Germany: great expectations encounter the EU's reluctant hegemon

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Abstract
This paper explores the growing perception, prompted by the euro-zone crisis, of Germany as a hegemonic power in the European Union. The paper explores hegemony conceptually and in terms of economic fundamentals and practice. Despite Germany's role as 'extraordinary trader' and its emergence as the leading economic power, it is argued that both international and, increasingly, domestic constraints have limited a leadership role. The euro-zone crisis witnessed Germany's ordo-liberal economic philosophy conflicting with its traditional pro-Europeanism. Ordo-liberal emphasis on stability culture provided a valuable strategic resource for securing German objectives within the euro-zone while satisfying the requirements of domestic politics. However, the need to be attentive to growing constraints arising from German domestic politics extends beyond government policy on the euro-zone and limits, inter alia, the scope for policy action to address the imbalances arising from its huge trade surplus. In consequence, Germany is intrinsically a reluctant hegemon: one whose economic leadership is recognized and regarded with great expectations but where domestic politics act as a significant constraint. The conclusion considers the significance of these findings for the EU's most important member state and the EU more widely.

Explanatory note about the paper
The paper is the draft of a chapter on the Eurozone crisis for a forthcoming book with William E. Paterson, University of Aston, entitled *Germany and the European Union: Europe's Reluctant Hegemon*, to be submitted in late-2015 to Palgrave.

The paper explores the tension between Germany playing a leading role internationally at a time when the politicization of European policy domestically is arguably greater than ever. The analytical framework is set out in the Introduction to the book. It uses different understandings of hegemony to explore Germany's international role: hegemonic stability theory, Gramscian notions of hegemonic ideas, but counter-balanced by English School considerations that hegemony is only successful if it commands legitimacy from partners. Domestic politicization refers to growing institutional constraints on policy, notably from the Federal Constitutional Court, parliamentary processes and the re-emergent Bundesbank, as well as to increasing party-political contestation. International legitimacy and domestic politics are important counterweights to German hegemony and explain the reference to 'reluctant hegemony'.

The chapter on the Eurozone was written by Simon Bulmer. William Paterson has written a contrasting chapter on whether Germany can be understood as playing the role of hegemon in European foreign policy. He will summarize his contrasting findings in the presentation. A summary table of his findings (Box 7.1) has been appended at the end of this paper. If you are interested in William Paterson's chapter, please contact him via email at the above address.

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Introduction

The Eurozone crisis represents an important area for exploring Germany's role in the EU. A series of factors thrust Germany into the centre of seeking the necessary policy solutions. These factors included: the design faults of the Maastricht blueprint for EMU and the resultant lack of clear supranational authority for fiscal policy coordination; the relative economic weakness of France and the consequent unbalancing of the default Franco-German motor of European integration; Germany's status as the leading economy of the Eurozone; and Chancellor Angela Merkel's position as the leading politician of her era in the EU.

Germany has indeed played a leading role throughout the crisis in advancing and brokering solutions. However, the leadership offered has been distinctive in nature and has varied in character over time. In 2009, at the outbreak of the crisis, Germany was hesitant but in autumn 2010 adopted a more decisive approach and contributed much by way of ideas and policy to the emergent fiscal union. Of particular importance to its leadership was its prescription of policies of 'sound money', the implementation of which were the condition for its agreement to accompanying rescue packages. However, the prescribed policy medicine encountered resistance of different types. In the debtor states of southern Europe the validity of the austerity policies was challenged on a popular level, most clearly with the election of a new Greek SYRIZA-led coalition government in January 2015 opposed to austerity but having to sign up for a controversial third rescue in July 2015. However, other Eurozone states, such as Italy and France, sought to press the case for more emphasis on economic growth while 'pushing the envelope' in barely conforming to the rules on public borrowing.

Internationally, Berlin had to undertake a difficult balancing act in finding solutions acceptable to all states. At home there were also challenges. There had been dissent amongst economists and a scattering of politicians about the Eurozone from the outset. Public opinion was sensitised in the early stages by the red-top press framing the crisis as feckless southern Europeans availing themselves of German taxpayers' money. Litigation before the Federal Constitutional Court addressed concerns that the Eurozone rescues breached constitutional-legal provisions both procedurally and in terms of substance. The consequence was a greater politicisation of European policy within Germany. A notable manifestation was the emergence of Alternative for Germany as an anti-Euro party that secured seats in the European Parliament (in 2014) and five state parliaments (Saxony, Thuringia, Brandenburg, Hamburg and Bremen), albeit failing to exceed the 5 per cent threshold needed for seats in the 2013 federal election.

Alongside these aspects that reveal Germany's reluctant emergence as a hegemon through its *policy actions*, there are other aspects that need to be taken into account. Critical political economy helps shine a light on these factors at play: the contribution of the German banks to excessive borrowing in southern Europe; Germany's large structural trade surpluses; and the indirect effects of its labour market institutions and policy to boosting German trade competitiveness in the Eurozone.

In order to examine this broad canvas the chapter is organised as follows. First, we explore the roots of Germany's attitudes towards monetary integration in the EU, including their basis in its ordoliberal economic philosophy. Secondly, we look at the ways in which Germany shaped the original design of monetary union. Thirdly, we dissect the Eurozone crisis through three mini case-studies. These examine Germany's policy at the start of the crisis; its impact on the new system of fiscal governance in the EU; and its impact on the Banking Union. Our analysis then turns to the tensions between German diplomacy and underlying structural economic circumstances that remain unaddressed. Finally we conclude utilising the insights offered by hegemony and domestic politicisation.

Towards Economic and Monetary Union
Economic and Monetary Union (EMU) had been on the agenda of the European Community from the 1969 summit meeting at The Hague. This first attempt failed due to turmoil in the international monetary arena, where the dollar's centrality faded, and the Bretton Woods international monetary system collapsed in 1973. It ended up by 1976 as a group of states that limited their exchange-rate fluctuation in what was termed the 'mini-Snake'. These EC member states were West Germany, Denmark and the Benelux states (Belgium, Netherlands and Luxembourg); in other words, a set of states with policies capable of exchange-rate stability with the Deutsche Mark (DM), the German currency.

The second phase of monetary integration was the rather less ambitious European Monetary System (EMS), launched in 1979. A Franco-German initiative, it created as its heart the Exchange Rate Mechanism (ERM), a fixed but flexible system of currency relationships that was not dependent on the dollar. It was increasingly stable till 1992, when the UK's brief membership and that of Italy came to an end. What had become clear by this stage was that the DM was the anchor currency and that the interest-rate decisions of the Bundesbank in Frankfurt were shadowed by the other ERM member states. Notably, when the Bundesbank raised interest rates due to increased domestic borrowing arising from German unification, this move was mirrored across the EMS states, with adverse effects on some of their economies, despite the circumstances being specific to Germany. The participants in the ERM were more numerous than in the mini-Snake but the DM remained at its core.

These two prior episodes of monetary integration are worth noting because the size of the economy, underlying trading patterns, economic competitiveness, monetary performance on inflation and fiscal performance on public debt have tended to place Germany in a position of structural power within the EU. Part of the story of the Eurozone crisis is the salience of Germany's structural power in the EU economy. However, there is a much wider story of Germany emerging, initially with reluctance, as the state offering leadership in diplomatic efforts to address the crisis.

Strong elements of continuity are evident in Germany's negotiating approach to monetary integration since the 1970s, so it is worth outlining what they are. Of key importance is the economic philosophy that has guided the Federal Republic's policies since creation, namely ordoliberalism.

Ordoliberalism developed during the 1930s from the Freiburg school, comprising not just economists but also lawyers. Of central importance were the ideas, first, that a strong state was needed to ensure a competitive economy and, second, that the state's role should be merely as a regulator of the economy (Bonefeld 2012; Blyth 2013: 135-7; Dullien and Guérot 2012). Unlike neoliberalism, which reifies markets' efficiency, ordoliberalism presupposes the need for an 'economic constitution' to correct the markets' inefficiency. When linked to the traditions of the Bismarckian welfare state, the resultant model of political economy established in the early years of the Bonn Republic was the 'social market economy'. The fusion of ideas was found in the 'unique configuration of institutional mechanisms to co-ordinate capital, labour and public authority' that makes up Germany's co-ordinated market economy (Kitschelt and Streeck 2004: 2). Key institutions that provided the necessary 'policy of order' (*Ordnungspolitik*) to economic markets were: the Federal Cartel Office, the Bundesbank, the Federal Economics Ministry, the distinctive industrial relations institutions of works councils and supervisory boards as well as a system of social insurance (Dyson 2005: 115). This set of institutions has been variously called Rhineland capitalism or a 'coordinated market economy' (Hall and Soskice 2001).

