## Ever Challenged Union: Exploring Ways Out of the Crises

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# Making Sense of Germany's Role in the Euro Zone:

# The Outlier Hypothesis

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# Introduction

This paper aims to characterising Germany's role in the euro zone since the outbreak of the sovereign debt crisis. As the most powerful member state located in the centre of the continent, any change in Germany's role is 'of seismic importance for the EU' (Bulmer and Paterson, 2010, p. 1051). Germany has long been characterised as being the 'posterboy of European integration' (Paterson, 2011, p. 58). This assessment has met increasing contestation over the last years. It is argued instead that Germany is in a process of 'normalization'; as Kundnani puts it, it is 'normal in the sense that it is a sovereign state that pursues its national interests in the way that others are perceived to behave' (Kundnani, 2012, pp. 39–40). This includes an assertive German government being willing to engage in hard bargaining to assert its interests unilaterally.

This paper largely agrees with the normalisation literature on the aspect of the *approach* to European policy-making. The German government is increasingly willing to pursue its interests unilaterally. However, the argument made in this paper is that the normalisation literature leaves out an important part of the picture. While it grasps the increasingly assertive nature of the German government's *approach* to European policy-making as characterised by a willingness for hard bargaining and unilateral pursuit, it oversees that even a normalised Germany is everything but 'normal' regarding the actual 'content' of its policies. In this dimension, the German government is an outlier in the euro zone. Its preferences towards core questions of the future of the euro zone are distinct from those of the broad majority of member states and EU institutions.

This paper has two aims: first, it seeks to demonstrate that the German government is in an outlier position indeed. Second, it aims to analyse the domestic foundations of Germany's outlier position. It considers the relevant sets of ideas, interests and institutions that underpin the German preferences and positions. These more general findings are then tested regarding their impact with an in-depth case study: the EU banking union negotiations.

The next section critically assesses the literature that characterises Germany. It also puts forward the normalisation hypothesis and the outlier hypotheses. Afterwards follows the precise set of ideas, interests and institutions underpinning German preferences. This is tested at the banking union negotiations. It is then concluded that Germany has indeed normalised in its approach to European policy-making, but its policies themselves remain highly distinct.

## Germany in the euro zone: a normalised country in an outlier position

Over decades the most political paradigm informing the preferences of the German government has been a strong commitment to supranational European institutions and Franco German reconciliation (Bulmer, 2014, p. 1245; Olender, 2012, p. 2). European integration became the predominant normative belief. A discourse of national interest was long-avoided. By contrast, the European interest was perceived as equal to the national interest (Paterson, 2011, p. 57; Katzenstein, 1997, p. 25). Germany became the 'posterboy of European integration' (Paterson, 2011, p. 58) through its distinctive commitment to the European project (Olender, 2012, p. 3; Paterson, 2011, p. 57) and its 'European vocation' (Bulmer and Paterson, 2010, p. 1064). The starting point of the predominant narrative is Germany's attempts to seize power unilaterally in the short century from 1870 to 1945. The experiences following these attempts constitute the other in Germany's state identity (Marcussen *et al.*, 1999, pp. 622–623; Paterson, 2011, p. 57). The hostile relationship with France during the short century as another part of the other constitutes the background of Franco-German cooperation in a European context. France's role as co-leader resonated with Germany's 'European vocation' (Bulmer and Paterson, 2013, p. 1394) and its commitment to Franco-German reconciliation (Katzenstein, 1997, p. 26; Paterson, 2011, p. 58). Embedded in European institutions, Germany acted as Europe's 'tamed power' (Katzenstein, 1997) and was 'leading from behind' (Paterson, 2011, p. 57).

German reunification posed a critical juncture to Germany's European vocation and challenged the underlying normative beliefs. A reunited Germany was seen as challenge to the normative commitment to Europe and met resistance across other European powers. The British Prime Minister Margaret Thatcher worried about a new 'colossus' (Thatcher, 1993, p. 1095) in Europe and the French Foreign Minister Jean-François Poncet feared a 'political and economic hegemony' of this colossus (cit. in Görtemaker, 2009). Despite these widespread fears the 'federalist consensus' (Risse *et al.*, 1999, p. 165) in Germany remained stable. According to Chancellor Helmut Kohl, only deeper integration could guarantee Germany's commitment to and integration in Europe and hereby ensure peace on the continent (Kohl, 2014, pp. 68–76; see also Paterson, 2011, p. 59). The strong commitment to Europe had another crucial impact at another critical decision: the move towards a single currency. The euro faced strong opposition in Germany because the national currency was by many seen as the basis of Germany's post-WW II economic success. In this critical conflict, Europe provided legitimacy to give up the deutschmark as support for the euro was framed as support for European integration (Risse *et al.*, 1999, pp. 165–167). European unity was self-evident and not questioned as a goal; controversies were restricted to the means to attain it (Risse *et al.*, 1999, p. 167). Summing up, Germany was the 'posterboy' of European integration. German governments acted as 'reflexive multilateralist' and its policies were based on a 'federalist consensus' and its 'European vocation'.

