germany still has the one veto that matters on key issues in which France asks for more German solidarity. Moreover, Berlin can very credibly play two-level games, as the odds of getting domestic support in Germany for the French wish list are very low – giving the German Chancellor and Minister of Finance a strong hand at the European negotiating table.

Overall, it seems unlikely that France could build a winning coalition against Germany on crucial issues. Hence, if the new president Hollande wants to go beyond gesture politics for a domestic public and seriously influence the European course of events, he has little choice but to seek a concerted approach with Germany, perhaps in a less exclusive bilateral way than his predecessor did. Based on its financial resources and the comparative success of its economic model and economic policy of the last decade, Germany will remain the key actor in this play, whereas France has to rebuild its economic and fiscal credibility and regain lost ground in terms of competitiveness.

The first statements and the first steps of the new French president on the European scene indeed corroborate this assessment. Hollande's France does not seek a role as a leader of a Southern group of EU Member States opposing Germany and its Northern allies. Rather, he described the French role as a kind of "linchpin", holding together the EU's Northern and Southern parts and building bridges between them.[xlv] A more self-conscious French president Hollande who wants to be on an equal footing with Chancellor Merkel seeks to broaden the decision-making process beyond the "tête-à-tête" with the powerful German partner. Hollande, having criticized the exclusive bilateral approach of his predecessor, established close contacts to the prime ministers of Italy and Spain, Monti and Rajoy, and tried to embed the Franco-German bilateralism in a broader framework of multilateral consultations, the informal meeting of Hollande, Merkel, Monti, and Rajoy on 22 June 2012 in Rome, ahead of the European Council, being an example in kind. He also advocated a stronger role of European institutions, often sidelined by the Franco-German bilateralism during the crisis.

Contrary to his campaign statements, he did not insist on a formal renegotiation of the "Treaty on Stability, Coordination and Governance in the Economic and Monetary Union" (TSCG) which would have brought him in open conflict with Germany. He had to content himself with a growth pact (with few new elements) at the European Council of 28-29 June 2012, complementing the TSCG. And he found the support of Merkel (as well as Monti and Rajoy) when pushing for a financial transaction tax to be implemented by a subgroup of Member States in the framework of an enhanced cooperation scheme.[xlvi]

We even find evidence of a renewed Franco-German bilateralism after a moment of hesitation. Hollande and Merkel met on 23 August 2012 immediately ahead of their separate talks with Greek Prime Minister Samaras who asked for more time to bring down the Greek public deficit; they carefully prepared their statements in order to find a common line of communication, both of them reminding Greece of its duty to honor its obligations. German and French ministers of finance, Wolfgang Schäuble and Pierre Moscovici, set up a bilateral task force in order to prepare bilateral decisions to tackle the sovereign debt and banking crisis, another indicator of a renewed Franco-German bilateralism after the change of office holders in Paris.[xlvii] The left wing of the governing Socialist Party and leaders of its Green coalition partner already criticized Hollande's accommodating line towards the German chancellor Merkel and his willingness to ratify the fiscal compact treaty.[xlviii]

Conclusion

The current sovereign debt crisis generated a strong demand and provided ample opportunity for the exercise of European political leadership. After initial hesitations, Germany together with France provided this political leadership at important moments, especially as the crisis reached a critical point in mid-2011. They contributed to the promotion of deeper integration in terms of more constraining national commitments in fiscal policy; they most actively cooperated in situations of urgency to provide leadership in crisis management when the euro area approached the abyss both in May 2010 and in the second half of 2011; and they promoted differentiated forms of integration when they could not get their way with their preferred solutions at the level of the EU-27, pushing successfully for the establishment of a subgroup of Member States in order to get the fiscal compact treaty (TSCG) adopted and promoting another subgroup to implement a financial transaction tax.

Germany and France strongly influenced the European agenda by way of submitting a number of common contributions. They succeeded in defining the key parameters of the European rescue funds (EFSF and ESM) in terms of sums available, functions, and institutional setup, and they proved able to strike bilateral compromises acceptable to their partners defining the balance between solidarity and fiscal responsibility (see the overview in table 3).