The key principles of ordo-liberal policy in relation to European monetary integration are, above all, a strong commitment to monetary stability and fiscal conservatism ('sound money'; see also Howarth and Rommerskirchen 2013 for a related formulation, 'stability culture'). Two experiences of hyper-inflation have underpinned the Federal Republic's commitment to a culture of monetary stability. However, one caveat needs to be inserted, since there is no single version of ordoliberalism, as Wade Jacoby (2014) has noted. However, the result is contestation between politicians and economists to be the 'true ordoliberals' that plays into wider concerns in public opinion.

The preferred German pathway to EMU has been the so-called coronation theory (the Krönungstheorie). From this perspective other states need a lengthy period of economic policy convergence around the principles of 'sound money' and only after that could monetary union come as a final step, the coronation. During the initial attempt at EMU Germany was at the head of the 'economist' camp, namely those states which wished to see economic convergence before monetary union. France headed the 'monetarist' camp that comprised those states that wanted to see monetary union as an initial step that would then oblige the convergence of economic policies. Germany's position was maintained when EMU once again came onto the agenda in the late-1980s. As Dyson and Featherstone noted (1996: 334), the Finance Ministry and the Scientific Advisory Council to the Federal Economics Ministry produced documents in 1988 and 1989 that echoed this approach. Their prescription was that states needed to liberalise markets, prioritise price stability and thereby converge economies before any move to monetary union could take place.

Teasing a bit more out of Germany's position, two related observations can be made. First, the creation of a stability culture in EMU should take precedence over growth: a clear prioritisation of German over French goals. Secondly, EMU must institutionalise this stability culture. Or, as Krotz and Schild summarise the German position (2013: 185): 'basic willingness to cede sovereignty but only in case European rules and institutions emulate the German stability model'.

A further accompanying concern relates to 'moral hazard'. German politicians have been very reluctant, if not completely opposed, to forms of mutual financial support that can be seen to reward states that have not pursued fiscal conservatism and monetary stability. It is precisely for this reason that economic convergence was prioritised in the pathway to EMU. Throughout the history of monetary integration Germany has been very reluctant to embrace fiscal transfer schemes. As Mark Blyth (2013: 140) has pointed out: 'The fact that *ordoliberalism, ordnungspolitik*, and the rest, are all about rules means precisely that good economic governance is not about spending'. Germany's likely exposure as the main contributor to any 'transfer union' is a further contributory factor to its opposition. To summarise the position on moral hazard: states should take responsibility for their own destiny, including through making the necessary domestic reforms to ensure competitiveness. The logic of this position is that the burden of policy adjustment falls on weaker states.

These key principles of ordoliberalism influenced the details of German policy towards the design of EMU and addressing the Eurozone crisis. In the design stages Germany's substantive requirements on the operation of monetary integration were accompanied (and thus moderated) by a pro-Europeanist rhetoric that, by contrast, was scarcely evident during the crisis (Bulmer 2014).

Who are the key actors and institutions responsible for articulating these policy principles over the course of negotiating monetary integration to the present? The German central bank, the Bundesbank, was entrusted with the task of ensuring price stability and axiomatic to that task was the very high degree of independence it was given (Marsh 1993). The Federal Finance Ministry was entrusted with pursuing policies of 'sound money' in the task of managing the federal budget. The Federal Ministry of Economics, by contrast, has held the brief for ensuring functioning economic markets through the economic constitution, and of intervening in those cases where markets might otherwise fail, such as in assuring balanced growth across Germany. The chancellor of the day has been a key actor because of the intermittent 'high politics' of EU politics, while the Foreign Office is engaged due to its responsibility for integration policy. Beyond the state sound money principles have commanded broad public support.

Germany and the design of EMU

France set the ball rolling in putting EMU back onto the agenda, with the January 1988 memorandum of Finance Minister Balladur (Dyson and Featherstone 1999:

163-6). A variety of motives lay behind this initiative but one passage is worth citing that alludes to Germany: 'It must be avoided that one single country has, de facto, the responsibility to fix the objectives of the economic and monetary policy of the entire system' (quoted in Krotz and Schild 2013: 192). Or, as Jacques Attali, President Mitterrand's international adviser is attributed as saying later on, 'the Maastricht Treaty was a complicated operation with a simple objective: to abolish the D-Mark' (Marsh 2013a: 81). EMU was to be part of lofty objectives relating to European integration but in the background was a wish to limit German influence in European monetary policy.

Within the pattern of Franco-German cooperation the wish to deepend integration through EMU found resonance and it was German Foreign Minister Hans-Dietrich Genscher who took things a stage further in proposing a committee of experts to explore possibilities. This proposal was agreed at the June 1988 Hanover European Council. German unification in the context of the end of the Cold War then added considerable political salience to the wishes of France and Germany to further cement European integration. In a manner analogous to the origins of the European Coal and Steel Community, the creation of EMU was regarded as a means of binding the newly unified Germany to a collective European destiny.

The German contribution to EMU was multi-faceted and achieved through multiple channels: bilateral meetings with French counterparts; EU wide negotiations; meetings of foreign ministers, 'chief executives' (Kohl and Mitterrand), finance ministers, central bankers and between senior officials of each of these (for an excellent analysis, see Dyson and Featherstone 1996).

On the overarching political level Chancellor Kohl shared Mitterrand's commitment to Franco-German symbolism, as part of underpinning an image of a 'Europeanised Germany'. German negotiators were successful in gaining an agreement that reflected a vision of Europe, while also securing 'sound money' principles at the heart of the EMU project. The specific imprint of Germany upon the Maastricht design of EMU can be seen as follows (see Dyson and Featherstone 1996, 431; Issing 2008; Krotz and Schild 2013, 194-9):

- the export of the Bundesbank institutional model of independent central banking to the European level;
- the primacy of price stability in the European Central Bank's mandate;
- the insistence on economic convergence as a pre-requisite for proceeding through each stage of EMU and formalised in specific convergence criteria on, *inter alia*, public debt and deficit ratios and combatting inflation;
- provision of a treaty article rejecting common liability for each other's debts, i.e. the so-called 'no bail-out clause' (Article 125 of the Treaty on the Functioning of the European Union, TFEU);
- creating a system of fiscal discipline for states breaching rules of fiscal discipline, the Excessive Deficit Procedure (Article 126, TFEU);

- prohibiting the ECB from monetary financing of member states' public debt (under Article 123 TFEU); and
- in sum , a rules-based system for EMU that avoided fiscal transfers, since they might undermine discipline.

Two major German goals were satisfied: to upload the German stability culture to the EU; and to maximise the chances—with an eye on the German electorate—that the single currency should be as stable as the existing DM. Ensuring that the Bundesbank was happy with the negotiating outcome was vital to selling EMU to a hesitant domestic public (Dyson and Featherstone 1996: 348).

There were, of course, areas where accommodation or compromise was reached with France and other states, such as on the time-frame and automaticity of EMU, with the German negotiators' concerned that the convergence criteria might be overridden by political considerations (as they indeed were subsequently). There were limits to what German negotiators could achieve and they remained reluctant to be isolated in negotiations but were assisted in this regard by other states with similar views, such as the Netherlands. German negotiators were helped by the admiration of Germany's economic model and the prestige of the Bundesbank as the most successful central bank in combatting inflation. As Dyson and Featherstone note (1996: 342-3), the one area where German negotiators were themselves somewhat disunited and correspondingly unsuccessful in securing their goals was on the accompanying negotiations on Political Union. Kohl and Genscher were prepared to tolerate more modest developments in this area of the Maastricht negotiations, whereas the Bundesbank and the Finance Ministry considered Political Union as vital to the political legitimation of EMU.

One final feature of EMU was the Stability and Growth Pact (SGP). Promoted at EU level by German Finance Minister Theo Waigel, the SGP, agreed in June 1997, was designed to ensure continuing fiscal discipline for the new currency, once it had been created. Pressure for a pact had originated from a 1992 report by the German Council of Economic Experts, and gathered momentum in the political arena (for details see Heipertz and Verdun 2004). Also relevant was the FCC's Maastricht judgment which, amongst other things, suggested that if EMU failed to sustain price stability, German citizens could complain against their country's participation in the Euro (Jones 2010: 24). Important politically was pressure from the Bavarian Christian Social Union under Minister-President Stoiber. Contributing as a party in the federal coalition—Finance Minister Waigel was from the CSU—the Stability Pact emerged as key part of the German government's policy at a time when domestic public opinion was sceptical about the proposed single currency (Bulmer, Jeffery and Paterson 2000: 94-6). The pact again uploaded ordo-liberal principles to the EU level.

At the heart of the SGP was committing states to keeping budget deficits below 3 per cent of GDP using the Excessive Deficit Procedure (EDP). However, from 2002-5 Germany became one of the transgressors due to its budget deficit exceeding 3 per cent (a consequence of the costs of German unification). In November 2003 the Commission launched the EDP against Germany and France, which exceeded 3 per cent from 2002-4, but these two states constructed a blocking minority and no sanctions were introduced. To compound matters, in 2005 the SGP was reformed at Franco-German instigation with relaxed rules.

