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Reforming the Institutions of Eurozone Governance

Editors

Anna-Lena Högenauer, David Howarth and Moritz Rehm

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Editorial

Reforming the Institutions of Eurozone Governance

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Abstract
The Eurozone has faced repeated crises and has experienced profound transformations in the past years. This thematic issue seeks to address the questions arising from the changing governance structure of the Eurozone. First, how have the negotiations, pressures of the crises and reforms impacted the relationships between key actors like EU institutions and Member States? Second, where did national positions come from and what role did domestic politics play in the negotiations? And finally, to what extent has the evolution of Eurozone governance left room for adequate control mechanisms and democratic debate? The articles in this issue highlight the developing role of Member States, domestic politics and democratic and legal control mechanisms.

Keywords
democratic deficit; domestic politics; Economic and Monetary Union; European Central Bank; Eurozone checks-and-balances; Eurozone governance; sanctions

Issue
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1. Introduction

Eurozone governance was in the beginning of this century dominated by an asymmetric institutional structure mostly relying on a strong monetary pillar and fiscal constraints stipulated in the Stability and Growth Pact (SGP; Howarth & Verdun, 2020). The contagion effect of the international financial crisis painfully highlighted the inadequacy of this governance structure and available response mechanisms, as Eurozone Member States struggled to protect their economies and contain the growth of public debt. In the course of successive crises since 2007, a wide range of reform ideas were launched to strengthen the governance structure with more integrated financial, fiscal and economic policy tools (Chang, 2016). In parallel, the European Central Bank (ECB) introduced non-standard measures to cushion the adverse impact on banks.

Economic policy coordination was enhanced by the so-called 'Six-Pack,' 'Two-Pack' and the Fiscal Compact, which strengthened the SGP and introduced the Macroeconomic Imbalance Procedure. These reforms, streamlined under the European Semester, were intended to facilitate sanctions under the SGP, reinforce fiscal discipline and make surveillance more elaborate so that imbalances could be identified and addressed earlier (Bauer & Becker, 2014).

The introduction of the multi-pillar structure of the banking union was intended to reinforce the stability of the European banking system, for example through a single rule book for banks and several instruments for Eurozone banks. The main objective was to break the sovereign-bank doom-loop by putting financial institutions under a common supervisory and resolution framework and to create a common deposit insurance system (Dehousse, 2016). The Single Supervisory Mechanism and a Single Resolution Mechanism were adopted in 2013 and 2014, whereas political deadlock prevented the adoption of a European Deposit Insurance Scheme (Howarth & Quaglia, 2016). Likewise, agreements on

detailed implementation of banking union components such as the Single Resolution Fund, the financial backbone of the Single Resolution Mechanism, proved to be problematic.

The crises also highlighted the lack of an effective financial support structure within the Eurozone. Member States created various bailout funds in and outside of the EU legal framework with the European Stability Mechanism becoming the centrepiece for Eurozone assistance in 2012 (Ioannou, Leblond, & Niemann, 2015). Between 2010 and 2015, EU and Eurozone Member States channelled assistance through the European Stability Mechanism and other mechanisms often accompanied by International Monetary Fund support and strict austerity measures. The ECB also created monetary stabilisation instruments by enlarging its long-term lending operations and engaging in bond purchases on the secondary market, with the latter creating controversy on both the national and European level.

However, disagreements between Member States or between national governments and European institutions delayed some decisions and led to foot-dragging and slow implementation of others, as is the case with the banking union. A few years after the beginning of the reform efforts, the so-called *Five Presidents' Report* called for new efforts in reforming Eurozone governance and for completing the Economic and Monetary Union. Amongst other elements it particularly emphasised the need to establish the European Deposit Insurance Scheme, a backstop for the Single Resolution Fund and to setup a common fiscal capacity to cushion macroeconomic shocks (Juncker, 2015). However, disagreement on the detailed design of these and other issues remained and curtailed the reform process of Eurozone governance.

The repeated crises faced by the Eurozone and the profound transformations it has experienced raise important questions that this thematic issue seeks to address. First, how have the negotiations, pressures of the crises and reforms impacted the relationships between key actors like EU institutions and Member States? Second, where did national preferences come from and what role did domestic politics play in the negotiations? And finally, to what extent has the evolution of Eurozone governance been accompanied by the creation of adequate control mechanisms and democratic debate?

2. An Overview of This Thematic Issue

The first section of this issue examines the evolving roles of European and national actors in Eurozone governance and the continuous renegotiation of their influence and relationship to other actors in the system.

Sacher (2021) analyses why the European Commission is reluctant to impose sanctions on Member States, despite the importance of this tool for the Economic and Monetary Union since its inception. In addition, provisions on sanctions have empowered the Commission and have become stricter in the aftermath of the financial and sovereign debt crises. An analysis of three post-crisis cases using process-tracing methods in combination with a normative institutionalist analysis shows that the Commission is reluctant to impose sanctions, as it does not perceive punitive action as appropriate.

Rehm (2021) analyses the development of financial assistance in the Eurozone since 2010. His liberal intergovernmentalist analysis finds that reforms to assistance mechanisms are best explained by a re-occurring pattern of mixed preferences. On the one hand, the threat to Eurozone stability encouraged Member States to expand and deepen the assistance formula. On the other hand, potential creditors and debtors tried to shield themselves from incurring direct costs or protect their economies. The resulting reforms advanced financial support in size and scope but failed to effectively address the difficulties at hand.

Kavvadia (2021) focuses on the role of the European Investment Bank (EIB) in promoting a greener agenda for EU development. She argues that the EIB's announcement of its metamorphosis into a 'Climate Bank' in the context of the EU's Green Deal makes it an important actor in the EU's climate agenda. She analyses the EIB's climate pivot by examining the bank's rational interests within a sociology of markets analytical framework and uses a principal-agent model to illustrate the changing relationship between the European Commission and the EIB.

The second section of this issue focuses on domestic politics. The goal is to understand the factors that determine how national governments act at the European level. The articles in this section contribute to the literature on the domestic politics of Eurozone reform, which tends to analyse government preferences through the prism of a competition between structural economic factors and political considerations (Tarlea, Bailer, & Degner, 2019; Van der Veer & Haverland, 2019).

Commain (2021) argues that national positions on the EU's adoption of harmonized capital requirements between 2008 and 2010 can be explained by structural factors and the 'varieties of financial capitalism' approach (Howarth & Quaglia, 2013; Story & Walter, 1997). Regulating banks, he argues, requires policy-makers to balance restrictions of the risk-taking behaviour of banks and the economy's reliance on bank lending for growth. Therefore, while governments generally support the proposed increase of bank capital requirements, they seek targeted preferential treatments aimed at preserving the domestic supply of retail credit.

Van Loon (2021) applies a societal approach to governmental preference formation inspired by Schirm (2018, 2020) to examine the Economic and Monetary Union's impact of issue salience and actor plurality, subsequently triggering material and ideational considerations on government preferences towards the Financial Transaction Tax introduction. By analysing the German, French and Irish cases of domestic preference formation, she argues

that the lack of consensus on the European level was shaped by governments' responsiveness towards both societal dynamics and material interests within the domestic societies of these member states.

Similarly, Högenauer (2021) studies the extent to which the banking union was scrutinized by the French and German parliaments and to what degree this reflects ideas and material interests. An analysis of parliamentary salience and polarization shows that—in line with public salience—the German Bundestag was indeed a far more active scrutinizer. However, the positioning of parliamentarians in the two countries is largely explained by structural economic factors and the interests of domestic banks.

Donnelly (2021) studies the degree of domestic support in German political parties for the country's change of stance on the issue of European grants to Member States, and its impact on intergovernmental negotiations on the Eurozone budget between 2018 and 2020. He argues that Christian Democratic politicians and voters are likely to limit Germany's support for a larger EU budget or European grants in the future, despite Social Democratic efforts to keep the door open.

Finally, the thematic issue ends with two articles looking at the checks-and-balances in Eurozone governance and the democratic nature of reforms.

Fontan and Howarth (2021) analyse the national-level reaction to the problematic combination of the ECB's strong independence and ever broader interpretation of its own mandate. Applying elements of a principal-agent approach, they argue that the ruling of the German Federal Constitutional Court of May 2020 demonstrates the relative importance of national—as opposed to European-level—actors exercising ex-post control over ECB policies.

Sebastião (2021) examines the democratic nature of Eurozone governance reforms from an interdisciplinary perspective and closes the thematic issue on a normative note. She uses process-tracing methodology to argue that, while the Eurozone and Covid-19 crises evidenced different kind of policy outcomes, the EU democratic deficit remains. Economic crises convert economic power into 'representative' political power, thus perpetrating the political over-hegemony of previous surplus economies. Ideological debate is constrained and national interests prevail over politicisation. Political representative power and democracy are losing out in the process.

The contributions of this thematic issue highlight the persistent divisions among Member States, the negative impact on democracy of the crises and the latent distrust within creditor states. They also provide insights into the factors that shape Member State positions and the new roles of several EU institutions in Eurozone governance.

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Conflict of Interests

The authors declare no conflict of interests.

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Article

Avoiding the Inappropriate: The European Commission and Sanctions under the Stability and Growth Pact

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Abstract
Fiscal policy surveillance, including the possibility to impose financial sanctions, has been an important feature of Economic and Monetary Union since its inception. With the reform of fiscal rules in the aftermath of the financial and sovereign debt crisis, coercive provisions have been made stricter and the Commission has formally gained power vis-à-vis the Council. Nevertheless, sanctions under the Stability and Growth Pact for budgetary non-compliance have so far not been imposed. This article asks why the Commission has until now refrained from proposing such sanctions. Using minimalist process-tracing methods, three post-crisis cases in which the imposition of fines was possible, are analysed. Applying an adaptation of normative institutionalism, it is argued that the mechanism entitled “normative-strategic minimum enforcement” provides an explanation of why no sanctions are imposed in the cases studied: Given that the Commission does not perceive punitive action as appropriate, it strategically refrains from applying the enforcement provisions to their full extent.

Keywords
European Commission; fiscal policy coordination; fiscal surveillance; logic of appropriateness; process-tracing; sanctions; Stability and Growth Pact

Issue
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1. Introduction

Rules on fiscal policy surveillance and financial sanctions have been an integral part of Economic and Monetary Union (EMU) since its inception. These provisions have, however, always been a source of dispute. After a softening of the EU’s budgetary surveillance framework in 2005, additional reforms were deemed necessary in the aftermath of the financial crisis and the subsequent sovereign debt crisis. Amongst others, this latest reform intended to limit the role of the Council concerning the imposition of sanctions (EU Regulation of 16 November 2011, 2011). The reform has indeed formally increased the Commission’s power vis-à-vis the Council (Bauer & Becker, 2014; Dehousse, 2016; Seikel, 2016; Van Aken & Artige, 2013), without, however, discarding from the rulebook the flexibility provisions introduced in 2005.

While the application of the surveillance rules was never a purely technical exercise, the degree to which political considerations should interfere with technical surveillance is the source of recurrent debate. Similarly, the respective roles of the Council and Commission, as well as their relationship, are far from consensual and static. While at the beginning of EMU, the Commission was supposed to act as the technical supervisory authority, it has become clear under President Juncker that the Commission is willing to enforce the budgetary rules politically. This development continued under Commission President von der Leyen, under whom the fiscal requirements of the Stability and Growth Pact (SGP) were even temporarily suspended in the wake of the COVID-19 crisis. Despite the post-crisis reinforcement of coercive provisions, the Commission has indeed applied the SGP flexibly (Mabbett & Schelkle, 2014; Schmidt,

2016), and has not proposed sanctions based on the SGP for non-compliance with fiscal recommendations, although this would have been possible in several cases. This article, therefore, asks how we can best explain why the Commission has so far refrained from proposing financial sanctions.

This article will draw upon an adaptation of normative institutionalism. It argues that while actor behaviour follows a logic of appropriateness, actors act strategically to pursue their objectives. Applying minimalist process-tracing methods, Commission behaviour is explained by a mechanism that is entitled "normative-strategic minimum enforcement." It argues that because punitive action is not perceived as appropriate in the cases at hand, the Commission strategically refrains from applying existing enforcement provisions to their full extent.

This article will draw upon three post-crisis cases in which the imposition of sanctions for fiscal non-compliance was possible. These are the cases of Belgium in 2013, France in 2015 and the double-case of Spain and Portugal in 2016.

The article is organised as follows. In the next section, the development of EU fiscal surveillance rules is presented. Following this, the theoretical assumptions of normative institutionalism and their implications for the case studies are explained. After turning to the article's methodology, the cases are analysed as explained above. The article ends with a summary of the findings and concluding remarks.

2. Rules and Rule Change in EU Fiscal Policy Surveillance

Fiscal policy surveillance has been a fundamental part of EMU since its introduction with the Maastricht Treaty in 1992. It aims to prevent and correct budgetary deficits and debt levels that respectively exceed 3% and 60% of a country's GDP. With the Excessive Deficit Procedure (EDP), the possibility to impose financial sanctions for non-compliance with the fiscal requirements was present from the beginning of EMU. The degree to which coercive provisions should be automatic, the level of political discretion and the Council's control over the EU's executive, were, however, constant sources of political disagreement (see Heipertz & Verdun, 2010). The SGP, adopted in 1997, consists of a preventive and a corrective arm, with the latter operationalising the application of the EDP (Heipertz & Verdun, 2010; see also Council Regulation of 7 July 1997, 1997). The SGP was first reformed in 2005. This reform consisted in making the SGP more flexible in that it, for example, relaxed the definition of what counts as 'exceptional economic circumstances' in the assessment of the member states' fiscal situation (Heipertz & Verdun, 2010, p. 168). Also, it introduced the possibility to adopt a revised Art. *126*(7) recommendation with a new deadline for the correction of an excessive deficit if a country has taken effective action, but 'unexpected adverse economic events with major unfavourable consequences for government finances' had occurred (Council Regulation of 27 June 2005, 2005, p. 7).

In reaction to the sovereign debt crisis, fiscal rules were again reformed. The Six-Pack—the first set of measures reforming the SGP in the wake of the crisis–entered into force in December 2011. Sanctions for non-compliance with fiscal obligations could now be introduced earlier and are more automatic. If for example, the Council, upon a Commission recommendation, and per Art. *126*(8) of the *Treaty on the Functioning of the European Union* (TFEU, 2016), finds that a member state has not taken effective action to correct its excessive deficit, the Commission is now required to recommend to the Council the imposition of a fine of up to 0.2% of the member state's GDP (EU Regulation of 16 November 2011, 2011, Art. *6*(1)). The Commission can, however, recommend to the Council to reduce or cancel the fine, on grounds of 'exceptional economic circumstances or following a reasoned request by the Member State concerned' (EU Regulation of 16 November 2011, 2011, Art. *6*(4)). In addition, with the introduction of Reverse Qualified Majority Voting (RQMV), Commission recommendations under the corrective arm of the SGP are considered as adopted by the Council, unless there is a qualified majority that rejects them (Bauer & Becker, 2014; EU Regulation of 16 November 2011; Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, 2012, Art. 7).

For the Commission and its role in fiscal surveillance and enforcement, this means that it has seen its competences and powers enhanced (Bauer & Becker, 2014; Dehousse, 2016). RQMV and the possibility to trigger sanctions earlier in the procedure are likely to add 'significant political weight to the recommendations of the Commission' (Bauer & Becker, 2014, p. 220). The Commission, at least on paper, has certainly gained power vis-à-vis the Council, as it is now more difficult for the member state representatives to reverse the Commission's recommendations. This simultaneously gives the Commission a large degree of discretion concerning the interpretation of fiscal rules (Dehousse, 2016; Seikel, 2016; Van Aken & Artige, 2013).

Indeed, despite the reinforcement of coercive provisions in the framework of the SGP, policy-makers have not taken back the above-mentioned flexibility provisions that were introduced with the 2005 reform. What is more, the Six-Pack has introduced even more exemption provisions that form the so-called "general escape clause" (see European Commission, 2020). Therefore, considerable flexibility still exists concerning the assessment of the fiscal performance of member states (see also Mabbett & Schelkle, 2014). In its application of the reformed economic governance framework, the Commission has indeed shown flexibility (Bekker, 2016) and leniency (Mabbett & Schelkle, 2014). Using its discretion, the Commission has even reshaped the

coordination process (Vanheuverzwijn, 2017) and has re-interpreted the governing rules, applying them more and more flexibly (Schmidt, 2016, 2020). While the Commission under President Barroso did not acknowledge its flexible application of the rules and hid behind an austerity-oriented discourse, the Juncker Commission made its more political and flexible stance public (Schmidt, 2016, 2020). Nevertheless, the Commission appears to signal its role as a determined supranational surveillance body by increasing the number of country-specific recommendations to member states with a more polarised public opinion regarding the EU (van der Veer & Haverland, 2018). While aiming at presenting itself as empathetic towards member state authorities, the Commission seems to avoid showing too much leniency, suggesting that it tries to find the right balance in its application of economic and fiscal surveillance rules (see Vanheuverzwijn, 2017). Still, since the sovereign debt crisis and through policy-learning, the views of Commission officials have moved away from austerity orientation towards a flexible and politicised view on fiscal governance (Miró, 2020). In a similar vein, the Commission, in its approach towards the Art. 7 procedure concerning the non-respect of the rule of law, prefers to find a solution in cooperation with the government in breach of the rules, rather than resorting to force (Closa, 2019).