The late-1990s and early-2000s mark a turning point in Germany's European policy. It has increasingly been argued that Germany has become a 'normalized' country during the chancellorship of Gerhard Schröder from 1998 to 2005 (see e.g. Bulmer and Paterson, 2010; Kundnani, 2012). According to Kundnani, normalization means that Germany perceived itself as 'normal in the sense that it is a sovereign state that pursues its national interests in the way that others are perceived to behave' (Kundnani, 2012, pp. 39–40). The concept of normalization describes Germany's newly won readiness and willingness to pursue its interests unilaterally and with hard bargaining. It stands in a marked contrast to the reflexive multilateralism characterising its European policy in the past. The non-negotiable commitment to multilateralism and leading from behind has increasingly become questioned and Germany showed preparedness for hard bargaining. As Bulmer and Paterson put it, 'Germany's 'European diplomacy has become more assertive: Germany will if necessary proceed alone (*Alleingang*) rather engage in exhaustive consultation, and is more prepared to seek out alternative intra-EU policy venues to pursue its interests' (Bulmer and Paterson, 2010, p. 1052).

The normalization of Germany became manifest in the 1990s (Katzenstein, 1997, pp. 27–29; Paterson, 2011, pp. 60–61). Already in 1998 after assuming power, Chancellor Schröder stated:

> *'I am convinced that our European partners want to have a self-confident German partner which is more calculable than a German partner with an inferiority complex. Germany standing up for its national interests will be just as natural as France or Britain standing up for theirs.'* (cit. in Financial Times, 1998)

While the Schröder government had already been shifting the government's approach to European policies towards that of 'normal' countries, the development cumulated in the Merkel government's reaction to the events unfolding in the euro zone crisis (Kundnani, 2012, p. 52). The crisis proved to be the 'tipping point for classic German Europeanism' (Paterson, 2011, p. 57). Featherstone argues that 'none of [Merkel's] post-1945 predecessors seemed so willing to show such limited regard for the health of the European project' (Featherstone, 2011, p. 201). Bulmer and Paterson observed 'a decided tilt in influence away from those advocating political integration as a goal in its own right towards a coalition of those focused on economic and financial objectives' (Bulmer and Paterson, 2013, p. 1398). According to Kundnani, the German government has also been more willing to pursue its interests unilaterally; multilateralism was no longer reflexive and bilateral or unilateral solutions were often preferred over multilateral ones (Kundnani, 2011, pp. 34–36). Both the replacement of formerly internalised beliefs about the benefits of European integration with cost-benefit calculations about integration (Paterson, 2011, p. 67) as well as the incremental fading-out of the former practice of equating the national interest with the European interest mark a remarkable shift in German European policy. Germany became a 'normalized country' (Bulmer and Paterson, 2010), willing to pursue its interests unilaterally and prepared for hard bargaining.

Analysing Germany as 'normalized power' captures very well its assertiveness to pursue its interests in a hard bargaining mode as observers have witnessed during the euro zone crisis (e.g. Paterson, 2011; Featherstone, 2011). However, this article argues that the normalization literature oversees important parts of the picture. While Germany has normalized in its approach to European policy-making, it remains highly distinct in its actual policies. Germany assumes the position of an outlier in the euro zone, defined as pursuing policies which are distinct from those of the broad majority of member states. The origin of this outlier position lies in the particularity of ideas, interests and institutions in Germany. On the ideational dimension, German policies during the euro zone crisis were largely determined by the economic theory of ordoliberalism. It is a unique German set of ideas with German economists being a highly influential epistemic community promoting their impact on policies. On the material interest dimension, the country is characterised by a hypercompetitive economy relying on the export-strength of small- and middle-sized companies and a highly regulated financial market. It is an economic model that is unique on a European scale and causes economic policies that are biased towards supporting the export industry. It is an outlier on the institutional dimension with a set of domestic institutions that constrain the government through imposing formal and informal constraints on the government. The Constitutional Court, the central bank *Bundesbank* and ingrained beliefs in the Foreign and Finance Ministry narrow the government's room for manoeuvre to a political course which corresponds to ordoliberal ideas. The particular configuration of ideas, interests and institutions constrain the government and narrow its policy options to a narrow set.

This paper contributes to the literature on Germany's role in the euro zone. It argues that Germany's role in the euro zone crisis can only be understood when considering the concept of 'normalization' in conjunction with the outlier position regarding policies. The characterisation of Germany as outlier is increasingly salient in the relevant literature. De Ville and Berckvens speak of the 'outlier position of German economists' (De Ville and Berckvens, 2015, p. 36). On the material interest side, Nedergaard and Snaith speak of 'the "outlying" German economy' (Nedergaard and Snaith, 2015, p. 9). Bulmer also analyses the banking union negotiations and finds that 'Germany was pushed into the position of outlier' (Bulmer, forthcoming, p. 20). It is the precise combination of a normalized Germany willing to pursue its interests by means of power and being the most powerful member state in the EU, and its policies and preferences being deviating significantly from those of the other member states which explains Germany's current role in the euro zone. This argument is distinct to other arguments as it sees German exceptionalism and normalization as two sides of the same coin. In a remarkable contribution, Kundnani distinguishes between 'normality' and '*Sonderweg*' (special path) as the two opposed extreme conceptions of German foreign policy (Kundnani, 2012, pp. 39–40). The argument made in this paper rejects such dichotomy. Instead, Germany is both normalised and an outlier: a normalised state in its approach to EU negotiations, and an outlier regarding its policies as manifested in the unique set of ideas, institutions and interests. The argument put forward also explains the high level of conflict and current political deadlock in the EU: the hegemon being an outlier quasi-automatically results in a problematic configuration of state preferences and leads to high levels of conflict.