As this instance shows, whilst the commitment to a stability culture and ordoliberal rules has been a continuing feature of the German political economy, performance has not been perfect. The Schröder government took the view that it should not cut public spending in a domestic recession and wanted instead to retain control over its national budget. In taking this line 'Germany had weakened the very regime it had created' (Crawford 2007: 139). Presciently, Gerrit Zalm, the Finance Minister of the Netherlands, which backed application of the SGP rules against Germany and France, predicted the Eurozone members would 'pay the price of French and German fiscal incontinence' (quoted in Crawford 2007: 139). This episode has largely been overlooked during the Eurozone crisis, during which the 'fiscal incontinence' of other states has been presented by German policy-makers as the key problem. In November 2014 former chancellor Helmut Kohl published a new book in which he went as far as blaming the Red-Green government of Schröder for the Eurozone crisis (Zeit Online November 2014; FAZ 2014).

Diagnosing the Eurozone crisis

From the start it must be pointed out that the creation of the single currency came about relatively smoothly with a European Council decision in May 1998. However, this was not before over 150 German economists, including serving members of the advisory boards of both the Economics and Finance ministries, had publicly declared that EMU was coming too soon. The Euro formally came into being on 1 January 1999 but Greece was initially excluded. The Euro notes and coins came into circulation on 1 January 2002. By this time Greece had been deemed compliant, having addressed an earlier excessive deficit. The Council agreed Greek participation in the single currency in June 2000 (Council of the EU 2000).

In May 2008 the Commissioner for Economic and Monetary Affairs, Joaquín Almunia, spoke at an event celebrating 10 years since the European Council had agreed on the move to Stage 3 (Almunia 2008). While recognising the Euro's successes, including improved ability to withstand external shocks, one of three areas for improvement was to improve economic and budgetary coordination and surveillance. Barely a year later the Eurozone crisis had hit, with the absence of that surveillance being a major contributory factor.

What was the nature of the Eurozone crisis? First, it was about sovereign debt levels that became unsustainable, most obviously in Greece but also by contagion in Portugal and other states. The ability of both states and private actors in southern Europe and Ireland to borrow at rates lower than would have applied outside the single currency encouraged the accumulation of debt or an overheating economy. The unsustainability of this situation became plain in the aftermath of the global financial crisis. Secondly, the design flaws in the original EMU design resulted in inadequate surveillance over Eurozone states' fiscal policies. Thirdly, it also entailed a banking crisis, partly arising from the preceding global financial crisis but with an added Eurozone component. Banks in Ireland as well as Spain—two overheating economies—and Cyprus required intervention from their respective governments, thereby rapidly raising major problems for state borrowing.

The crisis has also been one of leadership and policy legitimacy. In the absence of a clearly empowered leader in the Brussels institutions and with weakness in the French economy making Franco-German leadership problematic, Germany moved 'centre stage' (Paterson 2011). The adjustment measures in the debtor states have led to a succession of incumbent governments being defeated at national elections, as austerity measures strongly shaped by Berlin encountered domestic rejection. Across the EU a wave of Euroscepticism of different varieties found support in the 2014 European elections with something between a quarter and a third of MEPs fitting this description, depending on the exact definition. It is little wonder against this backdrop that the terminology of hegemony has been applied to Germany to a degree unprecedented since the birth of supranational integration. Hegemony's twin meanings of leadership and domination have been experienced in the Eurozone. Northern states wanted German leadership, while in southern ones fears were expressed about German dominance.

The trajectory of the Eurozone crisis has been complex and has taken different turns reflecting both the nature of the crisis and the states affected (see Box 6.1). The 2007-8 financial crisis is important contextually, especially since it exposed EU states differentially to the need to rescue vulnerable banks. The Eurozone crisis can be traced to when the incoming Greek government announced in October 2009 that public borrowing was much larger than had been reported. The need for a rescue became clear in 2010, with a package agreed in May. Over the period to the end of 2012 Ireland, Portugal, Spain and Cyprus also requested financial support. From 2011 the moves got under way to provide enduring policy solutions.

The moves to introduce greater discipline over fiscal and economic coordination came through three major sets of measures: the 'six-pack', the 'two-pack' and the Treaty on Stability, Coordination and Governance (TSCG). The six-pack (five regulations and a directive) was the first step to improving economic and fiscal coordination and surveillance, including a strengthening of the SGP. It entered into force in December 2011. The TSCG, unlike the other two packages, is not EU law but an intergovernmental agreement of the EU states except the UK and the Czech Republic. It comprises a set of measures binding on all Eurozone states, with some overlap in details with the six-pack. The TSCG includes the requirement for each Eurozone state to introduce constitutional-legal provision for a 'balanced-budget rule' overseen by a panel of independent experts as well as for an automatic correction mechanism. These together with a debt-brake rule represent the heart of what is often termed the Fiscal Compact. However, there are other measures in the TSCG on economic policy coordination as well as Eurozone governance. Failure to implement the budget rules in a satisfactory way carries the ultimate sanction of a fine imposed by the European Court of Justice. Full ratification is also needed in order to be eligible for the rescue funds of the ESM. Signatories to the TSCG have also undertaken to adhere to rulings under the Excessive Deficit Procedure unless they can secure a blocking *majority* to overturn the ruling (reverse qualified majority). The TSCG gives the rules of the SGP stronger teeth than previously, when the application of the EDP could be obstructed by a blocking *minority*. The TSCG was signed in 2012 and came into effect for existing Eurozone states on 1 January 2014. Finally, the two-pack comprises two EU regulations on budgetary surveillance. They were agreed in May 2012 and came into effect in May 2013.

The European Stability Mechanism (ESM) was established in 2012. It offered a purpose-built vehicle for funding rescues rather than the previous earlier short-term arrangements (the European Financial Stability Fund, EFSF, and the European Financial Stabilisation Mechanism, EFSM), created at the time of the first Greek rescue.

Weighed against these austerity measures, steps agreed on competitiveness and growth have been of much less significance, although the EU's Europe 2020 programme is concerned with that over the longer term. The main initiative undertaken during the Eurozone crisis was the Competitiveness Pact (or Euro-Plus Pact), agreed in March 2011. The pact was for all Euro states but open to other EU states as well. Its provisions comprised measures to enhance competitiveness and employment, to improve the sustainability of public finances (in reviewing pension, healthcare and social expenditure) and to improve control over private debt. Significantly, this pact was a matter of political agreement rather than legislative in nature so as to respect different national traditions. The final area of legislation concerned moves towards banking union. This phase of policy-making took place 2012-4.

Thus the extensive package of measures taken to address the crisis has been extensive. However, they have taken different form (legislative and non-legislative) and have also been characterised by variable geometry and measures taken outside the EU legal framework. Common to everything, however, has been the centrality of Germany's role.

Understanding German policy on EMU and the crisis

Three episodes in the crisis have been selected to offer insights into whether Germany has played a hegemonic role internationally and how that has found support or otherwise in domestic politics. The initial phase of the crisis that led to the first Greek rescue reveals a hesitant German reaction (reluctant hegemon). We then look at the period 2011-13 when the EU strengthens its fiscal rules to rectify gaps in the design of EMU. During this period Germany plays the role of 'shaping power', placing a very strong imprint on the rules. The third episode is the construction of the Banking Union (2013-14), where Germany again had clear views and attempted to use its veto power but was forced into concessions.

Throughout the entire period there are a number of guiding principles in German policy, namely:

- the debtor states should draw consequences from the crisis and undertake the necessary domestic reforms

- the gaps in the Maastricht design of EMU needed to be rectified to prevent a recurrence of the circumstances (strengthened fiscal rules);
- the EU needed to create a Banking Union to give it greater resilience; and
- rescue funding arrangements were needed to provide a firewall and limit contagion.

This listing reflects an ex-post rationalisation of the actions taken (interview, German Finance Ministry 13 November 2014. The clarity of the principles is more evident with hindsight than at the start of the crisis in 2010, when events were disorderly and responses unsystematic and cautious. The rank ordering is worth noting because it demonstrates German preferences particularly clearly.

Linked to the policy substance it is also possible to identify four guiding procedural principles of the German government through the crisis (based on Kietz 2013: 35-6):

- conditionality, requiring debtor states to undertake domestic structural reforms to recover their budgetary position through an improvement in competitiveness;
- aid should be granted only at *last resort*, when the debtor state's financial position jeopardises the stability of the system as a whole;
- member states' liability should be capped and joint liability avoided because of incompatibility with EU treaties and the German Basic Law; and
- veto powers should be retained (unanimous decision-making) on individual rescue arrangements.