3. Theory

In this article, it will be argued that although actors strategically pursue their objectives, these objectives are shaped by the actors' perception of appropriate action. An adaptation of normative institutionalism can help us theorise and operationalise this claim. Normative institutionalism is rooted in sociology and emphasises the role of institutional norms that proclaim appropriate action. In that, it can be distinguished from sociological institutionalism, which focuses more on cognitive aspects, such as the perception and interpretation of situations and problems, and less on the actors' political behaviour (Peters, 2019).

Normative institutionalism assumes that action is driven by rules, which prescribe appropriate behaviour (March & Olsen, 2011). Rules contain 'codes of meaning,' which 'facilitate interpretation of ambiguous worlds,' and 'embody collective and individual roles, identities, rights, obligations, interests, values, world-views, and memory' (March & Olsen, 2011, p. 484). Consequently, actors act according to what they perceive is appropriate given their role and position (see March & Olsen, 1989). Rules, however, are sometimes ambiguous. A change in the situation in which actors find themselves may therefore lead them to match the rules to the new situation. This realignment consists of a 'constructive interpretation' of the rules. By 'fitting a rule to a situation,' appropriateness is established (March & Olsen, 2011, p. 483).

Although normative institutionalism does not exclude cost-benefit calculations (see March & Olsen, 2011), the central role that the logic of appropriateness plays in the approach lends a structuralist tendency to it, which leaves little room for agency (see Peters, 2019). Therefore, and building upon the sociological critique of the distinction between the logic of appropriateness and the logic of consequentialism, it is assumed here that the two logics stand in an interdependent relationship: while actors act strategically in pursuing their objectives, these objectives are shaped by their institutional and social environment (see Jenson & Mérand, 2010).

Based on these theoretical assumptions and the findings of the literature review presented above, the following expectations regarding Commission behaviour can be derived. Given the Commission's discretion and the ambiguity of the SGP, the fiscal surveillance rules need to be interpreted by Commission actors in light of the situation at hand and in line with their perception of their role and obligations. Thereby, appropriate action is established. The main ambiguity of the rules stems from their openness in that both a strict and flexible reading and application are possible, and that the rules, therefore, allow for ideologically, economically and politically opposing policy choices to take form. The rules might further enter into conflict with wider policy objectives the Commission is pursuing, which reinforces the necessity to align rule application and perceived obligations. The literature suggests that the Commission perceives a flexible application of the rules—taking into account the political, social and economic impact of its actions—as appropriate (see Miró, 2020; Schmidt, 2020), without however neglecting that being too lenient does not correspond to its role as surveillance body (see van der Veer & Haverland, 2018; Vanheuverzwijn, 2017). In any case, finding solutions cooperatively is expected to be preferred to resorting to punitive action (see Closa, 2019), especially because sanctions might be seen as inappropriate given that under the SGP they would impose further costs on a country that is already in an economically difficult situation (see Hodson & Maher, 2004). In pursuing the objectives, it deems appropriate, the Commission is expected to act strategically.

4. Methodology

4.1. Process-Tracing

The above-mentioned expectations regarding Commission behaviour will be tested in three case studies, applying minimalist theory-testing process-tracing methods. Process-tracing allows us to trace a causal mechanism that links a trigger or event X and an outcome Y (Fontaine, 2020; see also Beach & Pedersen, 2019; Bennett & Checkel, 2015). Serving as a first test of the existence of a causal link, in minimalist process-tracing, the causal mechanism is not unpacked in its entirety (Beach & Pedersen, 2019). Nevertheless, mechanisms can still consist of different parts that are conceptualised as 'entities that engage in activities' (Beach & Pedersen, 2019, p. 3)

and linked 'in a relationship of conditional dependence' (Beach & Pedersen, 2019, p. 36). After spelling out what fingerprints we expect the activities to have left, we have to examine whether our empirical observations confirm these expectations. If this is the case, the observations can be regarded as mechanistic evidence that supports our claims concerning the existence and functioning of our theorised mechanism (see Beach & Pedersen, 2019; Smeets & Beach, 2020). The Supplementary File 1 provides an overview of the case-specific observations.

Process-tracing allows for making within-case causal inferences. However, we can also analyse several typical cases–that is cases in which the cause and the outcome are present–and examine whether the theorised causal mechanism functions in the same way across our population of cases. At least at the level of abstraction of the theorised mechanism, this then shows that the cases are mechanistically homogenous (Beach & Pedersen, 2019).

A mechanism provides only one possible link between a trigger and an outcome, as X and Y can be linked by several different mechanisms. Only if one claims that a mechanism excludes other mechanisms, it is, therefore, necessary to 'formulate alternative explanations' (Beach & Pedersen, 2019, p. 43; see also Beach & Smeets, 2020).

In this article, it will be argued that the mechanism entitled "normative-strategic minimum enforcement" links trigger—an EDP at a stage where the introduction of sanctions is possible—and outcome—the non-imposition of financial sanctions. It argues that because punitive action is not perceived as appropriate, the Commission strategically refrains from applying the enforcement provisions to their full extent. Building upon expectations derived from the literature review and the theoretical approach of this article, the mechanism consists of two parts.

Part 1 of the mechanism consists of the European Commission assessing member states' fiscal performance within the boundaries of the flexibility of the rules. The Commission respects the limits of the flexibility of the SGP concerning the assessment of fiscal performance, fulfilling its role as surveillance body and Guardian of the Treaties. At the same time, the use of flexibility provisions seems warranted if the data on fiscal performance indicates a borderline case, as, in such a situation, punitive action is not perceived as appropriate.

The fingerprints that would confirm the functioning of this part are official documents, news coverage or interview data that show that the Commission saw the numbers as clear and accordingly respected the limits of the flexibility it possesses, or that it saw the numbers as unclear, which justified the use of relevant flexibility provisions.

Part 2 of the mechanism consists of the European Commission trying to avoid punitive action, resorting to a flexible reading of the rules. Financial sanctions are seen as inappropriate by the dominant Commission actors because they are not in line with their perception of the Commission's role in fiscal policy surveillance. Therefore, the Commission applies the rules in a way that does not lead to the imposition of sanctions and accordingly acts strategically in pursuing its objectives.

The fingerprints that would confirm the functioning of this part are documents, news coverage or interview data that indicate that the Commission believed that the imposition of sanctions would not have been appropriate and that it read and applied the rules flexibly.

4.2. Case Selection

Although financial sanctions based on the SGP for non-compliance with fiscal recommendations have never been imposed, there have been instances in which taking such a procedural step was possible. For this study, three cases have been selected that occurred after the first post-crisis reform of sanction provisions with the Six-Pack. These cases only concern euro area members, as SGP provisions regarding financial sanctions only apply to this group of member states.

The cases selected are presented in Table 1. All cases have in common that the member states concerned were under an EDP and did not receive a financial sanction. The cases diverge, however, in the procedural steps undertaken. The case of France serves as a highly politicised example of cases in which establishing non-effective action and thereby triggering sanctioning provisions was theoretically possible but not carried out. The cases of Belgium, Spain and Portugal are the only euro area post-crisis cases in which non-effective action was established. Despite this finding, the Commission did not issue a recommendation concerning sanctions in the case of Belgium. While the Commission issued a formal

Table 1. Overview of case studies.

Case	Existence of excessive deficit (Art. *126*(6) of the TFEU)	Establishment of non-effective action (Art. *126*(8) of the TFEU)	Formal recommendation concerning sanctions (EU Regulation No. 1173/2011, Art. 6)	Recommendation/ imposition of sanctions
France 2015	Yes	**No**	—	—
Belgium 2013	Yes	Yes	**No**	—
Spain and Portugal 2016	Yes	Yes	Yes	**No**

recommendation in the case of Spain and Portugal, it proposed to cancel the fines. As the steps under the respective EDPs of Spain and Portugal were largely dealt with jointly by the Commission, the two cases are treated here mostly as a single analytical entity.

For this article, 22 semi-structured expert interviews have been conducted with European Commission officials both at service (DG ECFIN) and Cabinet-level and with National Government officials in Finance Ministries and at Permanent Representations to the EU. The data gathered will be used to uncover and confirm actions, positions and perceptions of key actors. For triangulation, this article will additionally draw on official documents and news coverage. Each interview was attributed a code (see Supplementary File).

5. Analysis

Three post-crisis cases will be analysed, in which the imposition of sanctions for fiscal non-compliance was a valid option for decision-makers–Belgium in 2013, France in 2015 and Spain and Portugal in 2016. In line with process-tracing methods, each case study aims at exploring whether the mechanism entitled "normative-strategic minimum enforcement" was present and functioned as theorised.

5.1. Belgium 2013

As the first euro area country under the reformed rules, and still under the Barroso II Commission, Belgium was found not to have taken effective action to correct its excessive deficit. In light of this decision, the Belgian government was facing the potential imposition of a fine under the rules of the Six-Pack. However, the Commission did not issue any recommendation concerning sanctions.

The *trigger* was that in 2009, in the wake of the financial crisis, an EDP was opened for Belgium. At that point, a deadline was set for the Belgian government to correct its excessive deficit by 2012.

Part 1 of the "normative-strategic minimum enforcement" mechanism suggests that the Commission assesses fiscal performance within the boundaries of flexibility: In 2013, the Commission assessed whether Belgium had taken effective action concerning the Art. *126*(7) Council recommendation it had received in 2009. It found that it had failed to do so. It seems that the data clearly indicated that Belgium had not achieved its fiscal objectives.

Evidence shows that the decision to establish non-effective action was seen as rather technical. The Commission's assessment clearly showed that Belgium had not undertaken the required action (COM 1). According to the Commission's assessment, even without the recapitalisation of the Dexia banking group that amounted to 0.8% of its GDP, Belgium would have missed its deficit correction deadline (European Commission, 2013b). Even the Belgian administration perceived the decision as a rather technical step that was in line with the country's fiscal performance (MS 2).

Part 2 of this mechanism suggests that the Commission tries to avoid punitive action: After the Council confirms the Commission's assessment of non-effective action, the latter is required to issue a recommendation to the Council concerning the imposition of sanctions. This recommendation can either contain a fine, or the cancellation thereof. However, despite the Council confirming that Belgium had not taken effective action, the Commission did not issue any formal recommendation. The Commission apparently resorted to a flexible reading of the rules to avoid punitive action in this case.

Evidence shows that in the decision not to propose sanctions, legal considerations and arguments have played a major role. The Belgian EDP had been launched in 2009 and a Council recommendation was issued. It is in response to this recommendation that in 2013 the Commission deemed that Belgium had not taken effective action. The Six-Pack, based on which the establishment of non-effective action should lead to a proposal concerning sanctions, however, only entered into force in December 2011. The Commission's legal service questioned the legal firmness of proposing a sanction in this case (COM 1, COM 2). Indeed, a transition period—although not necessarily mandatory—for the application of fines is foreseen in the recitals of the relevant Regulation (EU Regulation of 16 November 2011, 2011, Recital 21). In this vein, Olli Rehn, Vice-President and Commissioner for Economic and Monetary Affairs at the time explained:

> As the six-pack legislation of reinforced economic governance entered into force only in mid-December 2011, imposing a fine for the years 2010 or 2011 could go against the principle of non-retroactivity which is essential in European law. In my view, therefore, it would be neither fair nor legally sound to apply it retroactively to those years. (European Commission, 2013a)

According to a Commission official, the possibility of Belgium not paying the fine, of discussing the decision being warranted, or of a court proceeding could have undermined the credibility of the rules (COM 2). Pursuing the normative goal of good cooperation and the legality and credibility of the rules in force, the Commission–in its strategic thinking–therefore took into account that the imposition of sanctions might have undermined achieving its objectives.

Evidence suggests that how the European Commission handled the French EDP in 2013 had also played a role in the decision. Given that the Commission aims at a consistent approach towards all member states, Commission officials deemed it possible that the lenient approach with regard to France, which at the time was about to receive a two-year deadline extension (Fontanella-Khan, 2013), might have contributed to

the Commission not proposing a sanction for Belgium (COM 3, COM 6).

Although Belgium did not fully deliver upon the Council's fiscal recommendations, it did not enter into an open conflict with the surveillance framework, and therefore the Commission did not see a reason to punish Belgium (COM 1). In a similar vein, Olli Rehn stated in a college meeting that the 'undertakings on fiscal consolidation given by the present Belgian government' and the 'absence of a fully operational government' in 2010 and 2011 were reasons not to impose a financial sanction (European Commission, 2013c, pp. 21–22).

In summary, when assessing the fiscal performance of the Belgian government, the Commission found that the numbers clearly indicated non-compliance with the recommendations. Therefore, it applied the rules in line with its role as Guardian of the Treaties. However, when it came to proposing sanctions against the Belgian government, the Commission opted for a prudent approach, not applying the newly introduced provision, as it was in conflict with several other norms. The legality of rule application, its consistency, and the cooperative behaviour of the Belgian government were valued by Commission actors and were in line with their perception of what the Commission should aim for. They accordingly concluded that sanctions that would undermine these norms were not appropriate. In interpreting the rules and setting aside a new provision to achieve the objectives it deemed appropriate, the Commission acted strategically.

5.2. France 2015

In 2015, asked by reporters why the Commission did not sanction France for non-compliance with the fiscal rules, Jean-Claude Juncker, then President of the Commission, simply answered 'because it is France' (Guarascio, 2016). Although this answer could potentially be explained by Mr Juncker's distinctive sense of humour, it seemed to confirm widely-held suspicions about the application of the SGP. But was France treated differently simply because of its size and weight within the EU? Or are there other factors that explain the non-imposition of sanctions in this case?

The *trigger* was that an EDP was opened for France in 2009. In 2013, the deadline to correct the excessive deficit was extended for two years—until 2015.

Part 1 of the mechanism was set in motion, and in early 2015 the Commission assessed the French government's compliance with the Art. *126*(7) Council recommendation it had received in 2013. In its analysis of France's progress under the EDP, the Commission services did not come up with a clear assessment. While the so-called 'bottom-up assessment' indicated that France had complied with the Council recommendation, the 'top-down assessment' showed a 'shortfall of 0.2% of GDP compared to the recommendation' (European Commission, 2015b, p. 13). In line with this unclear picture, the Commission's overall assessment of the French budgetary efforts stated that '… the information available does not allow to conclude that the recommended effort has not been delivered in 2013–2014' (European Commission, 2015b, p. 13). It seems that given the unclear data, the Commission has assessed the French fiscal performance using the flexibility of the rules.

The French case was the first major decision of the Juncker Commission in the area of the SGP. *Evidence* shows that in line with its announcement to be a "political" Commission, it had already made clear in January 2015 that it would use the flexibility that the SGP provides (see European Commission, 2015a). As acknowledged by a Commission official interviewee, the assessment of the French fiscal situation was borderline, also because the indicators the Commission is working with at this stage are complex and sometimes difficult to observe (COM 2). In line with the political and flexible approach in the area of the SGP under the Juncker Commission, 'the bar of evidence required to step up a procedure is relatively high,' with the French case being an example of this (COM 2). According to another Commission official, given this unclear picture, the Commission gave France the benefit of the doubt (COM 1). It did so by effectively–notwithstanding the double-negative phrasing–concluding that France had taken effective action, despite the weak numerical basis for this.

Part 2 of the mechanism proposes that the Commission tries to avoid punitive action: In its assessment, the Commission did not detect non-effective action, which if found and adopted by the Council would have required a proposal regarding sanctions. Instead, it recommended extending the deadline for the deficit correction for two years. It seems that the Commission has resorted to a flexible reading of the rules to prevent punitive action.