## The Sources of the Outlier Position: Ideas, Interests and Institutions in Germany

This section analyses the relevant set of ideas, interests and institutions in Germany. It is argued that Germany is different on all three accounts; it is an outlier in the euro zone. The general assessment in this section is complemented by a case study on the banking union in the following section.

### The power of ordoliberal ideas: hegemonic in Germany, inexistent beyond?

Germany's European policy has over the past decades been under strong influence of ideas. Two main sets of ideas have been particularly important. First, the integrationist paradigm as described above which has increasingly hollowed out over the past two decades. The second set of beliefs is the economic theory of ordoliberalism. By contrast to the pro-integrationist paradigm, the commitment to ordoliberalism has hardened over the last years (Van Esch, 2014).

Ordoliberalism (or Freiburg school of economics) is a particular variety of neoliberalism. The most prominent members of the first generation in the interwar period are Walter Eucken, Franz Böhm and Hans Grossmann-Doerth; later representatives are Wilhelm Röpke, Alfred Müller-Armack and Alexander Rüstow. Ordoliberal ideas have diffused largely in German academic circles and became the predominant paradigm as early as after WW II (Siems and Schnyder, 2014, p. 379). Despite the long tradition in Germany, they never diffused to other countries to a significant extent. Consequently, German economists are well-described as in an 'outlier position' (De Ville and Berckvens, 2015, p. 36) in Europe. This position as outlier is historically salient: in a seminal book on the spread of Keynesianism across nations by Peter A. Hall, the chapter on Germany is the only one analysing why Keynesian ideas have *not* diffused (Hall, 1989). German economists are embedded in an elaborate system of economic policy advice with close ties to decision-makers (De Ville and Berckvens, 2015, pp. 35–36). They constitute a homogeneous epistemic community and the unprecedented system of expert advice ensures their impact on policy-makers and the broader public (De Ville and Berckvens, 2015, p. 12).

The first core claim of ordoliberalism is the necessity of state interventions (Siems and Schnyder, 2014, p. 380). Even though ordoliberals see state interventions as indispensable, their scope is narrowed down to market-conforming policies, defined as efficiency-increasing policies[1] (Eucken, 1990, pp. 254–255, 336; see also Bibow, 2009, p. 168). The state is the 'guardian of the competitive order' (Eucken, 1990, p. 327). The state should not assume economic activity itself; Keynesian demand stimuli are strongly rejected (Eucken, 1990, pp. 140–144). Second, ordoliberals emphasise 'the importance of price stability above all other goals' (McNamara, 1998, p. 62). This requires independent central banks. They counter potentially excessive spending policies by governments (Berghahn and Young, 2013, p. 776). The third cornerstone of ordoliberalism is the principle of liability. According to the *haftungsprinzip*, economic actors must be liable for both benefits and costs of their actions; anything else will trigger moral hazard and lead to irresponsible behaviour (Eucken, 1990, pp. 279–285; see also Siems and Schnyder, 2014, p. 381). The principle of liability is a 'sacrosanct' (Nedergaard and Snaith, 2015, p. 8); ordoliberals reject debt mutualisation and joint liabilities in the euro zone as long as nation states have not surrendered their full sovereignty over economic and fiscal policy making (Dyson and Featherstone, 1999, p. 275; see also Bonatti and Fracasso, 2013, pp. 1032–1034). In short, a political union comes before a social union, as evidenced e.g. by the German preference for the fiscal compact (Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, TSCG). Fourth,

[1] More specifically, an action is market-conforming if it does not restrict the three most fundamental market forces: the tendency to reduce costs, to reduce profits in the long run and to increase profits in the short run (Siems and Schnyder, 2014, p. 380; see also Eucken, 1990, p. 255).

as a result on concerns about liability, ordoliberals advocate a 'put-your-own-house-in-order' strategy to prevent moral hazard. Ordoliberals suggested domestic reforms to restore the competitiveness of Southern European economies (Bonatti and Fracasso, 2013, p. 1032). In the words of Jürgen Stark, German ordoliberal hawk and former chief economist of the European Central Bank: 'Get your finances in order and stop blaming Germany' (Financial Times, 2014). Market pressure on governments is deemed positive and necessary to ensure the liability of governments for their actions. Fluctuating interest rates punish and reward governments for their fiscal policies (Buti and Carnot, 2012, p. 901).

There is strong evidence that ordoliberal ideas have guided German policies throughout the crisis. They provided the basis for an interpretation of the events and suggested policy solutions. Ordoliberalism 'informed [Germany's] preference formation and its strategic response (…) to address the crisis' (Olender, 2012, p. 8). The government has 'adhered tightly to many features of (…) the economic theory of ordoliberalism' (Bonatti and Fracasso, 2013, p. 1028) and based its policies on 'ultra-orthodox beliefs' (Bonatti and Fracasso, 2013, p. 1024). Olender argues that the commitment to ordoliberalism has hardened during the euro zone crisis (Olender, 2012, p. 5). This is supported by Van Esch's analyses of chancellor Merkel's discourse which is found to reflect ordoliberal beliefs in the absence of references to Keynesian policies (Van Esch, 2014, p. 294). More bluntly: 'Europe needs a stability culture' (Merkel, 2010) and Merkel promised to 'make sure together with our partners that the whole of Europe commits herself to a new stability culture' (cit. in Howarth and Rommerskirchen, 2013, p. 762).