(i) Germany and the first Greek rescue: reluctant hegemon

The initial German response to the emergent Greek sovereign debt crisis has been well charted by Jones (2010). The German government's initial reaction was that the issue was a Greek problem for which Athens held responsibility and should take the necessary action. In February 2010 the European Council took the decision to act resolutely to defend the single currency. In early-March Merkel and senior ministers met Greek Prime Minister George Papandreou but financial aid was not on the agenda. The government was still buying time in a complex two-level game of negotiations with EU partners while acknowledging concerns in public opinion. However, at the end of March Merkel acknowledged the 'last resort' scenario was approaching: financial assistance might be necessary, but it would be with the participation of the International Monetary Fund (IMF) (Passauer Neue Presse 2010). At a summit on 25 March, and with President Sarkozy's acquiescence, Merkel was able to push through the IMF's involvement as well as agreement on structural reforms for any Eurozone member that lacked budgetary discipline. Thus, the 'Troika' of the European Commission, ECB and the IMF became the institutions overseeing the various national rescues.

In early-May Chancellor Merkel declared that the last resort had indeed been reached and agreement on the Greek rescue came at the European Council on 7/8 May. However, by this stage the Franco-German consensus had been stretched by Merkel's attempts to delay agreement until after the North-Rhine Westphalian elections on 9 May. As illustration, the French Finance Minister, Christine Lagarde, drew attention to underlying issues of competitiveness and criticised Germany's huge trade surpluses (Krotz and Schild 2013: 202). Berlin's efforts to 'agenda-manage' the Eurozone crisis appeared to be at risk. Even so, the €110 bn Greek rescue was approved and 'the Troika' came into existence, with the IMF's inclusion at German insistence.

The criticism levelled at the German government in relation to the first Greek rescue concerns the slowness of reaching agreement. Erik Jones (2010: 25-6) argues that the delay meant that the costs of the rescue increased over the passage of time and that they could have been arrested if Merkel had announced at the end of 2009 that Greece would be supported as it undertook the necessary domestic reforms. Instead, not only did the costs of the eventual rescue rise, but the crisis began to gather its own momentum as the financial markets looked for the next Eurozone casualty (which turned out to be Ireland, later in 2010). The intervention then had to be bigger in order to settle jittery markets. Of course, we cannot be sure of Jones's counterfactual (and nor is he). So, why the delay? Two explanations can be offered. One is that the delay tactics were part of German policy. The second is that German domestic politics explains Germany's reluctant leadership.

The position advanced by a senior official in the German Finance Ministry (interview 13 November 2013) was that the rescue process had to be cautious to ensure Greece made the fundamental change in policy direction as a condition of the rescue. Too quick a rescue would have sent the wrong signal about the extent of reforms needed and would also have set a bad example for other states (moral hazard). It could have risked additional rescues over the longer term compared to what actually happened, thus raising the long-term costs. This counterfactual also cannot be tested. The caution had an indirect effect as well; it enabled exposed German banks to consider how to withdraw from their exposure in southern Europe (see below). Ulrich Beck (2013: 52) described Merkel as Machiavellian, using a hybrid term 'Merkiavellianism' to describe an approach based on four mutually-reinforcing components: 'the combination of nation-state orthodoxy and Europe building, the art of hesitaton as a means of coercion, the primacy of national electability and, lastly, the German culture of stability'.

The substance of what was achieved in May 2010 corresponds to the broad strategy of the Berlin government. It had been made clear to Greece that it needed to undertake major structural reform and that had been embarked upon (drawing the consequences). By this time the Eurozone states had acknowledged that the fiscal rules needed to be strengthened more widely, although it would obviously take some time for this to be achieved. Thus the rescue arrangements could be drawn up. Regarding the procedure, Greece had been left in no doubt about the structural reforms on which its rescue depended. The delaying of the rescue to the spring meant that the intervention only came when it was needed because the system was in danger (last resort). Capped liability was ensured in several ways. First, the involvement of the IMF introduced an international organisation experienced in running such interventions and injecting its own financial resources. Second, the European Financial Stability Fund was created at this time as an international-legal entity incorporated in Luxembourg, like the later European Stability Mechanism: another manifestation of capped liability. The German government did not want reliance on funds established under EU auspices for fear that its Federal Constitutional Court might deem them to be in conflict with the no bail-out clause in the EU treaties.

This last point highlights that the Germany's apparently slow response was conditioned by domestic politics, to which attention now turns. The Eurozone crisis entailed wide ramifications both for institutions (Chapter 3) and political forces (Chapter 4). Institutionally, positions had to be determined within the federal coalition and approval secured from the Bundestag and, via the Bundesrat, the Länder governments. Also actively involved with specific rulings was the FCC.

Within the federal government the key players in policy-making were a small group from the Chancellor's Office, the Finance Ministry, the Economics Ministry, the Foreign Office and the Ministries of the Interior and Justice (the last two due to the particular legal aspects involved). A consensus position gradually emerged from the coalition comprising CDU, CSU and FDP ministers. Amongst the nuances were initial differences over IMF involvement, which was not Finance Minister Wolfgang Schäuble's position; he favoured an EU solution and the creation of a European monetary fund (Spiegel Online 2010). This position was overruled by Merkel. FDP Finance Minister Rainer Brüderle was floating a solution for 'orderly' state bankruptcies but this lacked the necessary support or time-frame to develop (Focus Online 2010).

The government had to be mindful of a potential intervention from the FCC, given the willingness of dissenting politicians and economists to litigate. The FCC therefore cast a shadow over government decision-making, influencing in particular the principle of capped liability to limit the possible claims that the EU's no bail-out clause was being breached. Parliamentary engagement with the Greek rescue was significant procedurally (see Kietz 2013). The Bundestag and Bundesrat had to undertake rapid scrutiny and eventual approval of the Greek package within four days. However, approval of the EFSF and EFSM had to be undertaken in one day and without detailed information being available. The government's position was based on the urgency of the situation but it also argued that the use of international-legal rather than EU instruments meant the normal consultation process under Article 23 Basic Law did not apply.

Substantively, the two pieces of legislation passed with significant majorities (Greek rescue: for 391/against 72/abstentions 139; stability funds: 319/73/195). In both cases the federal government parties delivered a majority despite a handful of both CDU/CSU and FDP MdBs either voting against or abstaining (Wimmel 2013a). Opposition came from die Linke; the SPD largely abstained on both measures; the Greens voted with the government on the Greek rescue and abstained on the legislation on the new funds. The SPD abstentions in May 2010 represented a major breach of the usual bipartisan approach to European policy. However, this SPD position—which doubtless reflected the politicized nature of the debate in Germany—was criticized and not repeated in subsequent votes on the Eurozone crisis. The episode was doubtless influenced by the coincidence of the build-up to agreement at EU level and ratification in parliament with the state election in North Rhine Westphalia. The election was key for the government retaining a majority in the Bundesrat: on which it failed. During the campaign there was evidence of hostility to the rescue in public opinion, whipped up by the German tabloid press's campaign about the costs to German taxpayers (e.g. Bild, 2010). Indeed, there was criticism of Merkel on the grounds that she had not confronted Bild's anti-Greece campaign and gave the impression she was using it to build her own reputation as an 'iron chancellor' (Große-Hüttmann 2011: 355).

The FCC was involved in this initial phase of the Eurozone crisis (Schmidt 2013). Already in May 2010 it rejected a temporary injunction against the Greek rescue based on its likelihood following the European Council. A similar ruling came in June 2010 in relation to the actual May 2010 rescue. As Schmidt puts it (2013: 9), 'similar to the order in May, the FCC argued that … the government had acted within its margin of discretion'. In September 2011 (Schmidt 2013: 9-10) it made a further ruling on the process of Bundestag involvement in relation to EFSF funding. Specifically, the Bundestag's Budget committee was in future to give its explicit authorisation: something that had been prevented due to the rapid 'emergency' consultation in May 2010. Further procedural clarification came in a March 2012 ruling.

This first phase can therefore be seen as Germany playing the role of reluctant hegemon. The reluctance arose from three sources. First, the unprecedented nature of the Eurozone crisis meant there was no 'script' for its resolution at the Brussels level. Second, ordoliberal principles indicated that Greece needed to display concrete action on reform as did the Eurozone itself as regards gaps in the design of EMU before rescue arrangements could be agreed. But complementing this second explanation was the third. Domestic public opinion and the fear of interventions via the FCC all supported the adoption of a policy of this kind. Despite the reluctance, however, it was clear that Germany was playing the key role in shaping the conditions of the rescue.

(ii) Strengthening fiscal rules: Germany's shaping power

The European Council had already agreed in principle to the process of strengthening the EU's fiscal rules to rectify design faults in EMU in March 2010. A task force on economic governance was set up under its President, Herman Van Rompuy, and made up of representatives of all EU member states. For Germany there was an element of re-running the Maastricht and SGP negotiations to reinforce the rules. As Krotz and Schild put it (2013: 203-4):

> … the German success in uploading the German stability model at Maastricht was elusive, because its European-level elements turned out to be less resilient than assumed and because its 'download' by the Southern periphery of the euro area was incomplete, to say the least.