Evidence shows that a pattern emerged during this case regarding the internal conflict lines and balance of power in the area. This pattern consisted of Pierre Moscovici, Commissioner for Economic and Monetary Affairs, being the advocate of a more flexible approach and Vice-President Valdis Dombrovskis, responsible for the Euro and Social Dialogue, advocating a more rigid application of the rules. President Juncker emerged as taking on the role of arbiter (COM 3; see also Schmidt, 2020). Commissioner Moscovici argued that 'the Commission must be politically and technically credible and must therefore use expertise and the legal rules as the basis for making the right political decisions.' He was further of the opinion 'that the European Semester was an opportunity for the Commission to send messages to the member states to correct their… budget deficits' and that 'the Commission's general approach must strike the right balance between encouragement and a demand for results' (European Commission, 2015d, pp. 26–27). In light of the Commission's aim of encouraging reforms, Commissioner Moscovici saw the imposition of sanctions as a failure for both the Commission and the

member state concerned (see Chassany & Barker, 2015). Vice-President Dombrovskis, however, believed that 'any relaxing of these rules… would risk undermining the procedure itself and the equity of this procedure, as well as the Commission's power to apply it' (European Commission, 2015d, p. 26).

Other than Vice-President Dombrovskis, 'a half-dozen other Commissioners,' including Vice-President Katainen and Commissioner Vestager, were in favour of concluding that no effective action had been taken (Spiegel, 2015). In the absence of a compromise between Commissioner Moscovici and Vice-President Dombrovskis, President Juncker backed Moscovici, and concessions were made to Dombrovskis regarding the extension of the deadline, granting two-more years instead of three (Spiegel, 2015), although there were voices in the Council that were already critical of a two-year extension of the deadline (MS 1, MS 2).

Effectively concluding that France had taken effective action, together with the finding that the economic situation was weaker than expected when the recommendation had been issued, allowed the Commission—according to Art. *3*(5) of Regulation (EC) No 1467/97—to extend the correction deadline (see European Commission, 2015c). Accordingly, sanctioning a member state based on rather weak and inconclusive figures and taking the risk of receiving complaints afterwards was not in line with the Commission's approach on fiscal policy surveillance (COM 2) and its perception of appropriate action.

In summary, the fiscal data were borderline and subject to interpretation by the Commission, using the flexibility that the SGP provides. Against the background of unclear data, a flexible reading of the rules was applied to prevent punitive action that was deemed inappropriate in the situation at hand. Rather than resorting to punishment, the self-image of the dominant Commission actors proclaimed acting towards improving the fiscal and economic situation in the member state concerned.

5.3. Spain and Portugal 2016

Spain and Portugal came the closest to the imposition of sanctions. Both countries were found not to have taken effective action to correct their excessive deficits. While the Commission–as required by the rules of the Six-Pack–issued a formal recommendation to the Council concerning the imposition of financial sanctions, it recommended cancelling the fines.

The *trigger* was that Spain and Portugal had both been under the corrective arm of the SGP since 2009. In 2013, the deadline for the deficit correction for Spain was set for 2016 and the one for Portugal for 2015.

Part 1 of the mechanism was set in motion and, in 2016, the Commission assessed the action of both member states concerning their respective Council recommendations. It found that both countries had not taken effective action to correct their excessive deficits. The fiscal data, therefore, seem to have clearly indicated the countries' non-compliance with the recommendations.

Evidence shows that Commission actors saw the establishment of non-effective action for both Spain and Portugal as a rather technical and straightforward decision as the numbers were clear (COM 1, COM 2, COM 4, COM 5, COM 7). So unlike in the case of France, in this case, the establishment of non-effective action directly resulted from the analysis of the fiscal performance.

Part 2 of the mechanism suggests that the Commission tries to avoid punitive action: The Commission issued formal recommendations concerning sanctions following the Council's confirmation of non-effective action. However, the recommendations contained the cancellation of the fines. The Commission, therefore, seems to have resorted to a flexible application of the rules to prevent punitive action.

Evidence shows that, confronted with the legal requirement to envisage punitive action against Spain and Portugal, there was a division within the Commission. On the one hand, Commission actors in line with the tougher approach represented by Vice-President Dombrovskis thought that the imposition of sanctions, although of a symbolic amount (COM 5), would have served the credibility of the fiscal surveillance framework (COM 4, COM 5; see also Coman, 2018; Schmidt, 2020). On the other hand, a strict application of the rules was opposed by those Commission actors that were more in line with the approach followed by Commissioner Moscovici (see Coman, 2018; Schmidt, 2020). In particular, the thought was that financial fines would have been an additional fiscal burden, which could potentially have had counterproductive effects (COM 2).

In a similar vein, punitive action was not perceived as appropriate given the effort both countries had made in the previous years (COM 2, COM 3). In light of this situation, a fine would have been difficult to justify for the Commission, as stated by a Commission official:

> The political and the public perception of the Commission proposing a fine… on countries that were emerging from that sort of economic backdrop and with that social backdrop still present… would simply have been impossible for people to understand. And so Commissioner Moscovici was very much of the view that sanctions were neither desirable nor appropriate in that particular case. (COM 3)

A closely related aspect was of particular importance in the Commission's assessment of the appropriateness of punitive action–the member states' willingness to cooperate. Both countries were seen as being cooperative and were not questioning the surveillance framework or intentionally disregarding their fiscal obligations (COM 1, COM 2, COM 4, COM 7). As one Commission official put it: 'Spain and Portugal… did not deserve...to be punished because their fiscal performance, all in all, despite not being in line, was not in open conflict with the EU frame-

work' (COM 1). With regard to other EU institutions, such as the Council, given 'a broad European consensus in favour of cancelling the fines,' Commissioner Moscovici further 'felt it wise not to take the risk of provoking unnecessary divisions' (European Commission, 2016, p. 28). Ultimately, the Commission took a political decision in not proposing sanctions (COM 1). It did so by taking into account the reasoned requests submitted by the two governments, which allows the Commission to recommend to the Council the reduction or cancellation of a fine (EU Regulation of 16 November 2011, 2011, Art. *6*(4)).

In summary, the assessment of the two member states' fiscal performance clearly showed that they had missed their objectives. Accordingly, the limits of the flexibility provisions were respected and no leniency was shown. However, when it came to the requirement to propose sanctions, the Commission took into account the economic, social and political situation, including the countries' recent effort and their willingness to cooperate, and potential opposition from other institutions including the Council. Given the dominant actors' self-image as representing a political body that aims at supporting economic improvement, sustaining a cooperative oversight system and being responsive to the respective situation, they concluded that sanctions were not appropriate in the situation at hand. Consequently, the Commission applied the rules flexibly to prevent the imposition of sanctions.

6. Conclusion

Despite the reinforcement of coercive provisions with the post-crisis reform of fiscal policy surveillance and the strengthened role of the European Commission, it has so far refrained from proposing financial sanctions for non-compliance with fiscal recommendations. This article aims to understand the Commission's behaviour in this regard. Applying an adaptation of normative institutionalism, it is argued that the Commission strategically refrains from using coercive provisions to their full extent because sanctions are not perceived as appropriate in the cases at hand. Testing this assumption, a minimalist process-tracing analysis shows that the mechanism of "normative-strategic minimum enforcement" was present and functioned as theorised in the three post-crisis cases of near-imposition of fines.

When assessing member states' fiscal performance, the Commission acts within the boundaries of its flexibility. If the data clearly indicates non-compliance, the Commission states that no effective action has been taken. In line with its role as Guardian of the Treaties, it avoids showing too much leniency. If, however, the data on fiscal performance is less clear, it uses the flexibility of the SGP and avoids steps that might lead to punitive action. Even if based on its assessment of non-effective action, the Commission is immediately required to envisage sanctions, it applies the rules in a way that ultimately does not lead to the imposition of fines. Financial sanctions are seen as an inappropriate measure by the dominant Commission actors for several reasons. They are economically counterproductive, they might create conflict with member states that could damage the credibility of the overall surveillance framework and they would be difficult to justify vis-à-vis the European public. They accordingly go against the actors' self-image of the Commission as an institution that should work towards a cooperative and growth-enhancing system of economic and fiscal policy coordination and surveillance. In a context of ambiguous rules, a strict reading of the rules is therefore set aside to the benefit of a flexible reading. This means that the Commission acts strategically in pursuing the objectives it deems appropriate. On a theoretical level, this shows that strategy and norm-guided action can co-exist. While the theorised and confirmed norm-based mechanism provides one explanation of Commission behaviour, it is well conceivable that other theories and mechanisms equally explain why the Commission refrains from triggering sanctions. More research needs to be done to understand the explanatory value of other factors.

Regarding the mechanism's external validity, it is conceivable that a similar mechanism provides an explanation of the outcome in the case of Italy in 2018–2019. As in the cases studied in this article, the imposition of sanctions for Italy was discussed but finally avoided by the European Commission (see Schmidt, 2020). However, in the course of discussions, the Italian government moved its position from the overt rejection of the EU's fiscal surveillance framework to a more cooperative stance. Given the conflictual behaviour of the Italian government, extending the explanatory value of the causal mechanism might make a slight adaptation necessary to sufficiently take into account the specificities of the case. This could be the task of subsequent research.

To conclude, despite the reinforcement of coercive provisions under the SGP, there is no automaticity in their application. Cooperative behaviour and reform efforts—even if small—are sufficient for the Commission in order not to resort to punitive action. The idea of a cooperative relationship between the Commission and member states shapes the practice and the politics of the SGP and appears to trump considerations concerning the potential benefits that may result from imposing financial sanctions. Despite some hawkish voices within the Commission, most Commission actors seem less and less inclined to trigger financial sanctions under the SGP, thereby—at least indirectly—contesting the benefit and legitimacy of resorting to punitive measures. The European Fiscal Board, the Commission's independent advisory body on the implementation of fiscal rules, goes so far as to call for abandoning financial sanctions given their difficult enforceability in the current political context. Instead, it calls for a move towards a more incentivising framework (see European Fiscal Board, 2020). Surveillance under the SGP has been largely put on hold in the wake of the COVID-19 crisis and it is not yet clear when or if the EU will go back to applying the

fiscal surveillance framework in its current form (see Fleming & Brunsden, 2020). If the rules are not reformed and the current sanctioning provisions are maintained, they will most likely stay there, never to be applied (see European Fiscal Board, 2020), unless, perhaps, in the case of a member state's fundamental, overt and continuous rejection of the EU's fiscal surveillance framework.

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Conflict of Interests

The author declares no conflict of interests.

Supplementary Material

Supplementary material for this article is available online in the format provided by the author (unedited).

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Article

Tug of War over Financial Assistance: Which Way Forward for Eurozone Stability Mechanisms?

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Abstract

This article analyses the development of financial assistance in the Eurozone since 2010. It argues that reforms to instruments and bodies, notably the European Financial Stability Facility, the European Stability Mechanism, and the current Covid-19 recovery fund, are best explained by a re-occurring pattern of negotiations between potential creditors and debtors based on common Eurozone interests and national cost-benefit considerations. Building on a liberal intergovernmentalist approach, this article shows how this pattern influenced the step-by-step reform of financial assistance in the Eurozone. The threat to Eurozone stability served as a constant factor encouraging Member States to expand and deepen the assistance formula. Creditors' cost-benefit considerations were key for retaining disincentives, a limited liability for common debt, and intermediary borrowing and lending within the financing design. However, on the back of common Eurozone interests, debtors were able to push for an increase in assistance, an expansion of assistance into areas of banking sector support, and a softening of moral hazard elements in the more recent Covid-19 pandemic. Due to creditors' continuous insistence on safeguards and limited burden-sharing, reform outcomes were repeatedly unable to resolve the difficulties at hand.

Keywords

Covid-19; Euro crisis; European Financial Stability Facility; European Stability Mechanism; European Union; Eurozone; financial assistance; liberal intergovernmentalism

Issue

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1. Introduction

Since the beginning of the Euro crisis, extraordinary financial support in the Eurozone has been institutionalised through new tools and bodies with significant firepower to assist Member States in difficulties. After a first leap into this new area of Eurozone support with temporary assistance tools, Member States continued to adjust the structure repeatedly through new rules and practices and advanced deeper into the area of financial assistance introducing a permanent Eurozone support mechanism and instruments for bank recapitalisation, often subject to intense negotiations between core EU countries.

Scholars have become interested in the negotiation process finding explanatory merit in the strategic interaction between two ideational camps representing export and demand-led states (Hall, 2014), in hard intergovernmental bargaining and brinkmanship between creditors and debtors (Schimmelfennig, 2015), in the shift away from market policy to the state's core interest (Genschel & Jachtenfuchs, 2018), or in the previous institutional setting framing the choices at hand at the peak of the crisis (Verdun, 2015). Puetter (2012) acknowledged that the decision to govern new eras of EU activity was as much driven by national interests as by the willingness to find common solutions for common problems. These studies often account for complementary explanations but emphasise different explanatory variables in the intergovernmental process. Whereas strategic constructivists find that the cause of action at EU-level in the governments' rationale is based on the ideational foundation of their respective political economies (e.g., Hall,

2014; Schäfer, 2016), more rational approaches emphasise the aggregate welfare cost-benefit consideration by countries on the European level (e.g., Moravcsik, 2018; Schimmelfennig, 2015, 2018).

Scholars find that the post-crisis governance structure has put the adjustment costs predominantly on the economies of the countries receiving assistance with a strong emphasis on austerity being the fruit of ordoliberal German politics (e.g., Blyth, 2013; Matthijs, 2016). Scholars have emphasised the emergence of new formats and intergovernmental solutions in the aftermath of the crisis (Bickerton, Hodson, & Puetter, 2015), however, less attention has been given to the actual design of financial assistance and its adjustment in the last decade. This article complements these studies by emphasizing the concrete adjustments occurring to the financial assistance formula and the role Member States played in its continuous development.

The research question set for this article is: How can we best understand the last decade of Eurozone financial assistance reforms? As extraordinary financial assistance has the potential to carry significant costs for participating countries, the stakes in this policy are high, justifying an approach centred around Member States' interests and cost-benefit considerations in the design of support. This approach distinguishes between the potential roles of Member States in the different forms of financial assistance mostly oriented along a creditor-debtor divide. Whereas Germany and other potential creditors repeatedly favoured an assistance formula with limited liabilities, cost reduction, high disincentives, and the exclusion of bank support, France and other potential debtors favoured mutualisation of debt, low disincentives, and inclusion of bank support in the assistance. Often the result of negotiations between these two coalitions favoured the creditors' design, shifting the adjustment burden on potential receivers of assistance. However, as debtors repeatedly had difficulties adjusting, a continuous adaptation of the formula was necessary in order to achieve the common interest of Eurozone stability. This led to a tug of war between the two camps over the adjustment burden and costs of reform for each step of the way. It is argued that this mixed preferences situation of common Eurozone interests and diverging interests along the creditor–debtor divide explains best how the Eurozone reformed financial assistance.

In the following section, the theoretical framework is presented. Section 3 describes the initial stage of Eurozone financial assistance established in 2010. Sections 4, 5, and 6 present the empirical analysis on several issues related to financial assistance. Section 7 concludes.

2. Theoretical Framework

This article borrows from liberal intergovernmentalism by assessing the outcome of integration in the area of financial assistance based on state preferences and intergovernmental bargaining. Liberal intergovernmentalism builds on the assumptions that states are bounded rational actors (Moravcsik & Schimmelfennig, 2019), acting according to their respective preferences with the general objective of achieving the most preferred outcome in the least costly way (Knight, 2018). Moravcsik (1998) provides a three-stage framework for assessing the outcomes of intergovernmental negotiations. First, states form their preferences domestically. This process is dependent on the issue at hand and the respective constituency on the national level (Moravcsik & Schimmelfennig, 2019). The more specialised a policy and the smaller the number of stakeholders, the more representative is the state's position of a specific interest group. Conversely, in a more general policy concerning a diffused entirety of taxpayers, e.g., in macroeconomics, the state represents the interests of its economy as a whole. In the second stage, the states negotiate a common agreement. Liberal intergovernmentalism argues that this process is dependent on the relative bargaining power of states deriving from asymmetric interdependence (Moravcsik & Schimmelfennig, 2019), which favours positions of states with low incentives to compromise due to their expected lower gains from a common solution (Moravcsik, 1993; Schimmelfennig, 2018). Lastly, states find agreement in specific institutional choices. This locks the agreement reached in a more or less fixed manner and tends to favour the preferences of those countries with the greatest leverage.