As we have seen in this section, ordoliberal ideas are distinctively 'German' ideas that have never diffused to other countries. They are rarely emulated, but promoted by a powerful epistemic community in Germany. Their impact on decision-makers is significant and contributes to the outlier position of the German government in the euro zone crisis.

## Interests: The primacy of competitiveness and exports

Not only ideas, but also the material interests are a foundation of Germany's outlier position. This section argues that Germany's particular economic structure results in distinct economic interests. The German model is strongly skewed towards the promotion of a competitive export industry which generates high trade surpluses. This economic structure produces corresponding economic interests which reinforce the particular path of economic development in Germany. This brings Germany in the position of an outlier on the economic interests dimension. While this beggar-thy-neighbour strategy (De Grauwe, 2009, p. 4) is contested by almost all other member state governments in the EU, the support of domestic interest groups and within the population make change unlikely.

The German economic model is characterised by a strong industrial basis which is specialised in high-tech products of which a large ratio is produced by small- and middle-sized companies. They also provide the bulk of employment and tax revenues and play a crucial role in the education of the workforce with a cooperative public-private training system which guarantees quality benchmarks across companies and reduces transaction costs for firms (Bonatti and Fracasso, 2013, p. 1028). This basis of small and middle-sized companies is complemented by large multinational companies in manufacturing, such as the automobile industry (Bonatti and Fracasso, 2013, p. 1028). The company lending is overwhelmingly bank-based with 'patient capital' provided by around 1,400 publicly owned regional savings banks (*Sparkassen*). They benefit of a highly regulated financial sector and provide a significant amount of the lending to the real economy. Their lending is specialised on the needs of the small- and middle-sized companies (Hardie and Howarth, 2013, pp. 103–108). An inclusive welfare system reduces economic hardship at the lower bound of the workforce and among the unemployed (Bonatti and Fracasso, 2013, p. 1030). The system is encompassed by a conservative fiscal and monetary policy stance (Bonatti and Fracasso, 2013, p. 1028).

Germany's economy has since WW 2 'evolved along a particular trajectory' (IMF, 2012, p. 5). This neo-corporatist structure is the result from a decade-long promotion of an export-led economic growth model (Bonatti and Fracasso, 2013, p. 1028). The export industry has a strong political lobby which crosses the boundaries of political parties. This is, inter alia, reflected in the labour market and tax reforms conducted by the second Schröder government (2002-2005). While the government explicitly resisted OECD and IMF advice to follow the US-model with a more expansionary fiscal policy as allowed by the introduction of the euro, it was firmly committed to strengthening the long-held export orientation of the economy (Bonatti and Fracasso, 2013, pp. 1027–1028). Market-conform reforms orientated at ordoliberal economic theory by the Schröder government increased the work incentives in the labour market, reduced the fiscal wedge on labour costs. Wage restraint and greater organizational flexibility at the firm level boosted the economy's competitiveness (Bonatti and Fracasso, 2013, p. 1030).As the most recent step, the country has shifted attention from European markets to worldwide markets. Recent economic growth has therefore been largely driven by exports. The export ratio grew from 29% in 1999 to 51% in 2013 (Kundnani, 2014). Germany's exports on world markets have since 2000 outperformed those of other traditionally strong producer countries, such as France, Italy, Japan and the United States. This development means that Germany did not 'become the "consumer of last resort" of the eurozone, but rather its "main continental factory"' (Bonatti and Fracasso, 2013, p. 1031).

It is argued in this paper that the unique economic structure also results in a distinct policy position at the European level. These economic interests reinforce the German government's position as outlier in the eurozone. Indeed, German governments in the last decade have defined their interest increasingly in economic terms (Kundnani, 2012, p. 53). Kundnani argues that in times of the euro 'export nationalism' succeeded the former D-Mark patriotism (Kundnani, 2014). Habermas already warned in 1990 that Germany was prone to develop 'economic nationalism' as it was perceived as the only legitimate source of national pride (Habermas, 1990). Any policy changes are inconsistent with the long-standing export commitment of German governments supported by a powerful advocacy coalition which builds on internalised economic beliefs, political support across parties and broad support in the population (Bonatti and Fracasso, 2013, p. 1033). While the trading surplus shifts adjustment costs entirely to the European periphery and has become an obstacle to stability in the euro zone (Bulmer and Paterson, 2013, p. 1396), the majority of member states opposing the German trade surplus have not managed to bring about change. German governments have in different coalitions have until now refused to rebalance the economy and reduce its export dependence, but promoted export-driven growth as model for crisis countries, hereby neglecting obvious flaws that go along with an export of the German model itself (Kundnani, 2011, p. 37). We therefore conclude on Germany acting increasingly unilaterally while pursuing outlier positions. In Kundnani's words, it is a country which ‘increasingly defining its national interest in economic terms, but also increasingly using its economic power to impose its own preferences on others’ (Kundnani, 2011, p. 37).

## Institutions: Constraining the government by politicising the debate

This section analyses the impact of domestic institutions on the German government’s policy. It is argued that the institutional landscape in Germany has an unusually high impact on the government’s policy-choices. The Federal Constitutional Court (FCC), the Bundesbank, and the Foreign and Finance Ministries are guardians of ordoliberal policies and therefore constrain the government with both formal and informal means. This leads to a lock-in of specific policies which are largely distinct to those of the other eurozone member states.