The German government's position during the 2010-11 period (see Krotz and Schild 2013: 204) emphasised the strengthening of the SGP framework. It endorsed slightly more encompassing economic policy coordination, notably the Franco-German Competitiveness Pact (see above). It also advocated an 'orderly default procedure' to indicate that states would not be bailed out without complete disregard for the circumstances. It proposed unilaterally that private investors should share the pain in taking a 'haircut' in the restructuring of Greek debt. At the same time Germany was a resolute opponent of mutualising debt through 'Eurobonds'. On a much broader level it was during this period that Angela Merkel repeatedly uttered the mantra 'if the Euro fails, Europe fails' as a way of underlining the commitment to solving the crisis and to the EU.

The French position was rather different, emphasising solidarity (with its implication of mutuality of debt contrary to Germany's position), favouring the strengthening of 'economic governance' (which implies more power for politicians rather than strengthened rules over which politicians have little discretion), and appearing to interfere politically with the work of the ECB, while expressing scepticism about private sector haircuts (Krotz and Schild 2013: 204).

In terms of the policy outputs—specifically the six-pack, two-pack and the TSCG—Germany was the more influential. Fiscal rules were tightened and the automaticity of the EDP was strengthened, including through reverse majority voting. The Fiscal Compact is particular evidence of German influence: with a balanced budget rule (like the one Germany had itself introduced in 2009 via Article 109 of the Basic Law); a debt-brake rule to reduce debt ratios of states exceeding the 60 per cent threshold; an automatic correction mechanism if these rules are not complied with; and the requirement of the states to give these rules at least at the status of law. 'This approach to resolving the crisis comes straight out of the ordo-liberal toolbox: stringent fiscal rules with little or no scope for discretionary intervention' (Bulmer 2014: 1254). Finally, Germany got its way on a private-sector haircut for Greek bondholders and, whilst it was agreed to be a special case, a similar approach was later applied during the Cyprus rescue. Finally, when the ESM was set up, an amendment to Article 136 TFEU was agreed that was deemed necessary by the German government to help avoid an adverse judgment before the FCC.

Where Germany was less successful was on three points. First, Merkel and Sarkozy agreed that the European Council should be the Eurozone area's economic governance, a term that had been a French fixation since the Maastricht Treaty. Twice yearly Euro summit meetings were subsequently agreed. However, this procedural change does not seem to have changed the direction of Eurozone policy. Secondly, one of the measures of the six-pack that was put into operation was a new Macroeconomic Imbalance Procedure, which brought with it some risk for Germany with its large current account surpluses in trade. In its report issued in November 2013, the European Commission indicated that the German surplus was above the upper threshold (Gros and Buesse 2013). Happily for Germany this procedure does not entail the automatic application of sanctions. Finally, the orderly insolvency proposal was dropped.

Many of these measures were agreed with Franco-German backing, despite their predominantly German flavour, during the height of the so-called 'Merkozy' period in 2011, where the two leaders were seen as coordinating responses to the crisis. Germany can certainly be seen as having substantially shaped the strengthened fiscal rules. The downgrading in January 2012 by Standard and Poor's of the credit rating of France (and eight other Eurozone states) symbolised Germany's evident elevation to 'number 1' in the Eurozone and EU. Franco-German cooperation became more problematic with the election of President François Hollande in May 2012 in view of his emphasis on growth policies.

One caveat is needed in relation to German influence. Germany strongly shaped the original Maastricht and SGP rules; it was their *application* that was part of the problem. Hence the jury is out on the efficacy of the new rules (e.g. see Hodson 2014: 194-6 for discussion of the 'room for manoeuvre' in the application of the six-pack). Thus in autumn 2014 France and Italy were submitting their budgets to the Commission and testing the boundaries of the 3 per cent ceiling on the proposed annual budget deficit. In March 2015 EU finance ministers approved a two-year reprieve to France to get its deficit—projected at 4.1 per cent of GDP for 2015—under control (*European Voice* 2015). The EDP has been applied to France since 2009. Political pragmatism is in the background, given that draconian economic measures might conceivably pave the way for the election of Marine Le Pen as French president: an outcome which could be dramatic for the future of European integration!

Domestically, the die had already been cast during the Greek crisis. Parliament, and more specifically the Bundestag, had become a potential veto-point. Every increase in the rescue funds, for instance, would need explicit approval from the Bundestag. Contrary to the situation in May 2010, the voting pattern shifted because the SPD swung behind the centre-right coalition, resulting in 'super-majorities', for instance in nine roll-call votes from September 2010 to November 2011. Only die Linke remained as resolute opposition to the various pieces of legislation and other coalition declarations on the Eurozone. However, as Wimmel (2013b) has pointed out, in six of these votes the coalition parties (CDU/CSU/FDP) could not secure a 'chancellorial majority' due to defections from their own ranks, thus making them reliant on support from the SPD and the Greens. This contingency demonstrated the Bundestag's potential as a veto-point and made the government especially attentive to domestic considerations.

Another dimension to the politicisation of German European policy came paradoxically from the relationship between the Bundesbank and the ECB, two independent central banks. With the French ECB President Jean-Claude Trichet's term approaching its end, the Bundesbank President, Axel Weber, emerged as the front-runner. With a reputation as a 'hawk' on the ECB Governing Council favouring the strict application of 'stability policy', his February 2011 decision to step down from his post at the Bundesbank and withdraw his (never declared) 'candidacy' for the presidency of the ECB was seen as something of a setback for German policy. It allowed the Governor of the Bank of Italy, Mario Draghi, to become the new president of the ECB in October 2011.

Further, in September 2011, before Draghi's arrival, ECB chief economist (and former Bundesbank deputy president) Jürgen Stark resigned his position. Both Weber and Stark had been critical of the ECB's bond-market purchases and sent a clear signal that Germany's 'stability policy' was not being pursued by the ECB. The specific concern was that the ECB's purchases of Greek, Italian and Spanish bonds, measures to reduce the pressure in the financial markets on those states' interest rates for re-financing debt, was the thin end of the wedge towards a 'transfer union'. A 'transfer union' is highly emotive in Germany, combining a breach of ordoliberal principles of moral hazard as well as conjuring up the vision of German taxpayers' money being used, directly or indirectly, to prop up the economies of states pursuing ill-disciplined policies. Suspicion of a transfer union has motivated German economists, politicians and the general public alike to pressure the Berlin government to hold a stability policy line in Eurozone negotiations. It has also motivated challenges before the FCC.

Weber's replacement was Jens Weidmann. A former senior adviser ('sherpa') to chancellor Merkel at G8 economic summits, he has been prepared to stand his ground in the ECB. His interventions have had resonance amongst economists, policy-makers in Berlin and the wider public. He considered the purchase of bonds undertaken by the ECB to be a 'gambit [that] betrayed its founding principles, which were rooted in the traditions of the Bundesbank' (Wall Street Journal 2012). Weidmann has therefore articulated a hardline ordoliberal position inside the ECB. When President Mario Draghi delivered his July 2012 speech in London committing the ECB to do 'whatever it takes to preserve the Euro', Weidmann reportedly considered resigning over the policy implications (Financial Times 2012). He subsequently opposed the large bond-purchase programme (Quantitative Easing, QE) agreed in early-2015 and openly expressed his dissent (Die Welt 2015). To protect the independence of the ECB the Berlin government refrained from comment. However, what was clear was that, after some years when it had been in the shadows, the Bundesbank had struck back, and had become another key player (see Marsh 2013a, 79-84). Whilst not a veto-player, since the ECB's decisions do not require unanimity, Weidmann's public interventions have been very influential in German domestic politics.

The FCC was also active during this period. In September 2011 the President of the FCC went so far as to pronounce that the granting of core competences to the EU had reached its limits and would need a new constitution (Große-Hüttmann 2012: 385), revealing how the FCC had also become an important 'co-player' in German European policy-making. A further ruling in June 2012 found the government had failed to give the Bundestag sufficient information to carry out its European policy duties by interpreting Article 23 Basic Law too narrowly.

Arguably the key FCC judgment related to Outright Monetary Transactions (OMT): the bond purchases which Draghi had proposed following his 'whatever it takes' announcement. By this stage the future of the Eurozone was almost hanging on the rulings of judges in the FCC. In its January 2014 ruling it considered OMTs *ultra vires*: first because the ECB would be acting outside its monetary mandate, and second because OMTs breach the prohibition of monetary financing of member states' public debt (under Article 123 TFEU). However, the FCC took the unprecedented step of seeking a preliminary ruling from the ECJ on the matter. The FCC's initial ruling challenged the ECB's deployment of its main policy instrument (or 'big bazooka'), potentially throwing the management of the Eurozone crisis into turmoil. The legal process is not yet complete but in January 2015 the ECJ's Advocate General rejected the FCC's position; a step that allowed QE to get underway shortly afterwards.