In order to provide this leadership, Paris and Berlin made full use of the exceptionally dense network of their "regularized ingergovernmentalism", the institutionalized formal and informal channels of communications, cooperation, and accommodation of interests between the two governments.[xlix]

Table 3: Examples of Franco-German Leadership

<table>
<tr><th>Types of leadership</th><th>Ways of providing leadership</th></tr>
<tr><td>promoting integration
– strong support for “six pack” of legislation strengthening SGP framework and establishing and excessive imbalance procedure
– promoting a tightening of fiscal rules in the framework of the Treaty on Stability, Coordination, and Governance in the EMU (TSCG)
– promoting a permanent lending facility, the ESM</td><td rowspan="3">agenda setting and common proposals
– October 2010: Deauville summit proposal for treaty reform to allow for the establishment of the ESM and private sector involvement
– Spring 2011: proposal for Euro plus pact
– August 2011: proposal for institutionalisation of Euro area summits and putting forward Herman Van Rompuy as chairman
– August 2011: common advocacy of a balanced budget rule to be enshrined in national (constitutional) law
– Autumn 2011: proposal for a fiscal compact;

consensus building
– a series of bilateral deals combining elements of short-term crisis management plus elements of “economic government” with decisions on a strengthening of fiscal rules, thus bridging differences between “Northern” and “Southern” Member States

coalition building
– using and carrying out the threat of excluding the UK in order to go ahead with the fiscal compact treaty</td></tr>
<tr><td>crisis management
– core role in setting up of Greek rescue package in Mai 2010, and of the EFSF and EFSM
– pressure on Ireland (November 2010) and Portugal (May 2011) to make use of EFSF money
– core role in beefing up the EFSF in autumn 2011
– pressure on Greek government to abandon referendum plans in autumn 2011
– linkage strategy: making the ratification of the TSCG by a given country a prerequisite for its access to ESM money</td></tr>
<tr><td>creating smaller subgroups of Member States
– promoting Euro plus pact
– promoting the TSCG to overcome British resistance against treaty reform
– promoting introduction of a financial market transaction tax in the framework of an enhanced cooperation scheme</td></tr>
</table>

Source: own compilation

Even though we find ample evidence for Franco-German leadership since the start of the sovereign debt crisis, their common capacity to find suitable remedies to cope with it is by no means beyond doubt. Berlin, grudgingly followed by Paris, adopted a stepwise approach. Germany and France did not develop a common comprehensive strategy based on a common conceptual framework. The common approach rather followed an additive logic, combining the gradual strengthening of temporary and permanent financial support schemes, a French preference, with a concomitant strengthening of fiscal rules that was advocated by Germany. This left the impression of buying time, allowing for the stabilization of the banking sector and preventing contagion in case Greece could one day no longer avoid leaving the euro area.

As the leadership role of Franco-German bilateralism in the European management of the euro area crisis is not built on converging preferences but on the ability of France and Germany to bridge their differences and to strike "compromises by proxy", its continuation is by no means self-evident. It implies a strategic choice at the top level. The French elections of 2012 seemed to disrupt this pattern of exceptionally close Franco-German consultations in view of defining a common line ahead of all important European summits. At the time of writing, it is still too early to tell whether the new president Hollande makes the strategic choice to build his European policy on a continuation of the established and time-tested pattern of Franco-German bilateralism. Other presidents before him (including Sarkozy) hesitated before fully realizing the strategic importance of a close Franco-German relationship for the achievement of key French policy goals in Europe. They had to learn the lesson that France has little to gain from neglecting this special bilateral relationship, as alternative patterns of cooperation and strategic partnerships are not easily available in the EU—neither for France, nor for Germany.

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[ii] See Ulrich Krotz and Joachim Schild, *Shaping Europe. France, Germany, and Embedded Bilateralism from the Elysée Treaty to Twenty-First Century Politics*, ch. 8. (Oxford 2013, forthcoming). This article draws on chapters 1 and 8 of this book.

[iii] Eckhard Lübkemeier, *Führung ist wie Liebe. Warum Mit-Führung in Europa notwendig ist und wer sie leisten kann.* Stiftung Wissenschaft und Politik. Berlin 2007 (SWP-Studien, S 30), p. 7 (my translation).

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[v] Oran R. Young, "Political Leadership in Regime Formation: On the Development of Institutions in International Society," *International Organization* 45 (1991): 281–308, here: pp. 293-298.

[vi] Martin Koopmann, *A Driving Force Despite Everything. Franco-German Relations and the Enlarged European Union. Paris: Notre Europe*, Studies & Research. 36 (2004), p. 13, available at www.notre-europe.eu/uploads/tx_publication/Etud36-MKoopman-MoteurMalgretout-en.pdf.

[vii] Tobias Kunstein and Wolfgang Wessels, "Die Europäische Union in der Währungskrise: Eckdaten und Schlüsselentscheidungen," *Integration* 34 (2011): 308–22, here: p. 310.

[viii] Christian Deubner, *Saving the Euro – My Way. Competing French and German Visions for Euro Governance.* Berlin: Deutsche Gesellschaft für Auswärtige Politik, available at https://ip-journal.dgap.org/en/article/18457/print.