The Federal Constitutional Court’s influence on the government is unprecedented in the euro zone. Its influence in the crisis went beyond its formal role as guardian of the constitution with the power of nullifying legislative acts. Indeed, it has become a ‘co-shaper of policies’ (Bulmer and Paterson, 2013, p. 1399) and ‘major reference point’ (Bulmer, 2014, p. 1258) for the government. The risk of a negative FCC ruling has significantly constrained the government in finding solutions to the euro zone crisis (Bulmer, 2014, p. 1258). Despite being formally impartial, the FCC also represents the ordoliberal policy consensus. It became ‘a guardian and ultimate arbiter of ordoliberal beliefs’ (Nedergaard and Snaith, 2015, p. 4). The insistence of the FCC on the participation of the national parliament (*Bundestag*) in major policy decisions on the European level has reduced the government’s discretion for European bargains. While the FCC has approved the European Stability Mechanism (ESM), it has conditioned the disbursement of major sums on the *Bundestag*’s approval (Bulmer, 2014, p. 1258). This increases the political costs of the government to agree to such measures. With partly small majorities of the ruling governmental coalition, the need for parliamentary approval has significantly decreased the government’s appetite to grant any ESM credits to member states in the European periphery.

Likewise, also the Bundesbank stands out compared to central banks in other countries. It is the role model for independent central banks for decades and delivered the blueprint of the European Central Bank’s mandate (Berghahn and Young, 2013, pp. 774–775). It is known as a stronghold of the sound money policy consensus in Germany because of the 'absence of a significant historical context of Keynesian economic thought. The Bundesbank represented the central domestic institutional embodiment of a distinctive German "ordoliberal" tradition of Economics' (Dyson, 2009, p. 141). The Bundesbank is highly regarded among Germans. While the single currency led to a decline of the Bundesbank's formal influence on monetary policy, it re-emerged as important public voice in the euro zone crisis (Spiegel, 2012). As the former President of the European Commission put it: 'Not all Germans believe in God, but they all believe in the Bundesbank' (cit. in Bundesbank, 2015). The Bundesbank and its President Jens Weidmann used their public power to influence and pressure the government. It successfully cultivates its image as guarantor of the sound money policy (Howarth and Rommerskirchen, 2013). The policy solutions advocated by the Bundesbank consistently fit the ordoliberal policy paradigm (Bulmer, 2014, p. 1258).

The politicisation of the debate as pursued by the Bundesbank and the FCC has increasingly undermined the permissive consensus on European policies in Germany. This narrows the government's room for manoeuvre as it is constrained by the public power of the Bundesbank and its specific policy proposals (Bulmer and Paterson, 2013, pp. 1399–1400). Consequently, the government's actions were increasingly motivated by domestic concerns. Chancellor Merkel disgruntled other European leaders by delaying approval to the ESM because of state elections in the region (*Bundesland*) North Rhine Westphalia (Bulmer and Paterson, 2013, pp. 1399–1400). The abstention of the SPD in the voting on the ESM creation, its harsh line on the Cyprus bailout, the harsh critic of the liberals against a European debt mutualisation (eurobonds), the anti-Europeanism of the CSU government party in elections to the European Parliament are manifold examples of a so far unprecedented politicisation of European policy in Germany.

Further constraints on the government arise from administrative biases. Particularly the Finance Ministry, whose power in the inter-ministerial policy coordination has increased during the euro zone crisis, follows a long-standing ordoliberal bias. Similar to the *Bundesbank*, it has a long tradition of this specific economic theory (Bulmer and Paterson, 2013, p. 1393; Bulmer, 2014, p. 1257; Nedergaard and Snaith, 2015, p. 4). Ordoliberalism is regarded as 'basic value' (Nedergaard and Snaith, 2015, p. 14) by their civil servants. This administrative bias is also present in other ministries. The Economics Ministry is known to be a stronghold of ordoliberalism as well; the Foreign Ministry and Chancellery have the reputation of giving more weight to geo-political foreign policy beliefs, but these do not substitute ordoliberal beliefs, but exist in parallel to them (Kaltenthaler, 2002, p. 72; Segers and Van Esch, 2007, p. 1092; Nedergaard and Snaith, 2015, p. 4).

This section presented the constraints on the government that arise from domestic institutions. The unusually broad scope of the Federal Constitutional Court making it a co-shaper as policies, the unique reputation and public power of the Bundesbank as well as strong administrative biases in key ministries result in a highly constrained government. This unusual configuration of domestic institutions leads to a politicisation of the public sphere with regard to European policy. It accelerated the end of the permissive consensus and constrained the government's policy choices. The domestic institutions have locked it in the domestic ordoliberal policy consensus.

## Case study: The Banking Union negotiations

This paper employs a case study to find evidence for the claimed role of Germany as being a normalised country in an outlier position. For the case study to confirm the argument above we would Germany expect to pursue its interests in a hard bargaining mode ('normalisation'). Furthermore, we would expect German preferences to deviate significantly from those of the broad majority of member states ('outlier hypothesis').