Additional to national preferences, this article conceptualises common 'Eurozone' or 'EU' preferences shared by all Eurozone members. This common EU or Eurozone preference is the stability of the Eurozone and the proper functioning of the common market, which this article considers as fixed. The common interests derive from the interdependence of European economies. The danger to the integrity of the Eurozone through sovereign defaults or even the breakup of the Eurozone would have devastating effects on European economies and hence on the future stability of their respective fiscal and economic positions. This creates a situation of mixed preferences in which Member States agree to resolve the difficulties at hand, but disagree about the distribution of adjustment costs (Scharpf, 1997; Zürn, 1992). In game theory, this situation is referred to as a "coordination game with distributional conflict" (Wolf, 2002, p. 39). Scholars assessed the moment of the Euro crisis as a situation of mixed preferences, in which Member States shared the common preference of safeguarding the Euro, while in parallel following diverging preference on the concrete form of adjustment, which determined how the burden is split among the states (Moravcsik & Schimmelfennig, 2019; Schimmelfennig, 2015). In 2010, the German governing coalition's behaviour showcased the common interest as it called this common or shared preference of Eurozone stability *alternativlos* (unavoidable).

Hence, while keeping the underlying interdependence from common preference on safeguarding the Eurozone and the common market in mind, this work will focus on the diverging preferences in the reform process. Similar to previous studies on intergovernmental negotiations, the diverging preferences are assessed based on national cost-benefit considerations. These are dependent on the expected adjustment costs linked to the materialist burden associated with financial assistance following a creditor–debtor divide (e.g., Copelovitch, Frieden, & Walter, 2016; Schimmelfennig, 2018). In the context of financial assistance, this cost-benefit analysis is related to specific elements of assistance including the scale, the timing, the source, the form, the control of assistance and the disincentives attached to it. Finally, this article emphasises the preferences of representative core-states in the bargaining processes.

Financial assistance can be generally regarded as a favourable loan or permanent transfer of capital to a recipient. These loans or transfers bear different costs for states depending on the assistance format and the expected financial involvement. Member States are expected to have entered into assistance negotiations according to their shared preferences that some form of financial assistance structure was needed or improved and have shaped the development of the Eurozone assistance structure according to the individual cost-benefit consideration of their expected involvement.

In the following, this article will assess several reforms to the financial assistance structure since the Euro crisis using preferences, intergovernmental bargain, and the institutional outcome.

3. The European Financial Assistance Formula

As the international financial crisis swept over to the EU in 2008–2009, non-Eurozone countries received assistance via the EU's Balance of Payments assistance facility. An instrument that borrowed via the EU on the market and on-lend to states. For Eurozone countries, no assistance tool existed from within the EU. To avoid uncertain and potentially very high adjustment costs caused by a systemic spill-over of a Greek default (Colasanti, 2016) and its potential negative signalling effect to the market about the debt sustainability of other Eurozone countries (Schimmelfennig, 2018), the Eurozone explicitly marked their common preference of Eurozone stability and established several assistance tools (Council of the EU, 2010; European Commission, 2010). First, the Greek Loan Facility (GLF) was created as a fast ad-hoc bilateral response to the Greek crisis with €80 billion of support. In parallel Eurozone countries established the European Financial Stability Facility (EFSF), a temporary 3-year special purpose vehicle that could provide loans to Eurozone members. The agreement on the EFSF allowed for the lending of up to €440 billion and was complemented by a Council regulation on the European financial stabilisation mechanism (EFSM) that allowed the EU to use its leftover financial margin as assistance as long as the crisis prevailed (see Table 1).

This first firewall was a mix of a fast-paced response to Greece's imminent difficulties and a broader approach to a potential future system of assistance. All assistance was provided via loans, a fiscally neutral way in the medium-term. Out of foresight on the costs of bilateral assistance for other Eurozone countries, the EFSF was

Table 1. Assistance instruments adopted in 2010.

	EFSM	EFSF	GLF	Assistance formula
Guarantee structure	Guarantees on the EU budget	Individual guarantees by Eurozone Member States	Bilateral loans with individual share	Limited liability
Eligibility for assistance	Conditionality	Conditionality	Conditionality	Disincentives
Decision-making	Decision by Council	Decision by Eurogroup	Decision taken nationally	Member States' control
Lender	EU (intermediary), expected €60 billion	Eurozone (intermediary), €440 billion	Member States, €80 billion	Mix: No direct fiscal impact for EFSM and EFSF and direct fiscal impact for GLF; fiscally neutral in medium-term;
Time limitation	Implicit temporary (as long as exceptional occurrence justifies instrument)	3 years	Only once	Temporary

supposed to provide loans as an intermediary in the same way the EU did through its Balance of Payments assistance facility (European Stability Mechanism [ESM], 2019). This structure would prevent creditors from worsening their fiscal position during a time of general economic upheaval. Whereas the EU could in general fall back on its own resources as collateral for lending through the EFSM, the Eurozone countries had to provide guarantees for EFSF loans. This was achieved via a contribution key and oversubscription (guarantees), stating the share and potential financial involvement of each country in EFSF activity. The intended assistance formula aimed at limited liabilities for creditors and for the lowest possible cost, as the EU and the EFSF would lend as an intermediary, sparing the countries the direct fiscal impact of bilateral assistance.

Whereas the common interest of saving Greece and establishing a rescue fund derived from contagion risks, the EFSF followed a creditor-centred design. In particular, German and British national preferences on a non-EU instrument for Eurozone support were the reason why the Commission's alternative of assistance exclusively provided via the EU was ruled out (Gocaj & Meunier, 2013). Decision-making for assistance was in the hands of the Member States and in the case of the EFSF and GLF entirely based on national laws to ensure legal certainty and control. For the EFSM, the Council decided by qualified majority voting; for the GLF and EFSF, Eurozone countries decided unanimously with several Member States requiring approval from their parliaments. Assistance carried policy conditionality, which was set as 'strict' including extensive austerity demands, which intended to restore market confidence. These instruments increased risk-exposure of potential creditor states, but also favoured creditors' preference of including substantial obstacles to accessing assistance and to rerouting debt in order to avoid direct costs.

4. The Fault in Our Assistance: EFSF Reform

This initial creditor-centred design unintentionally somewhat weakened the common interest of establishing a support structure for Eurozone stability. Shortly after the establishment of the EFSF, several issues arose as the intended signalling effect to markets failed and market tension continued to rise in the Eurozone in 2011.

First, in this context, the European Central Bank (ECB) started its Securities Market Programme through which it purchased over €200 billion worth of periphery countries' government bonds on the secondary market (ECB, 2013). These interventions were contested within the ECB's Governing Council and by several Eurozone governments (Howarth, 2012), as well as by German and Dutch members of parliament (Fontan & Howarth, 2021). The main dispute was about the ECB's balance sheet stretch, with bonds from countries under increased market pressure. The intervention by the ECB effectively lowered the funding rate for these countries without them having to undergo reforms to strengthen their economic situation, which was seen by some as the root cause of their fragile market position. This undermined to some extent the previously set strict conditionality that usually accompanied extraordinary assistance.

Second, the problematic relationship between banks and sovereigns became palpable as debtor countries required substantial funds from assistance instruments because having rescued their banks they had significantly weakened their fiscal positions (Blyth, 2013; Tooze, 2018). A large part of the loans to Ireland and Greece were used to recapitalise banks, creating the situation in which the debtor countries had to substantially increase their debt. This assistance came as conditional loans, carrying strict provisions on economic reform, as it was considered a national ex-post fiscal problem (Hadjiemmanuil, 2015). However, contagion risks made financial sector assistance a Eurozone issue.

Third, the EFSF-design had two flaws, which were linked to its legal and its guarantee structure. The oversubscriptions of the EFSF were not enough to achieve the sought-after high credit rating for the total amount of €440 billion (it only achieved €250 billion). Meanwhile, Eurostat decided that guarantees for assistance under the EFSF had to be reported as government debt by the creditors (Eurostat, 2011). The GLF and the rerouting of EFSF debt had direct fiscal implications for creditor states in the short and medium-term as their debt level rose (Bundesrechnungshof, 2019). This went against the intended assistance formula, which was supposed to avoid direct national expenditure for assistance.

Fourth, the Eurozone used favourable, yet relatively high, interest rates for assistance to Greece, Ireland, and Portugal, in order to encourage swift reform implementation and hence a rapid return to the market (Colasanti, 2016; Pisani-Ferry, 2014). However, the intention to incentivise structural reforms did not have the intended effect. Creditors and European institutions did not sufficiently consider the effect of assistance via loans and their interest rates on debt sustainability. With this background, the Eurogroup decided to reform the EFSF and "adopt further measures [to] improve the euro area's systemic capacity to resist contagion risk" (Council of the EU, 2011a).

The creditor countries, particularly Germany, preferred reforms to protect their rather stable fiscal position and shield their taxpayers from assuming potential costs from mutualised instruments. They preferred to avoid being exposed to periphery states' liabilities and not to incur costs from rescuing periphery banks. Most notably, they defended the use of policy conditionality for any form of assistance in order to avoid moral hazard. Furthermore, they favoured a legal structure with effective intermediary borrowing and lending to avoid further increases of public debt through EFSF activities. Debtor states, on the other hand, favoured an increase of the EFSF firepower, a mutualisation of debt and lower interest rates for support as their fiscal position worsened.

Italy's finance minister Tremonti called mutualisation of debt the "master solution" to resolve the crisis (Hollinger, Bryant, & Peel, 2011). France favoured ECB involvement and pushed for EFSF leveraging via the ECB and a mutualised system for bank recapitalisation (Carnegy, 2011).

In early 2011, the Eurozone agreed to use EFSF funds for primary market purchases in order to allow struggling states to maintain market access. Primary market interventions were EFSF state loans with conditionality applied through a different channel. This was intended to reduce the amount of lending necessary as recipients would partially be able to fund themselves on the market (Spiegel, 2012). This solution allowed Member States to maintain control over the scale of the liabilities they assumed via interventions in the debt markets. However, as the ECB acted in parallel on the secondary market, creditors saw risks rerouted onto their central banks' balance sheets. In Germany, the Securities Market Programme was seen as the introduction of common Eurozone debt via the backdoor of the ECB's balance sheet, which was guaranteed according to the Eurozone's capital key (Bundestag, 2011a).

To regain control of assistance and ensure proper conditionality, the German coalition government considered a secondary market instrument for the EFSF, not only as an additional supporting tool but also as a replacement for uncontrolled ECB action (Bundestag, 2011b). Germany expected that Eurozone governments would take over intervention on the secondary market with conditionality, thus disarming the ECB and ensuring government control over liabilities (Bundestag, 2011c). A grand majority of German members of parliament even passed a motion stating that there was no further need for the ECB's Securities Market Programme (Bundestag, 2011d). The message was understood in the ECB and the Securities Market Programme's successor, the Outright Monetary Transactions programme, explicitly pointed to a parallel EFSF/ESM programme with conditionality as eligibility criteria for action (ECB, 2012). Primary and secondary market interventions were introduced to regain control of targeted interventions on Eurozone debt markets and allowed the recipients, in theory, to maintain market access.

Debtor countries were more concerned with avoiding adjustment costs of recapitalising their banks as none of the assistance instruments were targeted directly at the banking sector but functioned as loans to governments. France favoured a solution of recapitalisation via the EFSF (Pidd, 2011), whereas Germany preferred national solutions ("Paris et Berlin," 2011). Both countries eventually agreed on a potential use of the EFSF as a last resort for bank recapitalisation, as the market situation deteriorated and sovereign yields spreads increased considerably, putting periphery countries' debt sustainability at risk (Bundesbank, 2011). The risk associated with a cascade of defaults of periphery countries was immense and foregrounded the common Eurozone interest of stability preceding the negotiation on recapitalisation.

Together with the increase in the effective lending capacity of the EFSF from €250 billion to 440 billion (achieved by raising the guarantees), Member States agreed on a common tool for bank recapitulation. Creditors' insistence on the established assistance formula forced potential debtors to accept an indirect recapitalisation instrument. This instrument worked as a state loan, however, its conditionality was only targeted at the financial sector reducing the stigma of a full programme (ESM, 2017). Creditors refused to take over direct liabilities for difficulties occurring in other countries' banking sectors. This increased the funds available but did not ease the burden for potential debtors. Thus, the new instrument did not effectively resolve the issue of worsened fiscal positions due to bank bailouts.

The market turmoil in 2011 and the initial emphasis on disincentives by creditors in the form of strict conditionality and favourable, yet impractical, lending rates for GLF loans, brought Greece again to the brink of default. Thus, Member States decided to lower the interest rate for Greece and to lengthen the maturity of its debt (Council of the EU, 2011b). The abolishment of impractical rates for close-to-default countries was later presented as an 'impressive display of euro area solidarity' by the ESM's managing director (ESM, 2020a). This adjustment tempered the insistence on disincentives via lending rates as the common Eurozone preference and the potential risks and losses associated with a Greek default were a much larger threat than the costs associated with longer maturities and lower lending rates. However, agreement to these relieve measures and a substantial EFSF loan to Greece came again with 'appropriate incentives to implement the programme' (Council of the EU, 2011c). This could not avoid a restructuring of Greek debt held by the private sector in 2012 (Colasanti, 2016).

The future issue of counting debt as national expenditure was resolved by defining the legal structure for the in parallel negotiated design of the ESM, the successor of the EFSF, as permanent international financial organisation allowing intermediary borrowing and lending (ESM, 2019; Eurostat, 2013). The capital structure of the ESM was based on a similar logic as the EFSF, however, the ESM included a significant share of paid-in capital, which functioned as collateral together with additional national guarantees. When in late 2012 the ESM became operational, it absorbed all functions and instruments from the EFSF and reset the effective lending capacity to €500 billion. The step towards the ESM was a rectification of the faulty design of the EFSF's legal structure and increased the direct costs attributed to assistance via paid-in capital and made the formula permanent to showcase a credible commitment. However, it significantly lowered the states' guarantees and achieved the major objective of effective intermediary borrowing and lending easing the potential creditors' immediate burden.

The choice of reforms for the EFSF shows how the resolution of the crisis was a situation of mixed

preferences. Eurozone countries agreed on a way forward to resolve the crisis and to achieve the common interest of Eurozone stability by increasing the lending capacity, lowering the costs for debtors and by introducing new instruments. While both, creditors and debtors, tried to deflect adjustment costs in the detailed implementation of the assistance formula. Concessions made by Germany and other creditors to include instruments on market interventions and bank recapitalisation are in detail dominated by a creditor-centred design of the assistance formula. All instruments relied on the same structure of conditional loans to states with limited liabilities, fiscal neutrality in the medium-term, and intended intermediary borrowing and lending to avoid direct costs.

5. Tug of War over ESM Reform and Banking Sector Support

As the crisis progressed, scholars and experts pointed towards the different pre-conditions that led Member States to seek assistance. One of these aspects was the sovereign doom loop. Arguably, this problem was made worse via the ECB's long-term refinancing operations in 2011 and 2012 as banks in Southern Europe accessed ECB financing using government bonds as collateral to buy new government bonds (Howarth & Quaglia, 2016). Another aspect was the previous use of assistance by individual states and their banking sectors. Ireland argued that it bared disproportionate costs of rescuing banks and that the Eurozone should share the cost of the Irish bailout as it reduced contagion risks for the Eurozone (Smyth, 2011). As in 2012, Spain required substantial assistance to rescue its banks, it preferred to receive recapitalisation for its banks, rather than a government loan, as it insisted that its problems were bank-made (Minder, Kulish, & Geitner, 2012). However, creditors relied on the assistance formula of loans to states. It became apparent that in order to effectively break the doom-loop and achieve Eurozone stability, bank recovery and resolution was to be shifted away from the state (van der Kwaak & van Wijnbergen, 2017).

This was acknowledged at a Euro summit in 2012. Governments saw the advantage of direct recapitalisation and agreed on providing the ESM with the possibility of recapitalising banks directly in a first step towards Banking Union. However, while France, Italy, and Spain supported direct recapitalisation, Germany and other creditor countries remained concerned about legacy issues in periphery banks and feared that the costs of losses, due to failure of nations to reform, would be spread among the Eurozone countries. Germany also feared a disadvantage for its alternative banking sector of corporate and savings banks (Commain, 2021; Howarth & Quaglia, 2016). Debtor countries favoured this instrument as it would lower their burden for potential bailouts. Creditors insisted that the establishment was coupled to progress in setting up the Single Supervisory Mechanism to monitor banks and a liability cascade to avoid disincentives for states to clean up their banking sectors (Council of the EU, 2013a). These demands were intended to prevent already struggling banks with legacy issues from tapping into the ESM funds (Howarth & Quaglia, 2016).

Other ex-ante requirements were attached to assistance including the threat to fiscal sustainability for the country in which the banks were based, systemic relevance of the bank in question, private creditor bail-in, host Member State participation in bank recapitalisation, and the inclusion of institution-specific and potentially general economic conditionality (Council of the EU, 2013b). In 2014, the Direct Recapitalisation Instrument was added to the ESM toolkit (capped at €60 billion). However, the above-mentioned requirements, mostly due to creditors' preference to avoid the moral hazard and costs of bank bailouts, made its use less likely as debtor states still had to bear most of the adjustment costs ex-ante (Merler, 2014). The step from common assistance to sovereign states to assistance to banks came with higher risks for creditors as loans to banks were riskier than state loans (ESM, 2014). Thus, creditors insisted that in this case, the formula should include additional disincentives which had the effect that the link between sovereign states and banks was only superficially cut.