Domestic politicisation also found expression in the dissent that was being expressed in the coalition parties regarding Eurozone votes in the Bundestag. In advance of the Berlin state elections in 2011 the FDP Chairman, Philipp Rösler, 'tolerated' Eurosceptic voices within his own party, although this tactic was electorally unsuccessful. In 2012 Frank Schäffler, a dissenter in the FDP ranks, initiated a survey of FDP members on the Eurozone rescues. If it had ended with support for Schäffler's position, it could have brought the coalition down. Speculation had already mounted in 2011 about whether the Chancellor's own position would be tenable if votes on the Eurozone measures should fail to secure a majority in the Bundestag (Große-Hüttmann 2012: 387). In the event there was no such outcome because of the 'super-majorities' supporting the measures (Zimmermann 2014). Nevertheless, the evidence of senior CDU politicians positioning themselves as potential successors, and critique of Merkel's policy from other states led to a situation that was highly uncharacteristic of the 'domestic politics' of German European policy. Yet, populist voices continued to be heard from the FDP and CSU in particular. Senior officials in the CSU questioned Greece's ability to remain in the Euro and tapped into an ongoning anti-Greek strand of the media in the run-up to the 2013 Bavarian state election (Große-Hüttmann 2013: 406). Finally, it was in April 2013 that the anti-Euro party Alternative für Deutschland (AfD) was established (Marsh 2013b). Headed by a professor of macroeconomics at Hamburg University, the party's core policy was opposition to the Euro. Reportedly, Lucke had been a supporter of the Euro and a CDU member for 33 years but changed his position at the time of the Greek rescue. The AfD was an additional calculation for the Berlin government to take into account in a federal election year. Its emergence was further evidence that the Eurozone crisis had prompted an unprecedented public party-politicisation of German European policy.

Germany's predicament over this period of the Eurozone crisis was well summarised by historian Timothy Garton Ash (Handelsblatt 2012). History was hanging upon Angela Merkel. However, she could not act alone but was having to deal with the 'four big B's': the populism of the main tabloid newspaper—Bild Zeitung—as well as the interventions of the Bundestag, the Bundesbank and the Bundesverfassungsgericht (the FCC). Seen by its partners as playing the lead-role in shaping the strengthened fiscal rules, domestically the federal government's position was under considerable pressure. The actions of the Bundestag or the FCC could potentially impact very adversely on the successful management of the crisis. Seen in this way, Germany was truly trapped between hegemony and domestic politics. Nevertheless, the serious nature of the domestic constraints certainly served as a valuable negotiating resource in

Brussels. The way out of the trap for the Berlin government was to insist on a strengthening of the Eurozone's stability culture, for that was consistent with its long-term policy preferences on EMU and the sole way of satisfying the 'four big B's'. In other words, domestic politics did not act as a constraint on German hegemony but actually strengthened the government's position in its negotiations with Eurozone partners.

(iii) Banking Union (Germany as would-be veto player?)
Banking Union (BU) came onto the EU agenda in 2012. The principle was agreed to in June 2012 and a key commitment in the European Council was that it was 'imperative to break the vicious circle between banks and sovereigns'. This view was reiterated at its December meeting in setting out a roadmap for the completion of EMU (European Council, 2012: 3). The BU comprises three components: creating a single rule-book with common standards of regulation; creating a Single Supervisory Mechanism (SSM); and the establishment of a Single Resolution Mechanism (SRM) along with the associated resolution fund. These measures were largely agreed in the period 2013-14 and constitute a major strengthening of EU powers transforming the regulatory landscape (Epstein and Rhodes 2014). The ECB took up its role as banking supervisor from November 2014, including undertaking periodic 'stress-tests' of the banks. The SRM is subject to an intergovernmental agreement that the UK and Sweden have not signed and will not be fully operational till 2016.

A number of key issues emerged in the negotiations. Particularly of note were the scope of the BU, the question of using ESM resources to rescue banks, the creation of the SRM and the funding of the resolution fund. Germany would inevitably be a key player in the negotiations. However, its fingerprints were much less evident on the resultant regulatory regime despite its weighty interventions during the legislative process. The policy-making framework offers part of the explanation. Contrary to the strong reliance on intergovernmental policy-making in the European Council in our previous two cases, in relation to the BU the supranational institutions (Commission, ECB and European Parliament) were able to play a significant role. Accordingly, Epstein and Rhodes (2014) argue that 'modified neofunctionalism' can explain the way in which banking regulation has been moved to the EU level.

Why did Germany play a much more limited role in determining the shape of the legislation adopted? Epstein and Rhodes's account (2014) is that the Commission and the ECB were able at times to isolate Germany in the bargaining process. German headed a group of states including the Netherlands, Finland and Denmark that sought to block both significant transfer of sovereignty to the EU and further transfer of funds from creditor to debtor states (Epstein and Rhodes 2014: 16). Epstein and Rhodes also point to divisions within Germany that weakened the government's position. This interpretation is complemented by David Schäfer's analysis (201?). He argues that Germany was trapped rhetorically by its own overarching policy commitment, thus resulting in the government having to make concessions. We draw on these studies in what follows.

A first area where Germany presented strong views was on the scope of the SSM. At the start of negotiations in December 2012 Finance Minister Schäuble opposed full supervision at EU level. His position was influenced by an apparent wish to exclude the regional banks (Landesbanken) and savings banks (Sparkassen) from the SSM and leave them to national supervision. Domestically, the position was complicated by different interests. Public banks wanted to be excluded on the basis that their regional role in cultivating the *Mittelstand* was an important part of Germany's economic success. By contrast, the private banks wanted them included in order to ensure a level playing field. To complicate things further, Bundesbank President Jens Weidmann opposed the ECB having the twin tasks of running Eurozone monetary policy and bank supervision. The agreement reached was that the ECB would supervise the largest 200 banks but could in emergency step in and supervise any of the Eurozone's 6000 banks. The German government had had to make concessions.

A second area of negotiation concerned the use of the ESM to recapitalise failing banks, as proposed by the Commission (Epstein and Rhodes 2014: 19-20). Germany opposed this position, arguing that such cases should be matters for national authorities. However, in December 2012 it had already supported emergency aid from the ESM for four Spanish banks, so its negotiating position was weakened by having to argue that this was a special case due to urgent circumstances. In May 2014 the Eurozone Finance Ministers agreed that ESM could be used to recapitalise a bank if private investors or the specific national state failed to do so. Again, Germany had had to make concessions.

Regarding the resolution of insolvent banks the German government opposed the creation of a single authority. Here its concern was that a common resolution fund for banks entering insolvency would be a 'backdoor' bailout mechanism. Such a step, it was argued, would require a treaty change at EU level. However, once the 2013 German federal election had passed Chancellor Merkel accepted that treaty change was not needed, signalling a retreat.

Attention then shifted to the creation of the Single Resolution Fund that would intervene in the event of a bank's insolvency. Germany was distinctive in already having a national resolution fund and its banks pressed for its retention. The government was opposed to a joint fund, arguing that it breached moral hazard considerations since states with lenient regulatory regimes prior to the crisis would likely benefit from the SRF. Germany again became isolated as other states argued that the absence of a joint fund would undermine the idea of a banking union. Berlin argued then for the Council to take resolution decisions with a view to retaining a veto power but this was a position opposed by Geman public and private banks alike (Schäfer 201?: 16). However, the eventual agreement was for the decision to be taken by a Resolution Board, thereby avoiding a cumbersome decisional process, leaving the Council with only a 24-hour right of veto. The SRF was in fact to be an amalgamation of national funds, enshrined in an intergovernmental agreement, with a single fund of mutualised national funds delayed until 2025. Late in the the inter-institutional phase of decision-making the EP forced a much swifter mutualisation timetable (Epstein and Rhodes 2014: 22), again contrary to Germany's earlier position.

Both analyses reveal that Germany was far from playing a hegemonic role in the creation of the BU. One explanation lies in German domestic politics. Both analyses highlight divisions within Germany: between different parts of the banking industry; between Chancellor Merkel and her finance ministry; and intermittently with the Bundesbank. Schäfer (201?: 18) argues that German policy positions were consistent with ordoliberal ideas of self-reliance and avoidance of moral hazard. However, in 2012 Chancellor Merkel had signed up in the European Council to the strategic principle of breaking the vicious circle between banks and sovereigns. Schäfer's analysis is that 'rhetorical entrapment' relating to this overarching goal was repeatedly played to by the Commission, the ECB and other states to override specific German objections to the detailed arrangements. Germany's efforts to be a would-be veto-player were largely unsuccessful because intergovernmentalist procedures were criticised by Economic and Monetary Affairs Commissioner Olli Rehn as 'the playground of big countries' (Spiegel Online 2013). Instead, policy-making followed a more typical EU pattern. Germany was pushed into the position of outlier on some details, while signed up to the overall BU 'roadmap'.