The chosen case study is the EU banking union negotiations. It is one of the 'grand bargains' of European integration and by many seen as the most important development in the European Union since the introduction of the single currency in the Maastricht Treaty in 1993 (see e.g. Howarth and Quaglia, 2014, p. 125). Its importance and the complex nature touching many different layers and aspects of euro zone policies and negotiations make it a representative case study of euro zone negotiations. A banking union consists of four parts: The first component is a common rulebook on bank capital and liquidity that unifies the regulatory standards in the financial sector.[2] The second component is the Single Supervisory Mechanism[3] (SSM). It establishes a joint banking supervision for the euro zone and potentially other EU member states willing to join. The third component of the banking union is the Single Resolution Mechanism[4] (SRM). In case the solvency of a bank with systemic relevance is at risk, the SRM restructures or resolves the bank. This includes the competence to decide about the involvement of private investors which can be obliged to 'bail-in' and bear some of the resolution costs. It also draws from the Single Resolution Fund (SRF) which is a joint resolution fund of 55 billion euro financed by banks. The fourth element of a banking union is a joint deposit guarantee scheme (DGS). Negotiations on this were less ambitious and the member states opted for a mere harmonisation of national schemes.[5]

The negotiations were started after the respective European Council in June 2012 when the strain on governments reached another high in the sovereign debt crisis. This paper focuses on the SSM and the SRM; the single rulebook is a long term project initiated earlier and a far-reaching agreement on the DGS was soon off the table. The Commission's proposal on the SSM was published in September 2012. The Council's General Approach was agreed in December 2012 and the European Parliament approved the legislation in May 2013. The SRM negotiations started in July 2013 with the Commission's legislative proposal. The Council reached a common position in December 2013 with the European Parliament adopting the legislation in April 2014 (European Commission, 2015).

The preference of the German government was a banking union with a reduced scope. This 'banking union light' should only supervise financial institutions which pose a systemic risk to the financial system. This would only be the biggest 120 out of 7, 000 banks in the euro zone, covering about 85% of the bank assets (Agence Europe, 2013a; Financial Times, 2012; Gros

[2] The latest legislative acts for a common rulebook are the Capital Requirements Directive (Directive 2013/36/EU of the European Parliament and of the Council), Capital Requirements Regulation (Regulation (EU) No 575/2013 of the European Parliament and the Council) and Bank Recovery and Resolution Directive (BRRD; Directive 2014/59/EU of the European Parliament and of the Council).
[3] See Regulation 1022/2013 of the European Parliament and of the Council and the Regulation 1024/2013 of the European Parliament and of the Council
[4] See Regulation (EU) No 806/2014 of the European Parliament and of the Council and the BRRD.
[5] See Deposit Guarantee Scheme Directive (DGSD; Directive 2014/49/EU of the European Parliament and the Council)

and Schoenmaker, 2014, pp. 2–3; Howarth and Quaglia, 2013, p. 112; Howarth and Quaglia, 2014, pp. 131–133; European Central Bank, 2014). Furthermore it advocated strong bail-in rules. This refers to the obligation of investors to 'bail-in' parts of their capital in case a bank defaults. The logic is to shift resolution costs from the taxpayer to the financial sector (Agence Europe, 2014a; Agence Europe, 2013a; European Central Bank, 2013a; Financial Times, 2013a). The government rejected a joint resolution fund filled by banks to be used for resolutions (Agence Europe, 2013a; Howarth and Quaglia, 2014, p. 129; Schäuble, 2013). It also attempted to secure veto rights for national government regarding any decisions leading to the resolution of a financial institution (Agence Europe, 2013a; Agence Europe, 2013b; Financial Times, 2013b).

The preferences of the German government diverged from those of almost all other member states. It was in some instances supported by Finland, the Netherlands, Austria or some smaller member states, but could hardly count on permanent and strong support. The counter-coalition was led by France, Spain and Italy. It included a broad alliance of member states comprising almost any member state except Germany. They were on most issues also supported by the European Commission, the European Parliament and the European Central Bank. This counter-coalition wanted an all-encompassing scope of the banking union. They argued that small credit institutions would be equally systemically relevant as the Irish and Spanish banking crises had demonstrated (Agence Europe, 2013b; Agence Europe, 2013a; Howarth and Quaglia, 2013, pp. 112–113). The final agreement on the scope limits the supervision to systemic banks, but a concession by Germany is an emergency clause for the ECB which can assume supervisory powers for all banks if it deems it necessary (Gros and Schoenmaker, 2014, pp. 2–3; European Central Bank, 2014; Howarth and Quaglia, 2014, p. 131). Their interest was weak bail-in provisions with national discretion to avoid a fragmentation of financial markets (Agence Europe, 2014a; Financial Times, 2013a; Howarth and Quaglia, 2014, p. 134). Bail-in rules were finally adopted as demanded by Germany, although with some loopholes (European Parliament, 2014, p. 1). The counter-coalition considered a joint fund a fundamental requirement to give teeth to the new banking union (Agence Europe, 2013a; Agence Europe, 2013c; Bloomberg, 2014). The final outcome indeed contains a joint fund, albeit small, only mutualised over a ten year period, and without a fiscal backstop (Gros, 2013, p. 2). Last but not least, they lobbied for an independent decision-making authority. They argued that veto rights for member states would make a timely bank resolution impossible and hence render the banking union dysfunctional (Agence Europe, 2014b; Howarth and Quaglia, 2014, pp. 134–137). They reached that the possibilities for vetoes for national governments are limited to specific cases (Council of the European Union, 2014, p. 2).