A similar dynamic of mixed preferences is visible in the case of the Single Resolution Fund (SRF; for more details see Howarth & Quaglia, 2014, 2016). France's preference was for a single European fund that intervened to resolve or recover ailing financial institutions. Potential debtors favoured a common solution, which would ease the burden on banks and sovereign states, as costs would be mutualised through a European fund. Germany's preference was to safeguard its small banks, retain decision-making in the governments' hands and have a network of purely national resolution funds (Barker, Spiegel, & Wagstyl, 2013). Again, Germany feared that its corporate and savings banks would be forced to pay for failed banks in the periphery as a common system would not provide the needed incentives for debtors to restructure their banking sectors (Howarth & Quaglia, 2014). The compromise reached with Germany only included 128 larger banks and forced other Member States to accept an intergovernmental agreement for the SRF (Spiegel, 2013).

The compromise included a transitional period of 10 years (later reduced to eight), during which the SRF would be composed of national compartments. In this phase, the SRF was intended to be gradually filled with ex-ante contributions from financial institutions paying into national resolution funds until reaching a level of 1% of covered deposits (~€60 billion; Council of the EU, 2020a). Intervention until the end of the transitional phase would be limited to the collective contributions of the respective national compartment and the overall mutualised means available to the SRF at that moment

(see Table 2). With time, the national intervention quota reduces, and the mutualised means increase (for more details see Council of the EU, 2020a).

In this period the costs of assistance would predominantly be shouldered by the national banking sector requiring support. Whereas borrowing and transfers between the national compartments could be undertaken to have sufficient funds available, the banking sector receiving support would have to reimburse these loans or transfers, shielding other states from incurring losses in their compartments. Even though the Commission was given new competences, the Council maintained the possibility to object to a mutualisation (Council of the EU, 2020a).

The compromise on the transitional period followed, in particular, the German interest in using national resolution funds, including a shareholder bail-in and a reduction in the number of institutions covered by the SRF. However, the agreement also favoured the periphery states' interest in putting their larger banks under the umbrella of the Single Resolution Mechanism. The solution is a middle ground of a purely national and purely European solution, with safeguards allowing Germany to shield its banking sector and keep control within the Council. The SRF followed the logic of the assistance formula with limited liabilities for states, disincentives coupled to its setup and national involvement, as well as lending via an intermediary.

To make the SRF operational before the transitional phase ends in 2023, the Eurozone debated a potential backstop for the SRF. The Council put forward the possibility of using the ESM in the transitional phase in order to use the SRF's full capacity before all ex-ante contributions were collected (Council of the EU, 2013c). However, the same preferences leading to a semi-European solution for the SRF also fostered a similar solution for its backstop. Member States compromised on a system of bilateral Loan Facility Agreements, allowing for national bridge financing for their respective shares according to the intended size of their national compartments. Only after all means under the liability cascade of the intergovernmental agreement were exhausted, could national credit lines be drawn which had to be reimbursed in the medium-term. This meant that governments had to provide partial bailouts in the transitional period through a loan to their own SRF compartment, which would

Table 2. ESM instruments and SRF.

	ESM (general)	Direct Recapitalisation Instrument (ESM)	SRF	Backstop (ESM)	Assistance formula
Guarantee structure	Individual guarantees by Eurozone Member States	Same as ESM	By Backstop; before 2023 through national credit-lines for compartments	Same as ESM	Limited liability
Eligibility for assistance	Conditionality	Conditionality; ex-ante eligibility; Single Supervisory Mechanism	National quotas used before mutualised means;	Reducing risk exposure; (Conditions to be agreed by Eurogroup)	Disincentives
Decision-making	Decision by Eurogroup	Same as ESM	Decision by SRB and Council	By Eurogroup unanimity for instrument; by qualified majority voting for use (proposal)	Member States' control
Lender	ESM, €500 billion	ESM, €60 billion	Banking sector contributions, ~€60 billion (~42 billion collected 10/07/2020*)	ESM, limited to €68 billion	No direct fiscal impact; fiscally neutral in medium-term
Time limitation	Permanent	Until SRF is finalised with ESM backstop (2023)	Permanent, transitional period of 8 years	Permanent	Permanent

* = Source: Single Resolution Board (n.d.).

lend-on these funds. After the transitional period, the SRF compartments are supposed to merge and share the responsibility for the entire 128 banks. Creditors only agreed to the use of the ESM as backstop after the transitional phase elapsed or sufficient progress of reducing banks' exposure to risks had been made (Visco, 2019). Eurozone countries agreed on this in the revised ESM treaty in 2019 (yet to be ratified), which allowed the ESM to provide loans to the SRF up to its target level, with a nominal cap at €68 billion (ESM, 2020b).

The SRF is the first non-state funded assistance instrument with the potential to break the doom loop, however, the assistance formula upheld in the transitional period kept the burden on the country with banking sector difficulties. The intention to free Member States from adverse effects of bailouts will only be achieved partially and gradually in this period. The solution of the transitional phase was driven by creditors'—and predominantly Germany's—preferences, which included limited national liabilities, pre-requirements in banking supervision and bail-ins for SRF interventions. The common need to free Member States from the doom-loop in order to stabilise the Eurozone allowed for a deeper integration of support mechanisms favouring the debtors' positions. The rules applied in the transitional period underlined the strong adherence to disincentives and avoidance of directs costs by creditors, as most solutions only allowed for partial mutualisation and demanded that debtor states significantly participate in interventions.

6. Tug of War Continued: Dealing with Covid-19

After having provided immense national stimuli to their economies in order to counter the economic effect of Covid-19 (Anderson et al., 2020), several countries, including Portugal, Ireland, Greece, Slovenia, Luxembourg, and Belgium called for action in the form of a common EU debt instrument, allowing for assistance in form of grants (Dombey, Chazan, & Brunsden, 2020). The economic argument for the common European interest put forward was that the pandemic was symmetrical and that all states, regardless of their policies, were facing difficulties. However, most creditor states preferred the ESM as a potential resolution tool, which still had more than €400 billion of its capacity on standby.

The two camps agreed in April 2020 at the Eurogroup inclusive format on a 'comprehensive economic policy response,' a mix of EU budget allocations, national guarantees for European Investment Bank activity, and adjustment to ESM use. The ESM was allowed to provide credit lines of up to 2% of Eurozone GDP (€240 billion) which had to be spent on direct or indirect health-related expenditure (Council of the EU, 2020b). A new loan mechanism, SURE, was introduced at the EU level, which allowed the EU to borrow and on-lend €100 billion to Member States. The only condition was that the national government expenditure on short-time work and similar schemes increased since February 2020.

As of January 2021, the Council approved assistance to 18 governments via SURE with the largest share going to Italy (€27,4 billion) and Spain (€21,3 billion). The regulation worked with voluntary national guarantees of €25 billion to ensure the full capacity with beneficial lending rates, which was considered an 'important expression of solidarity' (European Commission, 2020a). Creditors adhered to the assistance formula via intermediary loans to avoid incurring direct costs and to limit their risk exposure in time through temporary instruments. The big concession on their part was the easing of conditionality for assistance, which was intended to encourage debtors to make use of the loans.

In May 2020, as the Commission projected a record economic decline in the EU, the periphery countries, but also France, refused to rely on support via Eurozone financial assistance instruments and French president Macron referred to the ESM instruments as throwing 'fake money' at the problem (Khan & Brunsden, 2020). The issue was that loans alone did not help already highly indebted countries as their fiscal sustainability was under threat and the ESM's senior creditor status could have negative effects on market lending rates. After the Commission's forecast, a Franco-German initiative proposed a €500 billion grant-based recovery fund for the EU, raised on the markets and funded by an increase in the EU's own resources and a fair taxation of the digital economy (Présidence de la République, 2020). This U-turn from the German government was defended as necessary solidarity, given that loans would not help countries with already high debt and that economic cohesion would have been severely disrupted (Bundeskanzlerin, 2020). German members of parliament argued that it was in Germany's interest to strengthen its EU neighbours due to its strong export-led market (Bundestag, 2020).

On the other hand, the Netherlands, Denmark, Sweden, and Austria (referred to as 'the frugal four') proposed only using loans for support (Rijksoverheid, 2020). In late May, the Commission combined both in a proposed recovery fund worth €750 billion (European Commission, 2020b). The dynamic was not creditor and debtor per se but between frugal states and a Franco-German-led coalition. The outcome of a record 4-day negotiation was a middle ground between both camps with a Recovery and Resilience Facility (RRF) worth €360 billion in loans and €312,5 billion in grants (Council of the EU, 2020c).

The Covid-19 overall response (see Table 3) is a step away from the previous application of assistance through conditional loans with disincentives. Even though grants were introduced and disincentives predominantly abolished, the regulation of the RRF referred to sound economic governance as part of the ex-post eligibility criteria. Thus, creditors upheld some form of conditionality. They also ensured the minimisation of direct national costs and limited liability for mutual support. The largest share of around €1 trillion worth of intended assistance

Table 3. Covid-19 assistance tools.

	EU RRF		Credit-line (ESM)	SURE	Assistance formula
Eligibility for assistance	Recovery and Resilience Plans (including sound economic governance)		Increased short-time work schemes	Healthcare, cure and prevention	Soft conditionality
Guarantee structure	Guaranteed by extraordinary EU expenditure		Individual guarantees by the Eurozone Member States	Guaranteed by EU budget	Limited liability
Decision-making	Council implementing decision, limited to 6,8% of respective national GNI	Predetermined allocation of grants	Decision on assistance taken by Eurogroup	Decision on assistance taken within the Council	Member States' control
Lender	EU, €360 billion	EU grants, €312,5 billion	ESM, Limited to €240 billion	EU, Limited to €75 billion, voluntary national guarantees for €25 billion	Mix: direct fiscal impact for Member States (grants), partially no fiscal impact (loans); partially fiscally neutral in medium- term
Time limitation	Until 2027	Until 2027	End of 2022	December 2022	Temporary

followed the previous assistance formula including temporary instruments in the form of intermediary loans having no direct fiscal impact and some conditions attached.

7. Conclusion

By applying the theoretical premise of liberal intergovernmentalism, this article provides one possible explanatory track on how the Eurozone has reformed in the area of financial assistance since 2010. The re-occurring pattern of common Eurozone interests and cost-benefit considerations of creditors and debtors led to a repeated tug of war over the detailed reforms of assistance, while both sides still tried to resolve the common difficulties at hand. These situations of mixed preferences are one way of understanding the interstate bargaining process over policies with potentially high costs for Member States.

Creditors' preferences were decisive for reforms in terms of disincentives, limited liability for common debt, and the adherence to intermediary borrowing and lending to minimise direct costs. They repeatedly favoured national safeguards and the use of loans. Control and some disincentives were held on to, which reduced the effectiveness of the assistance formula and only partially allowed for a slow de-nationalisation of assistance in the case of bank-related support. Through the enabling factor of common EU and Eurozone interests, debtors were able to push for softening of moral hazard elements and an expansion of the assistance into areas of banking sector support. The common interest was also decisive for Germany and other creditors to support grants.

This explains why financial assistance, even though increasing in size and in areas of applicability since 2010, was often accompanied by a reduced involvement for creditors, a temporary form of instruments, and reinforced disincentives for debtors. Apart from disagreement on detailed application of EU and Eurozone assistance, one should however not ignore the increased volume of assistance available since the beginning of the Euro crisis, which today stands at a total capacity of around €1,3 trillion and is at least partially permanent. While some instruments are certainly more appealing for debtors than others, assistance continued to be provided to a larger extent in the form of loans. The combination of loans and grants, as well as the general risks carried by all Member States associated with assistance, indicates the commitment to the European project and underlines the institutionalised shared European and Eurozone interests.

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Conflict of Interests

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Article

The European Investment Bank's 'Quantum Leap' to Become the World's First International Climate Bank

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Abstract
In November 2019, the European Investment Bank (EIB) announced its 'metamorphosis' into a 'Climate Bank.' Associated with the EU's Green Deal, presented a month later, the EIB claimed to be the first international climate bank and a front runner in the EU's priority climate agenda. The EIB is mandated through the treaties to support EU policymakers. However, with its 'makeover,' the EIB also announced the launch of a new climate strategy and energy lending policy, ending fossil fuel financing after 2021. It is thus valuable to examine the question of whether the EIB has developed into a policymaker, and if so, how this can be best understood. In exploring this question, this article follows a principal-agent approach, attempting to discern the rational interests behind organisational rhetoric and posits that the EIB's claimed transformation hints at a type of policymaking activism, exploiting a policy window to serve the EIB's rational interests in a strained political and market contest. This represents a paradigm shift in the EIB's institutional behaviour and rhetoric within the EU governance constellation and is, in fact, in this sense a 'quantum leap' as suggested by the EIB. However, it remains to be seen if the bank's metrics will prove a bold departure from their current activity or simply another adaptation to a policy field of intense interest to the EU, as has occurred on several occasions in the past.

Keywords
climate change; climate finance; European governance; European Green Deal; European Investment Bank; European Union

Issue
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1. Introduction

The European Investment Bank (EIB) has emerged as one of the international community's great success stories of the post-World War II era. Since its foundation in 1957, the primary financial arm of the EU became the world's largest multilateral bank—as lender and borrower—surpassing better-known institutions, such as the World Bank. With its operations undergoing progressive international expansion in over 160 countries, the bank has developed into a global actor. Set up to address a market failure in long-term capital flows to post-conflict Europe, the EIB has a dual nature that is unique among multilateral banks—it is both an EU body and a bank (Bussière, Dumoulin, & Willaert, 2008). Accordingly, it combines its institutional character with financial heft and technical knowledge. As a result of the EIB's dual nature, its activity has shifted on several occasions, adapting to both policy and market developments and reflecting the geo-economic landscape as well as the ever-emerging challenges, which call for global collective action and financing. Originally geared toward the EU's harmonised and integrated development, the EIB turned into a market-making support mechanism (Clifton, Diaz-Fuentes, & Revuelta, 2014) and subsequently a multifocal economic booster.

As a European body, the EIB has been increasingly solicited by the EU to assist in facing these ever-changing challenges. There have been repeated calls from the EU to extend the EIB's objectives and its geographical

and sectoral reach as well as to 'strengthen' its support in times of economic downturn. In this vein, it has been called upon to promote economic recovery against the backdrop of the financial crisis through the framework of the Juncker Plan in 2014 and to support the post-pandemic fight and economic restart in 2020 (EIB, 2020a). Climate change is one of the defining issues of our time which requires coordinated policy and action, in which the EIB can play a key role, as it is empowered to do both. Financing is important for unlocking the necessary investment for mitigating climate challenges (Alonso & Cuesta, 2021). In November 2019, the EIB announced its 'metamorphosis' into a 'Climate Bank': Associated with the EU's Green Deal, presented a month later, the EIB claimed to be the first international public climate bank and a front runner in the EU's priority climate agenda. In its EU institutional capacity, the EIB is mandated through the treaties to support EU policy initiatives and hence to follow rather than anticipate the Commission. Nonetheless, upon publicizing its claimed 'makeover' into a climate bank, the EIB also simultaneously revealed the launch of a new climate strategy and energy lending policy ending fossil fuel financing after 2021. The EIB is relatively well-positioned to play a proactive role in policymaking. Building on the green financial and operational initiatives, which the bank started to develop earlier than the Commission (as in the case of the issuance of the green bonds in 2007, which came well ahead of the Commission's streamlined climate policy involvement in 2015) the question is whether, and if so for what reasons, the EIB adopted a new policymaking role. Consequently, it is worth researching whether the EIB developed from a technocratic policy-taker into a policymaker, and if so, how this can be best understood. Is the EIB's 'pivot' to climate a paradigm change?

This article builds on existing scholarly work examining the EIB's evolving policymaking role (Clifton et al., 2014; Liebe & Howarth, 2019; Mertens & Thiemann, 2017, 2019; Robinson, 2009). However, it examines a new topic—the bank's claimed transformation into a climate bank—which is so recent that the academic community has not yet had time to develop an interest in it. The article is among the first, if not the first, to study the EIB's conversion into a climate bank, which thus constitutes its scientific contribution. The remainder of the article is structured as follows: Section 2 presents the underlying theoretical framework and applied approach. Section 3 provides a historic evolution of the bank's institutional trajectory in two sub-sections, from its policy-taking days to modern-day policymaking transformations. Section 4 studies contextual insights related to the background and motivations behind the EIB's switch to a climate bank and analyses whether the turn constitutes a preferred or forced change. Section 5 evaluates whether the 'pivot' represents a paradigm shift and a 'quantum leap.' Finally, the conclusion provides a synthetic overview of the key findings.