Germany and the political economy of the Eurozone

Two of the preceding mini-cases as well as the historical context have displayed Germany as the most influential state in EMU policy-making. However, hegemony is not just a matter of diplomatic influence. Underlying structural power is also relevant.

First, it is worth noting the fundamentals of the German economy in the Eurozone, since they underpin both the credibility of Berlin's diplomacy as well as its structural economic power. Table 6.1 shows Germany's relative position amongst the large states in the Eurozone at the height of the crisis. Its economic situation was strong, as demonstrated by its relatively low unemployment, current account balance and competitiveness ranking. Also it can be seen that German labour costs had risen less than those in the other large states in the period since 2005. Additionally, its budget deficit was only 0.8 per cent of GDP in 2011. Its debt ratio, at 80.5 per cent of GDP was above the 60 per cent guide but lower than all comparable states except, paradoxically, Spain, one of the debtor states for whom the steep rise in borrowing associated with its banking crisis was the core problem. Economically, Germany met the preconditions to play a hegemonic role in diplomacy.

Arguably the key factor relating to structural power has been the hyper-competitiveness of Germany as a 'trading state' making significant intra-EU/Eurozone trade surpluses. Moreover, German competitiveness has been on the rise since the early-2000s when it was regarded for a while as the sick man of Europe. The Hartz reforms under Schröder in the early-2000s addressed concerns about the competitiveness of Germany's labour costs (Eichhorst and Marx 2011) and helped its relative position. But the German model of Rhineland capitalism is an underlying contributory factor due the way in which the trade unions and workforce are integrated into corporate decision-making. In consequence, wage moderation to maintain competitiveness is possible within the German model of capitalism in a way unavailable to southern European counterparts. This wage restraint is a key component of Germany's export performance. The single currency has exacerbated it because, according to Wolfgang Streeck (2014: 214): 'For Germany and the other export-oriented surplus countries … eliminating devaluation in the European Single Market was a matter of forever protecting their terms of trade'.

Peter Hall (2014: 1223) has also made explicit the interconnection between models of capitalism and the Eurozone:

> Northern European economies equipped to operate export-led models suitable to success within a monetary union are joined to southern economies whose demand-led growth models were difficult to operate without the capacity to devalue.

Thus the export of German rules to EMU, the ECB and fiscal integration needs also to factor in the contrasting profiles of economic institutions across the Eurozone states. Southern European states are locked into a currency union without the same options for securing wage moderation and without the hyper-industrialised economic profile of Germany. Seen more widely still, German labour's consultative approach to wage restraint gives a kind of legitimation to its government's policy recommendations of a self-reliance approach in the Eurozone crisis, whereby debtor states 'should do their homework'. However, the debtor states are prescribed painful austerity medicine that may make the necessary changes in their industrial relations even more difficult to achieve.

The structural power arising from the Rhineland capitalist model is difficult for Eurozone policy-makers to address. It was criticised by southern European states and France at the start of the crisis (e.g. see Spiegel Online 2010). It also receives intermittent analysis (e.g. Tilford 2015). Germany's export performance—a surplus in foreign trade that had risen to €217 bn in 2014, the largest in history—had already criticised under the Macroeconomic Imbalance Procedure in 2013 (DESTATIS 2015; Gros and Buesse 2013). Moreover, Tilford (2015: 10) argues that the imbalances in the German economy may be worsening and that, in the absence of government efforts to re-balance, 'the Commission should step up the pressure on it to do so'. Yet the federal government regards wage moderation within companies and their success as exporters as the successful outcome of its Ordnungspolitik and therefore outside its policy remit. Any suggestion of penalising these characteristics doubtless would be rejected on the grounds that the EU as a whole needs to improve its competitiveness in global trade. The consequence, however, is that Germany is pursuing a 'beggar-thy-neighbour' approach.

A further hidden feature relating to economic characteristics relates to the German banks' quasi-complicit role in the Eurozone crisis. Germans have a very high propensity to save; Fratscher (2014: 82-4) terms Germany the world champion at saving (Sparweltmeister). But he also points out the savings have been invested poorly including by Germany's banks, who were sitting on the savers' cash. The banks elected to invest extensively in southern Europe such that their exposure was very large once the Eurozone crisis broke, particularly in Ireland, Spain and Italy. According to Helen Thompson (2013; see also Blyth

2015) over 40 per cent of the borrowing in the southern states plus Ireland was from French and German banks. So, while the Berlin government has lectured these states on their financial profligacy, the crisis also had roots in Germany itself. Moreover, the rescues and actions of the ECB in the bond markets allowed German banks to reduce their exposure considerably. Thompson (2013: 10) goes as far as to argue that the Eurozone rescues were an 'opportunity for Germany to "Europeanise" the problems of its own banking sector, particularly in regard to Italy and Spain'.

Seen from the perspective of critical political economy, therefore, German hegemony seems to be reinforced by its structural power and advantages that receive less attention in analyses that focus exclusively on diplomacy. Moreover, Germany's export proficiency and model of capitalism give it advantages that are neither addressed by the policy measures adopted and are not transferable to southern European states.

Conclusion

In exploring Germany's role in the Eurozone crisis we argue that hegemony and domestic politics shine considerable light on the issues at stake. However, it is important in sifting through the detail to return to the different understandings of hegemony. Leadership and domination can play out in different ways; the former through diplomacy, the latter through structural conditions as well as diplomacy.

Setting aside diplomacy to start with, it is clear that German economic strength, its export-orientation and performance and its labour market institutions place it in a strong position compared to some other Eurozone states, notably in southern Europe. These circumstances do not amount to dominance but they do constitute a bias that gives Germany advantages. States with a lesser degree of competitiveness are unable to use pull the traditional policy lever to bring about adjustment, namely devaluation. Moreover, given that Germany is opposed to a 'transfer union' the traditional policy instruments for managing such situations within a state are also excluded, calling into question the long-term sustainability of the Eurozone (Streeck 2013). Moreover, while the creditor countries over-borrowed, the exposure of French and German banks in the process also needs to be recorded. Blyth (2015) notes that the majority of the funding from the first two Eurozone rescues in effect went to the banks as lenders rather than to the Greek state. These circumstances do not amount to hegemony as such but they certainly tilt interests towards Germany in particular even before consideration of the diplomatic dimension is considered.

Hegemony can take different forms: playing a leadership role in stabilising the system in line with hegemonic stability, or offering 'hegemonic ideas' (see Box 6.2 for a summary). However, there is a precondition: to have sufficient power resources. We consider this pre-condition to have been met (previous section). However, whether the leadership is to be seen positively or negatively depends on the yardstick used and one's perspective.

With the initial Greek crisis Germany offered limited leadership since Berlin was reluctant to play the role of hegemon. It did not use its economic strength to exert a decisive intervention. Indeed, if German diplomacy is judged by the criteria of hegemonic stability theory, it failed. Furthermore, if the specific criteria for HST identified by Charles Kindleberger (1973) are deployed, Germany's contribution is not obvious (see Blyth and Matthijs 2011 for more detail). The one caveat with this specific set of criteria is that they are attuned to a Keynesian approach and therefore highly unlikely to be the way a German government would proceed, given the limited impact of Keynes on its postwar policies. Hence these criteria for leadership in line with HST—offering a market for distressed goods, countercyclical lending, macroeconomic policy coordination, lender of last resort, and bearing costs—were barely fulfilled but also not entirely appropriate. Germany was the largest contributor to the rescue funds (ca. 27 per cent) but it was the interventions of the ECB that did most to steady the financial markets and bring the Eurozone crisis into remission. Moreover, it has been the initiatives of incoming Commission President, Jean-Claude Juncker, that have sought to advance jobs, growth and investment, which are the long-term pre-requisites to reduce government debt.

Most convincing in its explanation is the role of hegemonic ideas. Ordoliberalism, despite this not offering a single precise and agreed prescription (Jacoby 2014), clearly featured prominently in the solutions to both the Greek crisis and in strengthening the fiscal rules. It has been an important shaper of the terms of the debate during the crisis (see Crespy and Schmidt 2014; Matthijs and McNamara 2015). Moreover, ordoliberalism offers the clearest link to domestic politics, since the FCC and the Bundesbank served as authoritative constraints, disciplining the Berlin government to this policy line. Domestic German politics have never been so politicized on European policy as during the Eurozone crisis with the possible exception of the 1950s. One of the paradoxes has been that non-elected and independent bodies—the FCC and the Bundesbank—have turned out to play major roles in domestic politicization. German public opinion and political parties also pointed to prescribing more ordoliberalism for the Eurozone as the way out of the dilemma of finding an international solution that would minimize opposition from domestic institutions and actors. Domestic politics served not to constrain German leadership but to reinforce its influence.