| Issue | Germany's position | Parties aligning to Germany | Position of the counter-coalition | Parties forming the counter-coalition | Outcome of the negotiations |
|---|---|---|---|---|---|
| **1** | Restrict SSM's scope to large banks | - | All banks covered by SSM | All member states except Germany; Commission, ECB | Scope limited to 'significant' banks, emergency clause for ECB |
| **2** | Restrict SRM's scope to large banks | Slovakia | All banks covered by SRM | All member states except Germany + Slovakia; Commission, ECB, EP | Scope limited to 'significant' banks; SRM resolution authority if SRF involved |
| **3** | Early bail-in (2015 or 2016) | Austria, Denmark, Finland, Latvia, Netherlands, UK; ECB, EP | Bail-in not before 2018; | Bulgaria, France (in the lead), Luxembourg, Poland, Portugal, Spain | Bail-in rules apply as of 2016 |
| **4** | Strict application of bail-in | Belgium; Denmark, Finland, Netherlands; Commission | Exemptions to bail-ins to reduce additional burden on banks | France, Greece, Italy, Luxembourg, Portugal, Spain, Sweden, UK | Exemptions after bail-in applied |
| **5** | Network of national funds; if joint fund slow mutualisation (10 years) | - (Austria) | Joint fund fully mutualised (5 years) | All MS except Germany, most visible: France, Ireland, Portugal, Spain; Commission, ECB, EP | Joint fund (SRF), 8 years mutualisation period |
| **6** | Council decides about bank resolution | Finland, Romania; later Germany isolated | Commission or Resolution Board decides about bank resolution | Large majority of member states, later all except Germany; Commission, ECB, EP, Lithuanian Council Presidency | Resolution Board decides on resolution scheme; Commission assesses discretionary aspects of Board decision and Council may only object to Commission's decision for specific reasons |

**Table 1: Overview of contentious issues in the BU negotiations: preferences, coalitions, and outcome**

The negotiations were time-intensive and at several occasions facing the risk of a break down. Finance Minister Schäuble even threatened with the break-up of the negotiations in case German demands were not taken into account (Schäuble, 2014a). This willingness for hard bargaining does not fit to the former characterisation of Germany as a member state 'leading from behind' and engaging in reflexive multilateralism (see above). The table above also suggests that the government stood in direct opposition to the huge majority of member states. This is characteristic for the outlier position that Germany assumed in the euro zone during the crisis. The origins of the government's outlier position link closely to the impact of ideas, interests and institutions as described above.

The following section discusses the German government's preferences in the banking union negotiations in the light of its distinct set of ideas, interests and institutions. It is argued that the banking union is a case in point for the high impact of these ideas, interests and institutions on the German governments' European policy.

As argued elsewhere, the ideational context in Germany with ordoliberalism as the predominant economic policy paradigm provides a convincing explanation for the government's policy (De Ville and Berckvens, 2015; Nedergaard and Snaith, 2015; cf. Siems and Schnyder, 2014). The banking union, like many other bargains in the crisis, contributed to the 'incremental ordoliberalization' (Nedergaard and Snaith, 2015, p. 14) of the currency union. According to the German Finance Minister Schäuble, 'we followed ordoliberal principles for the creation of the banking union' (Schäuble, 2014b). The government's preferences focus on preventing moral hazard by reinforcing market mechanisms and increasing liability. The overall goal of the banking union as seen in the German context is to make both banks and states more liable for their actions. The rationale of strong bail-in rules is to make financial institutions liable for their investments; it charts a different course of action than in the financial crisis when taxpayers bailed out banks and distorted market forces. The other rationale is make states liable for their banking sector. States with a lax banking supervision should be liable for any costs that follow bank defaults. Hence the banking union's core aim was to realign supervision and resolution in the hands of the same actor. Consequently, the government advocated a limited scope to mitigate the moral hazard problem, a mandatory bail-in to increase the banks' liability, national resolution funds (as opposed to a joint fund) to keep member states liable for their banks and finally veto rights to ensure a market-conforming use of bank resolution tools. 'If you get the opportunity, you also have to take the risk (…). This principle is also valid for banking regulation. This, ladies and gentlemen, is ordoliberalism' (Schäuble, 2014a). It matches core aspects of the ordoliberal policy paradigm with its strong emphasis on market forces and the risk of moral hazard. Finance Minister Schäuble again: 'We now have European-wide bail-in rules and a resolution fund financed by banks. Both measures are reasonable from an ordoliberal point of view' (Schäuble, 2014b).

Germany's position as outlier is reinforced by the particular structure of its economic model which is also reflected in its banking system. The banking sector in Germany is highly regulated and fragmented. It is divided between private banks with international and European champions such as Deutsche Bank or Commerzbank, and a huge number of public banks. About 1,400 savings banks (*Sparkassen*) as well as 8 regional banks (*Landesbanken*) have a market share of about 30% (Seikel, 2014, p. 176), which is an unusually high proportion for public banks. They are considered essential for the German economic model because they provide the bulk of the funding to the small- and middle-sized companies in the export sector (Howarth and Quaglia, 2014, p. 131). Their 'patient capital' is considered fundamental for the development of the export manufacturing industry (Hardie and Howarth, 2013, p. 103). They are highly intertwined with local politics across all political parties. In the past they have been highly successful in securing political support from the highest political level (Howarth and Quaglia, 2013, p. 112). When in the mid-1990s the European Commission aimed to implement its competition policy in Germany and disentangle the close connection between the government and the public banks, the Kohl government even threatened to revoke the introduction of the single currency (Seikel, 2014, p. 178). While in Germany the five biggest banks represent 22% of all bank assets, it is 51.8% for the five biggest French banks (Howarth, 2013, p. 142). This shows the particularity of the German banking system. It is both cause and result of Germany's economic structure with many small- and middle-sized companies. Consequently, half of the euro zone's 7,000 banks are located in Germany (European Central Bank, 2013b). The exceptional banking system produces material interests which contribute to the government's outlier position.