2. Theoretical Framework and Methodology

As EIB's nature goes well 'beyond that of a financial institution' (van der Zwet, Bachtler, Miller, Vernon, & Dozhdeva, 2016) being an EU body and a bank, this conversion influences EU governance as well as the market. The article thus uses the sociology of markets as a conceptual framework, which explains the social relations that exist between suppliers, producers, consumers, and the state. It is a framework used for theorising public banks as dynamic institutions (Romero, 2020), which allows the study of the EIB as an actor in relation to its major stakeholders, such as other EU governance counterparts and market players. In particular, this article analyses the background and motivation of EIB's turn to a climate bank—claimed to represent a 'quantum leap' (EIB, 2019b, p. 1). Accepting EIB's challenge of a claimed 'quantum leap,' the article draws from quantum mechanics. Specifically, it follows the view of Erwin Schrödinger that it is meaningless to analyse individual objects in real-time. He proposed instead that only the scrutiny of 'ensembles' of many particles and their record over time, can allow for understanding phenomena in their quantum trajectory. The article follows EIB's quantum trajectory and attempts to answer the following research questions: Is EIB's 'quantum leap' just a further term in its search for an identity in its perpetual pendular swing between the two poles of its nature, acting upon EU request and in alignment with new European policy, or for other reasons? What could these reasons possibly be? Is EU's policy-driven bank a policy-taking or a policymaking actor when changing into a 'climate bank'?

The article concentrates on the EIB's institutional nature. In examining the research questions within its chosen conceptual framework, the article examines the EIB from a 'collective dynamics' perspective, drawing on the sociology of markets, while examining the bank's policymaking and policymaking roles over-time for understanding its change into a climate bank. This framework helps to shed light on both faces of the bank's dual nature while viewing the EIB in interaction with its stakeholders to study what is 'at stake.' The stakeholders prioritised for analysis in this research are primarily the EU member states (EIB shareholders), and secondarily, the Commission, one of the three central EU policymaking institutions. The role of other stakeholders, such as NGO's, other multilateral banks, borrowers and investors, is also taken into consideration, albeit to a lesser extent. Given that markets are loci of exchange involving cooperation and antagonism among rational actors striving to fulfil a specific purpose (Hodson & Peterson, 2017), the EIB's 'shift' to a climate bank is analysed in relation to the varying interests of its stakeholders in order to identify the reasons—the EIB's own or external—that prompted such a 'pivot.'

To analyse individual actors, which within the sociology of markets framework are considered as rational, and to understand the EIB's role in the EU governance

constellation, the article uses rational choice institutionalism, notably a principal-agent model approach, well suited and used in literature to study European governance actors and regional development banks, such as the EIB (Clifton, Diaz-Fuentes, & Howarth, 2021; Fontan & Howarth, 2021). The methodology used is based on academic literature that has approached the EIB from similar angles—principal-agent model (Liebe & Howarth, 2019), and sociology of markets (Mertens, & Thiemann, 2019)—as well as different perspectives and more general perspectives, and a review of official documents, consisting mainly of public speeches, press releases, and annual reports, including elements relevant to the research questions. Viewing the EIB as the agent and the EU member states and the Commission as principals and policymakers who use the agency to maximise their objectives, the principal-agent model is useful for investigating the causal influences of their interactions on EU governance and policymaking (Pollack, 1997). Given that the principal-agent models assume that the interests of principals and agents diverge due to informational asymmetry, to the advantage of the agent, the results of such an analysis can unveil the background of EU decision-making and governance transformations. It is precisely this asymmetry that 'empowers' and motivates the agent to act in his own best interests. Thus, the principal is in a position to prescribe the pay-off rules in the relationship by limiting the ability of the agent to exercise policy discretion (Hooghe, 1999). The principal-agent model allows one to gauge whether and when the EIB was called by the principals or if instead, it exploited the political context and available policy windows and acted as a policy entrepreneur when it 'became' a climate bank. In this way, the article delves into whether and how the rational interests of the bank have led to the EIB's 'pivot.' Subsequently, it evaluates whether the EIB's turn constitutes a discontinuous change or, in other words, a 'quantum leap,' as suggested by the EIB.

3. The EIB's Quantum Trajectory: From Policy-Taking to Policymaking

The starting point of this research is a longitudinal study of EIB as an agent, attempting to identify whether it has been acting as the policy-taker of the principal's line and whether there are eventual deviations or changes of course.

3.1. Policy-Taking

Founded in 1958 by the Treaty of Rome as the EU's bank, the EIB is the EU's long-term lending arm. The EIB has a historical presence in Europe. Its statute has been annexed as a protocol in seven successive EU Treaties. The EIB's qualitative and quantitative development mirrors the evolution of the Union, adapting to calls to accommodate successive enlargements and priority reorientations. These are reflected in the bank's ever-evolving activity objectives, geographical spread, the volume of operations as well as its structure and processes. Accordingly, the EIB has portrayed itself as a principal vehicle for implementing EU economic policies.

The EIB business model is based on three pillars of value-added: (i) consistency with EU policies, support for the EU priority objectives and EU policy dialogue with partner countries; (ii) project technical, economic, environmental and social appraisal and conditionality; and (iii) EIB financial and non-financial contribution to the project. The EIB transfers the financial advantage of its funds to the beneficiaries and leverages additional finance from the public and private sector (EIB, 2011, p. 3).

For more than thirty years, the EIB has viewed itself as a technocratic implementation agency "having no organic ties with other Community institutions" (EIB, 1987, p. 3), "autonomous" (EIB, 1991, p. 1; Robinson, 2009, p. 652) and independent (Peterson, 2004). EIB's "independence" (EIB, 1987, p. 16) as proclaimed explicitly by President Bröder, let the EIB's bank-side curve out and dominate over its institutional-side. The bank's independence has also continued to prevail under the presidency of Sir Brian Unwin, stressing in parallel the bank's institutional role until the early 2000s: "The EIB it is in a sense the Unions 'house bank' operating as an autonomous non-profit maximising financing institution, owned by the 15 Union Member States" (EIB, 1996, p. 1). Subsequently, the EIB started to downplay its independence, highlighting a 'policy-driven' aspect, consistent with the bank's intention of closer integration in the EU institutional constellation, while continuing to stress its dual capacity. As stated by President Maystadt:

> The EIB is no ordinary bank: It was created specifically to provide financial support to the EU's objectives. I describe this special character with the term 'policy-driven bank,' namely a bank which in synergy with the other EU institutions and without burdening the public purse, contributes to the realisation of projects giving concrete expression to the economic, social and ultimately, political priorities of the Union. (EIB, 2001, p. 4)

Since 2011, under the current president, Hoyer, the term 'policy' has been dropped, albeit increasingly and systematically 'showcasing' the EIB's institutional role by branding the EIB as 'the EU bank' (EIB, 2012, p. 4). Nevertheless, progressive differentiation started thereafter. While demonstrating self-confidence by projecting its size—for the first ever time in a president's message in an annual report—as "the world's largest supranational borrower" (EIB, 2011, p. 5), it appears that the EIB is in search of an identity. In different months in 2019, its self-characterisations ranged from a 'crowding-in bank' (EIB, 2019a, p. 12) to a 'climate bank' (EIB, 2019b). This leads to a question: Is the EIB's 'quantum leap' simply a further term in its search for an identity? A further adaptation to

a policy field of intense interest to the EU, as on several occasions in the past? Or does the 'pivot' to a climate bank point to an EIB turn toward policymaking?

Beyond the EIB's agency role, its policy-taking has also been specifically, consistently, and increasingly emerging in its top officials' discourse over time. Under the Le Portz presidency in the 1970s, the bank described itself as "translating into practice the priorities, as formulated by the EIB's Governors, who are the member states' Ministers of Finance or Economy" (EIB, 1984, p. 10). Policy-taking continued to emerge explicitly or implicitly in later years, and President Bröder observed that the EIB "has constantly adapted its activity in keeping with successive enlargements of the European Commission and developments in Community policies, thereby serving Member States' needs as effectively as possible" (EIB, 1988, p. 3). Similarly, President Unwin described the bank's remit as "furthering the Union's priority economic objectives" (EIB, 1994, p. 5), and President Maystadt explained that "the Bank has defined itself as a public policy bank, and seeks to interpret this to the maximum as congruence with EU policy as developed principally by the Commission" (EIB, 2005, p. 1). President Maystadt explicitly stated that the EIB "does not have as part of its remit the power to define policies" (Bussière et al., 2008, p. 6). Following the same line, the current president, Hoyer, has claimed that the EIB is "providing finance and expertise for sound and sustainable investment projects which contribute to furthering EU policy objectives. The EIB also implements the financial aspects of the EU's external and development policies" (European Parliament, 2013, p. 2). Not only has the EIB portrayed itself as a policy-taker; it has been also viewed as such by its stakeholders when asked to support the implementation of evolving EU policies. Through the Council, the EU member states have regularly called on the EIB to support changing policies in a constantly mutating context by altering its objectives, volume and geographical reach in order to assist European policy objectives. Starting with the provision of development finance in the 1960s, examples over the years include the addition of other objectives, such as energy in the 1970s, the environment in the 1980s, priority lending to the Trans-European Networks in the 1990s, increased support for innovation in the 2000s, assisting economic recovery after the global economic crisis in the 2010s, and the Covid-19 pandemic in 2020. The Commission has also been calling on the EIB to "step up its efforts in designing new instruments" to support investments in green innovation (European Commission, 2005, p. 4). For the European Parliament, "The EIB is in fact a financial instrument serving Community policies" (European Parliament, 2000, p. 3). Peer multilateral banks have also been viewing the EIB as a policy-taker, given that "it makes long-term finance available for sound investment in order to contribute towards EU policy goals" (Asian Infrastructure Investment Bank, 2016, p. 1). In the same fashion, NGOs expect that "the EIB is supposed to follow EU legislation in its activities both in and outside EU" (Feiler & Stoczkiewicz, 1999, p. 5).

3.2. From Policy-Taking to Policymaking

In line with typical agency dilemma situations, while EIB's official rhetoric has focused on its policy-taking role, its practices have been increasingly drifting towards policymaking. The EIB has been tacitly but systematically prioritising its rational interests, departing from its technical know-how stronghold, with climate change being the latest example. Cognizant of this shift, the academic community has called for research on the bank's policymaking role (Clifton et al., 2014; Liebe & Howarth, 2019; Mertens & Thiemann, 2017, 2019; Robinson, 2009). These works have demonstrated a gradual and careful EIB shift from a policy-taking to a policymaking role, demonstrating normal entrepreneurship or policy entrepreneurship activism, depending on whether the pendulum was on the side of the bank or the institution, respectively. As a result, the EIB's aspirations to make a more proactive contribution to EU policy objectives have been revealed, albeit remaining 'under the radar.' Additionally, these works explored some of the subtle ways the EIB has been shirking and exploiting the political context and policy windows to increase its policy influence.

However, the situation changed when the EIB openly claimed, for the first time, a policymaking role under the current president. Confirming the bank's politicisation (Mertens & Thiemann, 2019), President Hoyer argued that he was the one who had pushed the Juncker plan along with Commission President Juncker. In a speech for Luxembourg's 'movers and shakers' in October 2015, he mentioned that he and President Juncker worked together to create the Juncker Plan, and he went on to explain the importance of the EIB in this policy development:

> When I met with Jean-Claude Juncker in the summer of 2014, he was preparing his program for becoming the new President of the Commission….This is the point where Jean-Claude Juncker and myself agreed to enable EIB to take risks on a much larger scale. If you want, this was the birth of the Investment Plan for Europe, or better known as the Juncker-Plan. (EIB, 2015b, p. 14).

President Hoyer also confirmed EIB's politicisation as a "political instrument…[as it] serves a political purpose" (Toplensky & Barker, 2019).

4. The EIB's Climate 'Pivot' Context

Tying back to the main thrust of this research, when President Hoyer explained the EIB's 'makeover' into a climate bank at the bank's annual conference in January 2020, he followed the same line: "We listened

to the European Council and to the President of the Commission, Ursula von der Leyen" (EIB, 2020a, p. 8). Seen from a principal and agency perspective, this statement—seemingly submissive—can be viewed as the starting point of a paradigm shift in the EIB's positioning in the EU governance setting. This statement is unlike his earlier rhetoric and the EIB's customary policy-taking discourse, showcasing the bank's efforts to "deliver on commitments to Member States" (EIB, 2015a, p. 1) or "to deliver on the promise of the Investment Plan for Europe calls" concerning the Commission (EIB, 2015b, p. 4). The 2020 statement could even be interpreted as an attempt to refer to the EIB as inter pares with the Council and the Commission. Although one should observe how the EIB rhetoric will evolve, there is further evidence of this. First and foremost, the timing of EIB's 'pivot' shows some intention to break away and challenge the EU governance set-up. The EIB released the news of its 'transformation' on November 14, 2019 (EIB, 2019b), well before von der Leyen's Commission presented the European Green Deal on December 11, 2019 (European Commission, 2019). This constitutes a change in the paradigm in which the EIB announcements usually postdate the Council and the Commission for courtesy reasons, as expected in a principal-agent relation. Second, the EIB's congruent new climate strategy and energy lending policy ending fossil fuel financing after 2021 and its simultaneous pledge of one trillion Euros by 2030 for climate change, publicised upon its 'pivot,' demonstrate a policymaking role. The latter, seen in conjunction with the EIB's pioneering climate-related capital market activity—well before the Commission streamlined its climate finance policy in 2015—shows that the bank has been feeling relatively well-positioned to play a more pro-active role in this area. Third, the context of the EIB proclamation falls during a period of tough negotiations in EU circles concerning the EIB's position within an eminent reshaping of the economic governance set-up related to: (i) the creation of a European development bank, with three possible scenarios under discussion, including an EIB subsidiary, an European Bank for Reconstruction and Development (EBRD) subsidiary and an independent institution as the third option; and (ii) the InvestEU, as a successor to the growth-promoting Juncker plan for the period 2021–2027. In these negotiations, the EIB appears to be losing its historic primacy of being entrusted with the exclusive mandate of managing EU funding or guarantees as the EU bank. In this context, the EIB is placed almost on par with other multilateral and national banks, although maintaining a preferential position, managing 75% of these resources. Depriving the EIB of its monopoly over the EU budget seems to be a new paradigm, also followed by the Commission under the European Green Deal:

> The Commission will also work with the EIB Group, national promotional banks and institutions, as well as with other international financial institutions. The EIB set itself the target of doubling its climate target from 25% to 50% by 2025, thus becoming Europe's climate bank. (European Commission, 2019, p. 16)

In addition to the paradigm shift in the EIB's principal and agent role-setting, the above analysis suggests that the EIB's 'transformation' into a climate bank was deliberated during strained institutional and market conditions. To better understand the prevailing background, particularly the EIB–stakeholder interaction, this article draws on a sociology of markets perspective. First, the profiles of the stakeholders are discussed along with the reasons for including them in this analysis. The EIB and its EU governance stakeholders have similar preferences regarding climate action, given an apparent change in public and institutional sentiment about the significance of the issue. The EU member states are the EIB's top-ranking stakeholders, as they are the bank's constitutionally exclusive shareholders. Serving their interests and needs is EIB's raison d'être and the sine qua non-condition for its existence. In turn, its shareholders have demonstrated extraordinary and continuous support, as evidenced by successive capital increases. The EIB enjoys the strongest shareholding support of all multilateral banks, mainly because its shareholders are, on the one hand, exclusively high-income industrialised countries, and on the other hand, because they are the EIB's prime beneficiaries, with a historic average of 90% of the bank's aggregate annual lending. Obviously, shareholders' support also recognises the bank's agency services in delivering upon their calls, adapting its activity to their ever-changing topical demands. Nevertheless, in parallel to their recent support—demonstrated by the replenishing of the EIB's capital post-Brexit—EU member states have also expressed a desire to reform the EIB and obtain a higher level of control through the EU governance setup, including supervision of the EIB by the European Central Bank (Brunsden & Khan, 2018; Khan, 2018; Mertens & Thiemann, 2018). In a lead-role among member states, France has been promoting:

> The idea of creating a bank to concentrate on climate change…[and] Ursula von der Leyen… signalled that shifting the mandate of the European Investment Bank is among the options under consideration [while announcing to the European Parliament on 10 July 2019 the 'transformation' of the EIB] into a European climate bank, a green bank, we will be role models worldwide. (Krukowska, 2019)