[ix] Erik Jones, "Merkel's Folly," *Survival* 53 (3): 21-38.

[x] See the interview with the French minister of finance, Christine Lagarde: "Il faut modifier le fonctionnement du pacte de stabilité", *Le Monde*, 4 May 2010.

[xi] *Spiegel Online International*, 7 September 2011, "'If the Euro Fails, Europe Fails'. Merkel Says EU Must Be Bound Closer Together," available at www.spiegel.de/international/germany/0,1518,784953,00.html.

[xii] Deubner (see note viii), p. 3.

[xiii] *Spiegel Online International* 14 February 2011, "'Enormous Damage'. Weber's Exit Highlights Merkel's Euro Problem", available at www.spiegel.de/international/germany/0,1518,745377,00.html; and *Spiegel Online International* 12 September 2011, "ECB Chief Economist Quits. Jürgen Stark's Resignation Is Setback for Merkel", available at www.spiegel.de/international/europe/ecb-chief-economist-quits-juergen-stark-s-resignation-is-setback-for-merkel-a-785668.html.

[xiv] See Michele Chang, "Reforming the Stability and Growth Pact: Size and Influence in EMU Policymaking", *Journal of European Integration* 28 (2006): 107–120.

[xv] For a first assessment, see Daniel Gros and Cinzia Alcidi, "Was bringt der 'Euro-plus-Pakt'?," *Integration* 34 (2011): 164–71.

[xvi] See *Frankfurter Allgemeine Zeitung*, 28 January 2012, "Schäuble gegen größeren Rettungsfonds".

[xvii] See *Le Monde* 28 October 2011, "Du clash de Francfort au sommet de Bruxelles, la folle semaine de l'Europe."

[xviii] See his *Financial Times* interview on 27 May 2010 in which he also publicly recognized that the rescue package for Greece and the emergency stabilization funds decided in May 2010 de facto altered the treaties, available at www.ft.com/intl/cms/s/0/d6299cae-69b5-11df-8432-00144feab49a.html#axzz1wRJJ5AZM.

[xix] For the Franco-German leadership role during the first phase of crisis management and reform debates from spring 2010 to the end of 2010, see Joachim Schild, "Quel leadership franco-allemand en matière de gouvernance économique européenne?," in: *Annuaire Français des Relations Internationales* 2011, Vol. XII, La documentation Française/Bruylant, pp. 493−510.

[xx] See their joint letters to the Presidents of the European Council and the Commission dating from 6 May 2010 <www.bundesregierung.de/Content/DE/Pressemitteilungen/BPA/2010/05/2010-05-06-brief-englisch.html>, the Franco-German Economic and Financial Council's statement on the economic governance of the Eurozone, Paris, 21 July 2010 <www.france-allemagne.fr/Conseil-economique-et-financier,5682.html#Gouvernement-economique-europeen>, the Franco-German declaration issued at Deauville on 18 October 2010 <www.france-allemagne.fr/Renforcons-le-gouvernement,5764.html>; the Franco-German communiqué on the Eurozone dating from 8 August 2011 <http://www.bundesregierung.de/Content/EN/Pressemitteilungen/BPA/_2011/2011-08-07-dt-fr-kommunique.html>, and again a common letter to the president of the European Council dating from 8 December 2011 <www.london.diplo.de/Vertretung/london/en/03/__Political__News/12/MerkelSarkozy__letter.html> (all documents accessed on 11 April 2014).

[xxi] Interview with a high official at the *Bundeskanzleramt* (German Chancellery), 14 March 2012.

[xxii] See *Les Echos*, 20 Octobre 2010, "Déficits: les eurodéputés dénoncent un 'diktat' franco-allemand", available at www.lesechos.fr/economie-politique/monde/actu/afp_00291209-deficits-les-eurodeputes-denoncent-un-diktat-franco-allemand.htm.

[xxiii] Eurogroup, "Agreed lines of communication by euro area Member States", Brussels, 30 January 2012, available at www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/127633.pdf.

[xxiv] See *Les Echos* 11 December 2010, "Gestion de la crise: Paris et Berlin unis contre la proposition du tandem Juncker-Tremonti".

[xxv] At their common press conference on 6 February 2012, Sarkozy attributed the Euro's rescue from the abyss to the "strategic" and "unwavering alliance" between France and Germany, see Conférence de presse conjointe de M. le Président de la République et de Mme. Angela Merkel Chancelière de la République Fédérale d'Allemagne, Palais de l'Elysée, available at www.elysee.fr/president/root/bank/pdf/president-12958.pdf.