The banking union negotiations also provide evidence for the impact of domestic institutions on the government's policy. They all narrowed the government's room for manoeuvre. Several formal constraints arouse from the legal basis. Basically every actor except the German government, i.e. all other member states, the Council Presidency, European Council Presidency, European Central Bank, and the European Parliament, supported the European Commission and its proposal which based the banking union on Art. 114 TFEU (Agence Europe, 2013d). By contrast, the German government suggested Art. 352 TFEU. However, this legal basis would have limited the banking union's scope (Agence Europe, 2013c). Neither would it have provided for the establishment of a resolution fund nor of a supranational resolution decision-making. This proved one of the strongest controversies in the negotiations. The German government feared a negative judgment of the Federal Constitutional Court and therefore rejected any solution which was not absolutely watertight (Howarth and Quaglia, 2014, pp. 129–130). The final result is an intergovernmental treaty for sensitive aspects of the agreement to master major legal challenges. Hence the negotiations dealt until the very end with detailed legal provisions. This concern was neither shared by any other member state, nor by the EU institutions (Agence Europe, 2013c). Several legal opinions by the Commission and the Council as well as the European Parliament did not share the German concerns (Agence Europe, 2013d), which were however rooted in the German (and not European) law. Despite the German government facing the opposition of all member states as well as the Commission, European Parliament, Council Presidency, European Council Presidency, and European Central Bank, it insisted on an intergovernmental treaty as legal basis (Howarth and Quaglia, 2014, pp. 135–136).

This section has provided an analysis of Germany's role in the banking union negotiations. It argued that the German government was largely isolated in the negotiations. Its policy positions deviated significant from those of the majority of member states. It has nevertheless achieved to shape the outcome of the negotiations through a hard bargaining negotiation mode. The outlier position of Germany has foundations in ordoliberal ideas, the particular domestic financial system, and the constraining impact of domestic institutions.

## Conclusion

This article has attempted to characterise the role of Germany in the euro zone. The starting point of the analysis were earlier assessments in the literature about Germany being the 'posterboy of European integration' relying on a 'federalist consensus'. Its approach was described as 'reflexive multilateralism' with 'leading from behind' and in close Franco-German partnership. Similar to an increasing scholarship, this paper has argued that the German European policy is in a process of normalisation. Germany's exceptionalism is fading out with regard to its approach to EU policy making. The government is increasingly willing to 'behave like other states do'. This includes a newly gained willingness to defend its interest in hard bargaining. This coincides with an increasing power asymmetry between an economically stable Germany and many crisis-stricken countries in the euro zone.

It is argued in this paper that a normalised *approach* to EU policy-making is contrasted by a continued outlier position regarding the specific *policies*. On the ideational side, the recent fading out of the 'federalist consensus' is accompanied by a hardening of the commitment to ordoliberal policies. This particular economic policy paradigm never diffused to other countries, but remains an ideational factor with a strong impact on decision-makers in Germany. It is promoted by economists as epistemic community with many direct ties to decision-makers. This paper also analysed the interests originating from Germany's - economic structure. The German economy is based on a strong export performance of high quality products. This labour intensive economic sector provides for the bulk of economic growth and jobs and hence has a significant political power. It biases powers in a specific direction which is diametrically opposed to the interests of many other European states. Finally, the German institutions are deeply biased towards an ordoliberal consensus. The Federal Constitutional Court and the Bundesbank's influence on policy-making is unusually high. Their means to exert influence are both formal and informal and have accelerated the fade-out of the permissive consensus on European integration and narrowed the government's room for manoeuvre. As both institutions are guardians of ordoliberalism, they lock-in the government's policies.

The more general claims about Germany's role in the euro zone were discussed more in depth in the banking union negotiations. This bargain serves as case study as it is representative for other major grand bargains in the crisis. The analysis found strong evidence for the impact of ordoliberal ideas as reflected in the prevailing discourse of the government. It also became evident that the fragmented banking sector with an usually high market ratio of small public banks provided the background of major safeguards pursued by the government in the negotiations, such as a banking union scope excluding the savings banks. The impact of institutions becomes particularly evident when considering the priority of legal aspects in the government's priority. It proved extremely careful and insisted on a watertight legal framework. This overcautious approach was a remarkable particularity as all other member states and EU institutions did not share the legal concerns. Overall, the banking union case confirms the outlier position of the German government as it had hardly allies during the negotiations. Its policy positions were distinct and rooted in the particular context of ideas, interests, and institutions in Germany.

The changing role of Germany has fundamental implications for European integration in general. While we witnessed an increasing number of calls in the crisis for Germany to become a benign hegemon and use its economic power to stabilise the euro zone, it seems that Europe ended up with a different kind of Germany: a member state being increasingly willing to engage in hard bargaining to assert its outlying interests unilaterally. With the hegemon being an outlier, there should be no surprise that interstate relations in the EU are increasingly of a conflicting nature.

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