Member states' goading and the European Commission's support of the need to turn Europe into a climate cause front-runner prior to the EIB's 'pivot' proclamation in November 2019 raises further questions about the timing of and reasons for the bank's announcement. The EIB's rush to anticipate the Commission's Green Deal makes the exploration of these questions more pressing. The Commission, as the 'guardian of the Treaties' and de

facto part of the EU policymaking scene, has a seat on the EIB Board of Directors and is becoming an increasingly important stakeholder of the EIB, due to strengthened joint action. In the run-up to the new Commission leadership, the Commission saw climate change as a way to mark its tenure, as it: (i) reflects public sentiment; (ii) would be able to consolidate the EU's climate worldview; and (iii) has growth potential because it touches all sectors of social and economic activity (Rifkin, 2011). Investments in climate-related areas are intertwined with quality of life as well as research, innovation, and industry 4.0. For financing investment schemes, the Commission is happy to rely on the EIB's agency skills. In need of specialised finance skills, the Commission views the EIB as a reliable and highly qualified technical partner with which "it has strengthened collaboration… and created stronger links between structural funds and the new financial instruments with the aim of leveraging… investment" (European Commission, 2019, p. 19). In this sense, the Commission is the EIB's sister organisation, offering the EIB a unique comparative advantage among its multilateral peers (Kavvadia, 2021). Their long-established cooperation covers policy and implementation arrangements, including funding and guarantees. In the EU governance setting, the two institutions have been conceived in a principal-agent relationship since the 1960s, when the EIB was mandated to provide financing outside the Union. Their relations have been characterised by the typical agency dilemma inherent in a "cultural gap" (European Parliament, 2016, p. 103) and "discontent" (Mertens & Thiemann, 2019, p. 21). Nevertheless, the two have increasingly been leaning on each other to address operational issues under various mandates. The EIB has been comforting the Commission by providing technically sound mandate management, while the Commission has bolstered the EIB with funding and risk coverage. The latter has been actively sought by the EIB in situations of high risk and during times of turmoil, such as the introduction of the euro, the global financial and economic crises, and the Covid-19 pandemic. With this increasing cooperation, however, the Commission feels a stronger need for exercising greater control over the 'resisting' EIB (Counter Balance, 2020b). With the Green Deal, cooperation with the EIB in the relatively new area of the green finance agenda is important for the Commission, which did not engage in mainstream implementation of climate action policy in capital-markets until around 2015, whereas the EIB structured its environmental involvement earlier, through the pioneering issuance of green bonds in 2007. This cooperation among the two EU actors did not go unnoticed by another EIB stakeholder, the European Parliament. The Parliament's current 'greener' composition is fully in line with the new EU policy agenda, acknowledging the benefits of Commission–EIB cooperation in green finance while also demanding increased control over the EIB (Counter Balance, 2020b). In its 2016 study of the EIB's role in EU's cohesion policy, the Parliament acknowledged that the Commission had to rely increasingly on the EIB's expertise and anticipated this pattern to further strengthen in the future based on the experiences from the financial crisis (European Parliament, 2016).

Beyond the EU governance set-up, the EIB context is also determined, shaped, and influenced by the bank's peers, which in the sociology of markets framework are viewed as key organisational stakeholders. Within the multilateral banks market, the EIB has already surpassed all of its peers, including the World Bank, in terms of capital and volume of activity. Despite the recent addition of new institutions in the multilateral banking scene, such as the Asian Infrastructure Investment Bank and the New Development Bank, the EIB's leading position seems currently unchallenged (Kavvadia, 2021). Given the global importance of the climate, 11 of the multilateral banks, including the EIB, have agreed to deepen their collaboration to promote sustainable infrastructure (EIB, 2017a) as a further example of cooperation initiatives. While certainly not excluding competition among peers, projecting cooperation is important for the relevance of public banks, especially in light of the increased scrutiny concerning their relevance, mainly from think-tanks and NGOs. As a result of this scrutiny in recent years, the slow climate action of multilateral banks has been voiced as an NGO prime concern. Uniquely equipped to implement policy and funding in a wide cross-border area, these banks are best suited for dealing with new and diverse global challenges, such as climate change. In 2016, there were already calls for turning the World Bank into a climate bank and "renaming the International Bank for Reconstruction and Development… as the International Bank for Reconstruction and Sustainable Development" (Montek, Lawrence, & Andrés, 2016). The World Bank, having a world-wide membership and being closest to the UN global climate policymaking, would be an ideal candidate to take over the climate funding leadership, for "making financial flows consistent with a pathway towards greenhouse gas emissions and climate-resilient development" (United Nations Framework Convention on Climate Change, 2015). Given that, in the sociology of markets framework, actors operate through agency, "framing and entrepreneurship" (Fligstein, 2011, p. 7), the EIB has slipped into the role of a lead multilateral climate financier aware of the position of its peers. The EIB has obviously used a policy window to its advantage, building on its strength of having shareholders committed both to the climate cause and the EIB. The bank could therefore act swiftly and establish itself as the first international climate bank. Although better positioned, it is difficult for the World Bank to achieve such a major 'transformation' due to its wide shareholding basis and concomitant slower processes. The EBRD also has ambitious climate policy and funding aspirations (van de Ven, 2017). It has been "a global leader at financing green investments, most notably through the private sector" (EBRD, 2020, p. 1), and in 2020 green energy represents 50% of its annual funding. Nevertheless, the EBRD did

not make a decisive move on climate finance, possibly because it was more focused on 'bearing down' on the EIB in terms of geographical reach, product mix and most importantly political support within the EU, as mentioned earlier. The EIB was the first to put on the climate bank hat, thus getting a head start and further strengthening its positioning among its peers. NGOs are the natural activist stakeholder in the EIB's 'makeover.' Starting from strained relations and a complete disapproval of "EIB's actual disregard for environmental considerations…[and the fact that]… the EIB is supposed to follow EU legislation in its activities… but does not seem to do so" (Feiler & Stoczkiewicz, 1999, p. 5), NGOs obviously hailed EIB's 'pivot,' considering it largely as a victory. After this rough start in the 1990s and the 'bumpy' relations with the NGOs, the EIB focused on increasing its knowledge and expertise in green finance. Indeed, it is thanks to prodding by NGOs that the EIB presented a new environmental policy containing numerous positive statements and requirements in 1996, becoming more climate aware and proactive in the last 10 years. Its green financial initiatives and environmentally upgraded operational criteria and processes have prepared the ground for assuming a prime role in the green market and finance policymaking. However, NGOs cannot be seen as the prime motivator of EIB's 'pivot,' rather, they acted as a supportive stakeholder. The last category of EIB stakeholders of interest in this research includes the bank's investors and borrowers. The former have already shown positive responses to the EIB's climate aspirations by supporting the bank's green bonds, representing on average 6.5% of the EIB's yearly issuance programme, while the latter account for 25% of the EIB's yearly lending activity on average. While these volumes constitute a good starting point—both on the asset as well as the liability side of the bank—they do not appear sufficient for an EIB turnabout into a purely climate bank. Consequently, the EIB does not appear 'mature' in its complete 'makeover' to a climate bank from a quantitative perspective. Increasing its lending to the interim target of 50% by 2025 from its record of 31% in 2018 appears challenging. This seems even more true in the post-pandemic context, as several investments will be halted and new investment priorities will be set, mainly in support of existing assets and entrepreneurial undertakings. Nevertheless, on the liability side, with more than €16 billion issued in the green format across 11 currencies, the EIB remains one of the largest issuers of green bonds (EIB, 2017b, p. 3).

The above analysis reveals that EIB's 'pivot' to a climate bank is not based on business grounds, given that its climate borrowing and lending activity (6.5% and 25%, respectively) do not justify such a radical step. The EIB's 'metamorphosis' into a climate bank targets climate-related lending of 50% of its aggregate annual lending within five years. Unlike its institutional side, which is aligned to EU policy objectives, the EIB's bank side is demand driven. In 2018, its environment lending was €17 billion, that is, 31% of the total annual lending of €55,6 billion. Extrapolating from these figures—ceteris paribus and based on the EIB's projection of maintaining the same lending volume (EIB, 2020b)—the EIB would have to achieve an additional €10 billion of climate lending beginning in 2025. Of course, the EBRD has already achieved green finance of 46% of its aggregate annual funding. Although the EBRD is much smaller than the EIB, in absolute terms this amounts to €4,6 billion (i.e., 1/3 of the EIB's 2018 climate volume, prior to its 'pivot'). The question of whether there are enough investment projects qualifying under climate funding is beyond the scope of this research and remains open, especially as climate-related projects are characterised by a higher innovation intensity and risk profile. With regard to its borrowing activity, the EIB has not committed to a target.

5. EIB's Quantum Leap?

Returning to the analysis above, although not publicly evident, the EIB decided on its 'pivot' based on an increasing trend toward 'politicisation' on grounds related to its stakeholders rather than business reasoning. The EIB has been acting as a policy entrepreneur, applying rational long-term thinking and a risk/benefit analysis. Driven by its principal interest of political and market relevance, the bank exploited a policy window and announced its 'transition' to a climate bank in a swift and timely manner. More specifically, for reasons of political relevance, the EIB has sought to primarily satisfy the EU member states, as they are its top-priority stakeholders. In doing so through its 'pivot,' the EIB also rendered service to the Commission, which was seeking ways to satisfy the EU member states while shaping its ambitious Green Deal plan. Having said that, the EIB was not acting as a policy-taker, not merely because it consciously raised its public profile as a policymaker by pre-empting the Commission announcements. Faced with pressure from its stakeholders, the EIB acted aggressively as a policy entrepreneur, aiming to change the game, shifting from being challenged to taking the lead and becoming the game-maker. In recent years, the EIB has been challenged by some of the EU member states, which have called for radical reforms (Mertens & Thiemann, 2019). Additionally, the bank has been under pressure from the Commission as well. In search of increased control, the Commission has been curtailing the bank's traditionally privileged position as the exclusive mandate manager of EU funds and guarantees by offering 'cake' slices to new 'beneficiaries,' such as the National Promotional Banks and the EBRD. Furthermore, the European Parliament has also been asking for increased control over the EIB since the early 2000s, when the EIB approached the Commission for stronger cooperation, as mentioned above. Naturally, the NGOs have been calling for EIB's decarbonisation. Meanwhile, peers have also joined the 'pressure circle.' The EBRD has been 'conquering' market territory and becoming stronger compared to the EIB, extending its

activities in new regions and countries, beyond its original remit, even within the EU—the EIB's 'stronghold'—in countries such as Greece and Cyprus. By sharpening its image and political influence, it has strengthened and extended its cooperation with the Commission. Even within the EU economic governance setting, the EBRD has often been placed on par with the EIB, despite its non-EU institutional global membership, including American, Asian, and Oceanian countries. In this situation, where stakeholders seek increased control over an organisation that has grown to become the world's largest multilateral bank, the EIB's quantum leap seems to be motivated by its rational interests of escaping EU political pressure and maintaining its relevance. The EIB's interests are topped by the bank's endeavours to maintain its relevance and safeguard its positioning, mainly in the EU governance context and, to a lesser extent, in the multilateral banking context. The EIB's observed propensity to assume a policymaking role contributes to its vital interest in controlling the developments and guiding them toward preferred solutions through early participation in the agenda-setting. Climate action has been chosen as the battering ram for breaking into the EU institutional policymakers' club for the following reasons: (i) it has wide political support; (ii) it is topical, but with a long-term future horizon; and (iii) the EIB is well placed to play a lead role given its long held and recognised expertise in climate finance.

The leap was swift and well timed to exploit a window of opportunity during a developing situation within the EU governance context. This first-entrant act solidified EIB's institutional and market position, building on its previously recognised climate mastery. While essential for supporting the implementation of EIB's 'pivot,' its business metrics do not yet justify its climate 'makeover' and cannot be seen as the factors motivating the conversion. Acting as a policy entrepreneur, the EIB used a policy window in a period of 'malaise' in the run-up to major changes in the European economic governance, some of which directly concern its activity in the EU as part of the InvestEU and others its role outside the EU in a new institutional European development banking set-up (currently under consideration). The EIB's climate turn is a paradigm shift toward policymaking and agency activism to satisfy the bank's rational interests of political and market relevance.

6. Conclusions

In a combined act in November 2019, the EIB 'metamorphosed' into a climate bank, while also announcing the launch of a new climate strategy and energy lending policy ending fossil fuel financing after 2021 and including targets and milestones. By pre-empting the EU official announcements concerning the Green Deal, which the EIB's 'pivot' is to support, and by using in parallel a rhetoric that deviates from the bank's customary discourse, the announcement constitutes a paradigm shift in the EIB's institutional behaviour. In this case, instead of its historical 'policy-taking' attitude, the EIB deliberately wished to take centre stage and enter the spotlight, a course usually taken by the policymaking actors within the EU governance. Furthermore, the act has not been justified by the bank's prior climate metrics, which at the time of the announcement were below those of some of the EIB's peers, and represented only a quarter of its aggregate annual lending, compared to half of the annual activity showcased by some of the peers. In this sense, the EIB's 'pivot' announcement diverges from the bank's path-dependent evolution and customary rhetoric, and as such, constitutes a 'quantum leap,' as stated by the EIB.

The article, therefore, argues that capitalising on its reputation, the EIB's resounding climate 'conversion' can be understood through its trend toward increased politicisation. The climate 'conversion' constitutes further evidence of the EIB's aspirations to make a more proactive contribution to EU policy objectives, as already revealed by several scholars. Demonstrating agency activism as a policy entrepreneur, the EIB used a policy window presented during a period of 'malaise' and fermentation in the run-up to major changes in the European economic governance set-up, to raise its profile for improved political and market positioning. Having grown to be the world's largest multilateral bank, a greener EIB agenda—consolidating and building on the bank's climate finance, renowned mainly due to its pioneering climate-related capital market activity—can have important implications for the economy, climate, and governance in the EU and beyond. However, whether the EIB's announcement will go beyond the 'quantum leap' in the bank's public appearance, to constitute a real metamorphosis, can only be benchmarked against the bank's future metrics. They will prove either a bold new departure from previous activity or simply an adaptation to a new European priority policy field, as has occurred on several occasions in the past.

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Conflict of Interests

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Article

‘Don’t Crunch My Credit’: Member State Governments’ Preferences on Bank Capital Requirements

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Abstract

Across Europe, banks remain, to this day, the main suppliers of finance to the European economy, but also a source of systemic risk. As such, regulating them requires that policymakers find an appropriate balance between restricting their risk-taking behaviour and increasing lending to support economic growth. However, the ‘varieties of financial capitalism’ that characterize national banking sectors in Europe mean that the adoption of harmonised capital requirements has different effects across countries, depending on the country-specific institutional setting through which banks provide lending to the national economy. This article conducts a new analysis of Member State governments’ positions in the post-financial crisis reform of the EU capital requirements legislation, expanding the scope of previous studies on the topic. Here, I examine in detail the positions of Member States on a wider set of issues and for a broader set of countries than the existing literature. Building on the varieties of financial capitalism approach, I explain these positions with regard to structural features of national banking sectors. I find that Member State governments’ positions reveal a general agreement with the proposed increase of bank capital requirements, while seeking targeted exemptions and preferential treatment that they deem necessary to preserve their domestic supply of retail credit.

Keywords

banking regulation; Basel III; Capital Requirements Directive; Capital Requirements Regulation; financial capitalism; financial crisis

Issue

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1. Introduction

On 27 March 2020, the Basel Committee on Banking Supervision, the international standard-setter for banks’ capital requirements, announced the deferral of implementation deadlines of the Basel III framework—adopted in response to the global financial crisis of 2008—to ensure “that banks and supervisors are able to commit their full resources to respond to the impact of Covid-19” (Basel Committee on Banking Supervision, 2020). As for the EU transposition of the final elements of the international standards, it seems that the European Commission (EC) has put on ice the legislative proposal amending the Capital Requirements Directive (CRD) and Capital Requirements Regulation that it was supposed to issue in June 2020.

This reaction to the emerging economic fallout of Covid-19 suggests policymakers, first, consider that banks should play an important role in fostering economic recovery, and second, fear that the planned tightening of capital requirements may be incompatible, in the short term, with said bank support of the real economy. How EU Member States face this perceived short-term trade-off is of particular importance in the context of Economic and Monetary Union. Economic and Monetary Union reforms in recent years (see e.g., Rehm, 2021) relied on the assumption that banking regulation—notably capital requirements—would, by

reining-in banks' excessive leverage, contribute to reducing the interdependence that tied together banks and public finances in a vicious circle and wreaked havoc on several Member States during the sovereign debt crisis (Merler & Pisani-Ferry, 2012). Nevertheless, the EU's transposition of the early parts of Basel III (known as CRD-IV) was criticised for watering down the international framework (Véron, 2013). Previous international political economy accounts of the negotiation have attributed much of this dilution to some Member States' demands for limiting the increase of capital requirements in order to protect the competitiveness of their respective banking sectors, but also to preserve short-term economic growth (see e.g., Howarth & Quaglia, 2013, 2016a).