However, German leadership brought with it considerable costs. First and foremost, Germany was thrust into a more exposed position in the EU. Whilst its leadership may have been welcome in northern states, in southern Europe its prescription of austerity has brought diplomatic tensions and popular protest. The Greek SYRIZA-led coalition's anti-austerity policy led it into a head-on collision with its German counterpart, resulting in a loss of trust, especially between Finance Minister Schäuble and his Greek counterpart, Yanis Varoufakis, who stepped down during the efforts to secure a third Greek rescue as he had been deemed a liability to finding a solution.

The legitimacy of German hegemony has therefore been problematic and divisive in the EU. Criticism of Germany was particularly pronounced in the aftermath of the July 2015 marathon Eurozone meetings in Brussels to pave the way for a third Greek rescue. During the course of the finance ministers' meeting Wolfgang Schäuble floated the idea of a temporary Greek exit from the Eurozone (Spiegel Online 2015a): the so-called Schäuble-Papier (Spiegel Online 2015b). The move caused widespread concern, illustrated by Italian Prime Minister Matteo Renzi's interview with *Il Messagero*, in which he criticized the humiliation of Greece and directed the words 'enough is enough' to Germany (reported in Speigel Online 2015c). Former Commission economic adviser Philippe Legrain (2015) commented:

> It is clearer than ever that Europe's dysfunctional monetary union has a German problem, too. As creditor in chief in a monetary union bereft of common political institutions, Germany is proving to be a calamitous hegemon.

Wolfgang Münchau (2015) opined that 'Germany has in a single weekend undone seventy years of postwar diplomacy'. German European policy has been criticized as never before and precisely because of the lack of legitimacy amongst partners with regard to its hegemony. The risks of assuming such a role, overstepping the line between leadership and domination, could not be clearer.

The effect of this episode was to weaken Germany internationally as well as unsettling the coalition domestically (Spiegel Online 2015c). The intransigence of the German position, centered on the finance ministry owes much to its ideological commitment to ordoliberalism. This credo and its effect opened up a damaging split between Germany and its key external ally, the IMF on debt reduction. The puzzle is why Germany has stood out against debt reduction of money that she would never recover even though it is clear to the IMF and others that Greece can never repay. The finance ministry seems stuck on a policy trajectory determined by ordoliberalism. German opinion has never been prepared for the debt reduction option that the IMF and others believe is necessary and it is left defending a seemingly impossible position—despite the efforts to the contrary of one of the ordoliberal members of Germany's Council of Economic Experts (see Feld 2015). The only policy alternative on offer was a temporary exit, which was advocated again by Schäuble ahead of the Bundestag's approval of the Eurozone agreement to proceed to a third rescue of Greece. Both approaches are putting great strain on its relations with France, Italy and other states. That there may be support from Finland, Slovakia and a set of smaller northern Eurozone states is too narrow a base of legitimacy

Of course, the risk of a Greek exit (Grexit) remains in the absence of a debt write-off. The IMF (2015) warned that the Greek debt burden was unsustainable. The day of reckoning may simply have been deferred. And some electoral 'blowback' might take place in other member states, such as in Spain, where the left-wing Podemos party has built support. Perceptions of too strong a dose of German hegemony could have serious ramifications for social democratic support for the EU, adding to the already strong critical voices of Eurosceptic parties.

The complete lack of any accompanying pro-European vision from the German government amidst the Eurozone crisis has made clearer than ever before how its diplomacy has been determined by national interests (Bulmer

2014). The entrenchment of ordoliberalism in Germany; concerns about public opinion; the support amongst a minority of christian democratic politicians for a Grexit, even SPD Vice Chancellor Sigmar Gabriel at one point; and a lack of vision on the part of Chancellor Merkel have built into an irresistible force behind the persistence of, and insistence on, austerity policies in the Eurozone. Politicisation within Germany, far from being a constraint on Berlin's European policy, has played a key role in strengthening the hegemony of German ideas within the Eurozone. That Germany's writ did not run so large in the shaping of the Banking Union, offering a reminder that the whole purpose of supranational integration was to remove concerns on the legitimacy of German policy or indeed German hegemony, is likely to be overshadowed by the longer-term damage of the Greek crisis.

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Box 6.1 The Eurozone Crisis: A Chronology

2008
September: collapse of Lehman Brothers triggers worst phase of global financial crisis, which commenced in 2007

2009
October: the new Greek government announces public debt is much worse than previously reported to Brussels

2010
May: €110 bn rescue package by Eurozone and International Monetary Fund for Greece
May: EFSM and EFSF established as rescue funds
October: European leaders agree on permanent rescue fund of ca. €500 bn, the European Stability Mechanism, agreed and established in 2012
November: €85 bn rescue package for Ireland

2011
May: €78 bn rescue package for Portugal
July: €109 bn second rescue package for Greece
August: European Central Bank buys Italian and Spanish bonds to avoid contagion
August: Merkel and Sarkozy reject Eurobonds as a solution
September: German Federal Constitutional Court (FCC) makes first ruling on the crisis
End-October: Mario Draghi succeeds Jean-Claude Trichet as ECB President
November: 'Six pack' of economic and fiscal coordination measures agreed. Commission proposes 'two pack' to strengthen budgetary surveillance
December: European Council agrees a new treaty—the Treaty on Stability, Coordination and Governance (TSCG, often termed the Fiscal Compact)—to be signed by March 2012 but the UK and the Czech Republic opt out.

2012
January: Standard and Poor's credit rating agency downgrades France and eight other Eurozone states
March: TSCG is signed
March: Greece's second bailout—now of €130 bn—is agreed after necessary assurances from Athens
March: EFSF/ESM ceiling increased to €700 bn
June: Spain requests assistance to recapitalise banks
June: Agreement on principle of banking union, with the ECB in charge of the Single Supervisory Mechanism
July: ECB President promises to do 'whatever it takes to preserve the Euro'
September: German FCC approval of ESM and TSCG Treaties

2013
March: rescue plan agreed for Cyprus
May: 'two pack' agreed
December: Ireland exits rescue programme

2014
May: Portugal exits rescue programme
November: ECB takes up role under Single Supervisory Mechanism

2015
January: Bank Recovery and Resolution Directive comes into effect

Year	2011	2011	2011	2011	2011	2011	2012=-3
	Population (m)	GDP bn euro	GDP per cap (EU-12 = 100)	Unemploy-ment	Nominal unit labour costs 2005= 100	Current account balance as % of GDP	Global Competitiveness Index Ranking
State							
France	65.2	1996	105.2	9.7	113.2	-2.6	21
Germany	81.8	2571	108.1	5.9	105.3	+5.6	6
Italy	60.7	1580	89.4	8.4	113.9	-3.3	42
Spain	46.1	1073	80.0	21.7	111.5	-3.7	36
UK	62.7	1737	95.2	8.0	117.8	-1.9	8
Euro-zone 17	332.4	9415	97.4	10.2	110.7	n/a	n/a
EU 27	503.1	12630	86.3	10.3	112.6	n/a	n/a

Table 6.1: Selected economic indicators of EU member states

Sources: European Commission (2012a; 2012b); competitiveness ranking from World Economic Forum (2012)

Conditions for hegemony	Evidence
Economic resources?	Yes
Hegemonic stabilizer?	Not really: reluctant, albeit growing leadership while political economy works against stability
Hegemonic stabilizer according to Charles Kindelberger's principles?	No market for distressed goods No countercyclical lending No macroeconomic policy coordination No lending of last resort (=ECB) Debtor states bear most costs
Hegemonic ideas	Yes: ordoliberalism
International consent for hegemony?	Debtor states critical, including on the streets ('indignados', SYRIZA etc.); creditor states and IMF supportive
Domestic support for hegemony?	Conditional on: 1) compliance with the Basic Law and 2) parliamentary approval. Influenced by: critical public opinion, intense politicization and dissenting ordoliberals (in the Bundesbank and in economist community)

Box 6.2: Germany, hegemony and the Eurozone crisis

Conditions for hegemony	Evidence
Economic resources?	No equivalent to economic power in eurozone crisis. Germany invests little in hard power or foreign policy. No comparison to the United States in the Cold War. Kundnani and Szabo suggest firms are the drivers of geo-economic hegemony but scarcity of evidence.
Hegemonic stabilizer?	No readiness to guarantee security in Europe
Hegemonic idea	Yes but 'Civilian power' much weaker than 'Ordoliberalisim'
International consent for hegemony?	Willingness to accept Germany as leader. See the Ukraine crisis but not hegemony.
Domestic support for hegemony?	Very weak. See public opinion. Will it be changed by Review 2014?
Leadership by default	In the initial stages of the Ukraine crisis and most evident in the eurozone crisis
Domestication of German foreign policy	Sectoral imposition of preferences by para public institutions resulting in a disjointed hegemony

Box 7.1: Germany, hegemony and European foreign policy