[xxvi] Interview with a high official at the *Bundeskanzleramt* (German Chancellery), 14 March 2012.

[xxvii] For instance on 8 December 2011, immediately before the start of the European Council, see *The Guardian* online, "Sarkozy and Merkel unveil two-speed EU plan to shore up euro", 7 December 2011, available at www.guardian.co.uk/world/2011/dec/07/sarkozy-merkel-two-speed-eu-plan. See also the overview in Table 2.

[xxviii] Interview German chancellory, 14 March 2012.

[xxix] See *Spiegel Online International* 3 November 2011, "Tough Words. Merkel and Sarkozy Halt Payments to Athens", available at www.spiegel.de/international/europe/0,1518,795638,00.html.

[xxx] See the press conference of Merkel and Sarkozy after their bilateral meeting at Berlin on 14 June 2010, available at www.france-allemagne.fr/Bundeskanzlerin-Merkel-trifft,5591.html.

[xxxi] See the Euro Summit statements from 26 October 2011 and 2 March 2012, available at www.european-council.europa.eu/council-meetings/conclusions.

[xxxii] See European Commission, EU economic governance: the Commission delivers a comprehensive package of legislative measures, Brussels, 29 September 2010 (IP 10/1199), available at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/1199&format=PDF&aged=1&language=EN&guiLanguage=en.

[xxxiii] Andreas Rinke, "Stunde der Entscheidung. Wie 'Merkozy' die Grundlagen eines neuen Europa schufen", *Internationale Politik (Online)*, January-Feburary 2012, available at https://zeitschrift-ip.dgap.org/de/ip-die-zeitschrift/themen/europaeische-union/stunde-der-entscheidung.

[xxxiv] See the statement of the Eurogroup summit on 9 December 2011, available at www.european-council.europa.eu/council-meetings/conclusions.

[xxxv] Frankfurter Allgemeine Zeitung 30 January 2012, "Union streitet vor dem EU-Gipfel über den Inhalt des Fiskalpakts".

[xxxvi] See *Le Monde*, 18 August 2011, "Euro: Paris et Berlin se font architectes, pas pompiers".

[xxxvii] See *Frankfurter Allgemeine Zeitung*, 25 August 2011, "Zapatero will Schuldenbremse rasch durchsetzen".

[xxxviii] See *Le Monde*, 7 December 2011, "L'accord franco-allemand. Enfin une bonne note".

[xxxix] This means that the annual structural deficit should, as a rule, not exceed 0.5 per cent of GDP. See Statement by the euro area Heads of State or Government, Brussels, 9 December 2011, available at <http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/126658.pdf>.

[xl] See the statement of the Eurogroup summit on 2 March 2012, available at www.european-council.europa.eu/council-meetings/conclusions.

[xli] See *Frankfurter Allgemeine Zeitung*, 6 December 2011, "Hollande zu Gast bei den Pickelhauben".

[xlii] See *Le Monde*, 9 February 2012, "François Hollande se fait fort d'imposer la renégociation du traité européen"; Handelsblatt, 25 May 2012, "Konflikt um Euro-Bonds spaltet Europa".

[xliii] See FAZ-Net, 7 May 2012, "Merkel: Fiskalpakt wird nicht neu verhandelt", availabte at <www.faz.net/aktuell/politik/inland/nach-wahlen-in-paris-und-athen-merkel-fiskalpakt-wird-nicht-neu-verhandelt-11742735.html>.

[xliv] See Agence France Trésor, State financing program 2012, < http://www.aft.gouv.fr/articles/state-financing-programme-for-2012_10057.html>.

[xlv] See his press conference after his first European Council of 29 June 2012, <www.elysee.fr/president/root/bank/pdf/president-13521.pdf>.

[xlvi] *See Libération.fr*, 22 June 2012, "La taxe sur les transactions financières bientôt sur les rails", <http://www.liberation.fr/economie/2012/06/22/1-du-pib-europeen-sera-mobilise-pour-la-croissance_828422>.

[xlvii] See *Les Echos.fr*, 28 August 2012, "Paris et Berlin créent un groupe de travail sur l'euro", <www.lesechos.fr/economie-politique/france/actu/0202232580268-paris-et-berlin-creent-un-groupe-de-travail-sur-l-euro-356059.php>.

[xlviii] See *Frankfurter Allgemeine Zeitung*, 28 August 2012, "Keine Nachsicht mit Vater Vorsicht" and *Le Monde*, 28 August 2012: Le traité européen divise le PS et les écologistes. "

[xlix] See Ulrich Krotz, "Regularized intergovernmentalism: France-Germany and beyond (1963-2009)." Foreign Policy Analysis 6 (2010) 2: 147-185.