This article pursues two objectives. The first is to provide a new examination of Member State positions on the CRD-IV reform, analysing a larger sample of countries than previous studies and delving into the technical detail of positions on a series of issues, some of which have not been examined before. Analysing the responses of fifteen Member States' national authorities to three EC preparatory consultations, I find that, instead of clear general preferences for tighter rules on bank capital or conversely, a general forbearance, each Member State's requests for preferential treatment focus on very specific instruments and institutions amid a general agreement with the necessity to increase bank capitalisation.

The second objective is to explain these particular positions. Important literature on Basel III and CRD-IV suggests that the lobbying of the banking industry—in particular by large, international banks—significantly shaped the debate on post-crisis capital requirements (e.g., Lall, 2012; Young, 2014). However, while many of the requested changes did benefit large banks, Member State positions and the wish list of international banks differ in important ways. International political economy, in turn, suggests that the 'varieties of financial capitalism'—that is, the country-specific institutional settings that characterise banking sectors—that coexist in Europe mediate Member State preferences on financial regulation (Story & Walter, 1997). Among relevant factors, previous studies have notably highlighted the role of bank capitalisation levels and bank-industry ties (Howarth & Quaglia, 2016a) and different degrees of foreign ownership (Spendzharova, 2012) in national banking sectors. Here I argue that, while these are relevant factors, in order to account for the detailed amendments the Member States requested, we must also consider the qualitative composition of banking sectors and the types of instruments on which retail lending relies.

The next two sections present the analytical framework (2) and methodological approach (3) of the article. I then examine Member State positions on CRD-IV, highlighting the conflictual issues and suggesting variables that explain these conflicts (4). I then discuss these findings in terms of 'varieties of financial capitalism' (5) and conclude (6).

2. Analytical Framework

International political economy has long framed policymakers' preferences on banking regulation as a 'dilemma' between two conflicting goals: financial stability through strict capital requirements and international competitiveness through reducing the cost of regulation of national banks (Kapstein, 1989; Singer, 2004). The economic downturn that followed the 2008 financial crisis added short-term economic growth to the list of concerns: Policymakers perceived that "trade-offs—perceived or real—might still have to be made and notably between financial stability and economic growth because, ceteris paribus, banks need to deleverage—and thus shrink their lending—to improve their capital position" (Howarth & Quaglia, 2016a, p. 206). There is however no consensus among economists about the relation between capital requirements, credit supply, and economic growth, and while in the short-to-medium term higher capital requirements are expected to increase the cost of credit for borrowers (Macroeconomic Assessment Group, 2010), higher capitalisation levels are likely to bring net long-term benefits in terms of GDP growth (Admati & Hellwig, 2013).

Here I assume that policymakers were aware of these debates as well as of the short-term costs and long-term benefits associated with higher capital requirements, but still perceived that a trade-off needed to be made between the long-term objective of a resilient banking sector and the short-term objective of maintaining a steady flow of credit to fight off the post-financial crisis recession. Whether, on a particular issue of banking regulation, Member States favoured one or the other depends, I argue, on the structural features of their national economies and banking sectors and the extent to which the proposal was likely to affect the supply of credit to the national real economy, particularly SMEs and households. This analysis then builds on the 'varieties of financial capitalism' approach (Story & Walter, 1997) and seeks to complement previous accounts of the CRD-IV negotiations.

In their respective works, Howarth and Quaglia (2013, 2016a) and Spendzharova (2012) have put forward three explanatory factors to account for Member State positions. Howarth and Quaglia explain the conflict between the Franco-German tandem and the UK on the level of minimum capital ratios in terms of systemic patterns of bank capital (different levels and composition) and bank-industry ties (degrees of real economy reliance on bank credit). Spendzharova, focusing on Central and Eastern European (CEE) countries, shows how the predominance of foreign ownership in those countries' banking sectors made their governments fearful of foreign banks depleting local subsidiaries in order to repatriate funds to the home country in case of trouble.

Following a similar approach, I argue that, in order to account for the specific exemptions and preferential treatments the Member States requested, we must

also take into account the types of banks that dominate each country's banking sector and the particular instruments on which they rely to supply credit to the real economy. Indeed, banks of different sizes (small local banks vs. large banking groups) and legal forms (joint stock vs. cooperative, mutual, savings, and public banks) which rely on different sets of financial instruments would be affected in very different ways by the Basel III rules. Where each country stands in relation to these structural factors is then likely to shape in important ways how their common double preference for stability and growth translates into positions on specific policy proposals. This is not to say that Member State positions are fully determined by economic and banking sector structures—the different levels of politicization (Högenauer, 2021), as well as different sets of value-based ideas (van Loon, 2021) of financial regulation issues across Member States, also contribute to shaping positions—but that these largely determine the material interests at stake in capital requirements. The analysis presented in this article should thus be seen as a complementary contribution to the fruitful research agenda on national preference formation about international financial regulation. The next section will detail which countries constitute the sample, as well as the CRD-related issues chosen for analysis. Section 4 will then outline, for each of the six selected issues, the positions adopted by Member States.

3. Methodological Approach

The focus of this article on Member State governments is justified, I believe, first by the central role that governments play in the policymaking process for capital requirements at the international and European level, and second by the fact that they remain, ultimately, responsible for macroeconomic stabilisation. I choose to extract Member State governments' positions on reform proposals from the written comments they submitted in response to three public consultations conducted by the EC in 2008, 2009, and 2010. These documents have the advantage (when compared to collecting positions through interviews or a review of press coverage) that they emanate directly from the national representatives involved in the negotiation, offering a detailed view of positions which have not been subject to any posthoc reinterpretation. Furthermore, because they all respond to the same set of EC questions, they facilitate the cross-country comparison of positions on a given set of issues.

The period 2008–2010 corresponds to the preparatory works for the EC's 2011 CRD-IV proposal, which the EC conducted in parallel to the elaboration of the Basel III standards. In this article, I limit the analysis to six broad issues: definition of capital, large exposures, liquidity standards, leverage ratio, treatment of mortgage loans, and supervisory arrangements. These constitute only a subset of all the issues consulted during the period but were selected for the potential of conflict among Member States on the degree of stringency vs. leniency and the degree of harmonisation vs. national discretion that the new framework should permit.

15 EU Member States are analysed (see Table 1). The selection includes all the Member States whose government (Treasury department) submitted an answer to at least one of the three consultations. 14 out of the 27 EU Member States provided comments at the time, but of these, I excluded Slovenia and added Italy and Spain. The 2008 Slovenian response did not address any of the substantial issues raised by the consultation—only one minor technicality—and could not be used

Table 1. Commenting national authorities.

Country/Year (issues)	2008 (large exposures; supervisory arrangements)	2009 (definition of capital; mortgages; supervisory arrangements)	2010 (definition of capital; liquidity; mortgages; supervisory arrangements)
Austria	Treasury/CB/Supervisor*	Treasury/CB/Supervisor*	Treasury/CB/Supervisor*
Czechia	Treasury	CB	Treasury
Denmark	Supervisor	—	Treasury/Supervisor
Estonia	—	CB	Treasury/CB/Supervisor*
Finland	Treasury	Treasury	Treasury
France	Treasury/FSA*	Treasury	Treasury/CB/Supervisor*
Germany	Treasury	Treasury/CB/Supervisor*	Treasury
Hungary	Treasury/CB/Supervisor*	Treasury/CB/Supervisor*	Treasury/CB
Ireland	—	—	Treasury
Italy	—	—	CB
Poland	Treasury/FSA*	—	Treasury
Slovakia	CB	—	Treasury/CB*
Spain	CB	CB	CB
Sweden	Treasury/CB/Supervisor*	—	Treasury/CB/Supervisor*
UK	—	Treasury/CB/Supervisor*	Treasury/CB/Supervisor*

Notes: CB = Central Bank; * = Joint submission; — = No submission. The documents are available with the article's Supplementary File.

to extract positions. Although there were no Italian or Spanish government responses available, I include these two countries using responses by their respective central banks as a proxy, supplemented by a review of finance ministers' public statements. With these additions, the selected countries constitute a representative sample of EU Member States, including in particular both large and small banking sectors with a variety of banking sector structures.

We should note that the absence of published comments from a government does not imply that it takes no position: A government may have required that its comments not be published or may have used another way, other than the consultation, to convey its views on the proposals (e.g., Council meetings). For reasons of comparability across different methods for collecting positions, I chose to limit the analysis to countries for which responses were available, Italy and Spain constituting the only exceptions which were partly compensated for by their central banks' responses.

To analyse positions, I first extracted from each document the sections devoted to each of the six issues and summarised them. The Supplementary File provides the reader with this summary of each country's position for each of the six issues. In a second step, I applied a "constant comparative method" (Glaser & Strauss, 1967, pp. 101–116) to identify similarities and differences across responses, thereby identifying recurrent themes and oppositions. The result of this process is presented in Section 4.

4. Member State Positions

4.1. Definition of Capital

At its core, the Basel framework defines how much of a bank's assets (its various investments and the loans it distributes) must be funded through financial instruments that contractually are able to absorb potential losses arising from borrowers defaulting or bad investments both during the life of the bank ('going-concern') and in case of failure ('gone-concern'). These loss-absorbing instruments constitute banks' 'capital.' Regulatory capital is broader than the equity held by its shareholders, and also include a series of debt securities. Defining bank capital then implies listing the instruments that are sufficiently loss-absorbent to be part of the capital base, which in Basel III, is divided into three buckets: common equity tier 1 (CET1), the most loss-absorbent and broadly corresponding to common shares or equivalents; additional tier 1, which includes debt instruments that can be written-down to absorb exceptional losses on a going-concern basis; and tier 2, which includes debt securities to be written down only in case of failure. Furthermore, 'prudential adjustments' have to be made to amounts of eligible instruments to account for particular situations that may make part of the capital base unavailable to absorb losses.

On eligibility criteria, the most recurrent theme regarded the limitation of CET1 to common shares. Pre-crisis, Member States could adjust the CRD rules to local specificities in the national transposition, thus definitions of core capital varied importantly across countries. The harmonisation on a common shares model would significantly affect banking sectors where non-joint stock banks (the various forms of banks whose core capital is not composed of traditional public listed shares, notably cooperatives, mutuals, savings banks and a number of public banks) are important actors, since these banks would have to either change their legal structures to meet the new requirements or disappear. The countries calling most forcefully in defence of non-joint stock banks' capital instruments were, unsurprisingly, those where non-joint stock banks represent a large part of the banking sector: Austria and Germany above all, followed by Finland and France. In 2016, more than half of the Other Systemically Important Institutions (O-SIIs)—that is, domestic systemically important banks—in those countries were either public banks (e.g., several German *Landesbanken*), or the central institutions of cooperative and savings banks (e.g., Austria's Raiffeisen Bank International, France's *Groupe Crédit Mutuel*, or Germany's *DZ Bank*, see Table 2), which shows their importance not only in terms of their size but also in terms of their centrality in the domestic economy. Illustrating the cost of harmonisation, Germany also made a plea for temporarily maintaining the possibility to include in tier 2 cooperative bank members' uncalled commitments which until then had been allowed under German law but excluded under Basel III and which constitute an important part of German cooperative banks' capital. By contrast, those countries that have no non-joint stock bank among their

Table 2. Systemic importance of non-joint stock banks (2016).

Country	Number of non-joint stock banks to total number of O-SIIS (pure numbers)
Austria	5/7
Czechia	0/7
Denmark	0/6
Estonia	0/2
Finland	2/4
France	4/6
Germany	9/14
Hungary	2/8
Ireland	0/7
Italy	0/3
Poland	2/12
Slovakia	1/5
Spain	0/6
Sweden	1/4
UK	1/16

Source: European Banking Authority (2016).

O-SIIs did not insist on the issue and merely mentioned the need to make the criteria compatible with different legal structures. The 2010 reform of the important Spanish *Cajas* sector, which transformed them into joint-stock banks largely explains why Spain did not voice concerns on this issue.

On prudential adjustments, the full deduction of 'minority interests' (capital instruments held by minority shareholders of a banking group subsidiary) was opposed by a diverse set of countries: Austria, Czechia, Denmark, Finland, France, Hungary, Italy, Slovakia, and Spain. The deduction would affect banking groups by reducing the contribution of subsidiaries to groups' 'consolidated' (i.e., aggregate) amounts of capital. For Austria, France, Italy and Spain—home to several internationalised banking groups—important amounts of minority interests (see Table 3) reflect a strategy to raise capital for the group through subsidiaries. Considering the generally low levels of bank capitalisation in those countries, minority interests were then to constitute an important resource to meet the increased capital requirements. Similarly, France—the land of the *bancassurance* model of financial conglomerates—forcefully opposed the deduction of investments in insurance subsidiaries which would also have impacted the capital ratios of all its major banking groups (International Monetary Fund, 2011). By contrast, the UK's large banks, being better capitalised than their continental peers (HSBC, Lloyds and Barclays all had above 10% of CET1 capital at end-2010, to be compared to 8.1% for France's Société Générale, 7.8% for Italy's UniCredit and 7.1% for Spain's Santander; European Banking Authority, 2011), did not need to rely on minority interests. Czechia, Hungary, and Slovakia, in turn, are in this debate hosting the subsidiaries raising minority interests (see Table 5) and highlighted in their comments the risk that the deduction would create an incentive for groups to undercapitalise local subsidiaries.

4.2. Large Exposures

So called 'large exposures' are a bank's exposures to a single client or group of connected clients that could put the bank's solvency at risk in case of that client failing to repay. Limits on large exposures existed in the pre-crisis CRD to penalise such exposures but included a number of options for Member States to grant exemptions, in particular to intra-group (between entities of the same banking group) and certain interbank (between two independent banks) transactions. In 2008, the EC suggested strengthening the regime and consulted on withdrawing options and exemptions. Limits on intra-group transactions are especially relevant for banking groups, as they limit their freedom to shift capital and liquidities from one group entity to another. Limits on interbank transactions are crucial for decentralised banking networks (those where members of the network are independent of each other but share a brand and some central institutions, for example, the German *Sparkassen*) inasmuch as they impact liquidity management within the network as well as more generally for banks' daily liquidity management, since banks may need to borrow or lend large amounts on the interbank market.

Among the responding countries to the 2008 consultation, we find two overlapping groups supporting a more lenient regime. One was composed of the countries whose banking sector includes important decentralised banking networks and was eager to maintain exemptions for claims on central institutions of decentralised banking networks and on transactions where both parties are part of a joint risk-management or institutional protection scheme, which usually is the case of decentralised banking networks. The second group includes countries that are home to large banking groups and called for maintaining the options to exempt intragroup transactions between entities submitted to the same consolidated supervision. Austria is part of the first group; Denmark,

Table 3. Capital ratios and minority interests (2010).

Country	Solvency ratio (%)	Tier 1 ratio (%)	Minority interests to total equity (%)
Austria	13.20	9.98	15.07
Czechia	15.25	13.61	2.07
Denmark	16.24	14.07	3.45
Estonia	16.29	12.69	0.02
Finland	14.56	13.73	0.23
France	12.56	10.76	8.74
Germany	15.28	11.41	2.30
Hungary	14.09	11.55	NA
Ireland	14.50	11.56	1.33
Italy	12.06	8.66	4.46
Poland	14.01	12.59	0.64
Slovakia	12.53	11.38	NA
Spain	11.89	9.65	6.58
Sweden	12.24	10.65	0.19
UK	15.86	10.86	5.47

Source: European Central Bank (2021).

France, Spain, and Sweden of the second; Germany and Finland are part of both. Furthermore, countries with highly concentrated banking sectors, France and Sweden, expressed concerns about liquidity management and a possible destabilisation of the interbank market unless further exemptions were made. Finally, Poland and Czechia joined Austria, Sweden, and Germany in welcoming the exemption for smaller transactions.

Conversely, Czechia and Slovakia, two countries with foreign-dominated banking sectors (see Table 5), called for maintaining the national discretion to impose more restrictive limits on large intragroup transactions. This discretion was necessary, they argued, to prevent local subsidiaries from being exposed to the failure of group entities in other Member States. Sweden, conversely, strongly opposed such discretion, warning that national authorities could use it for ring-fencing at the expense of efficiency.

4.3. Liquidity Requirements

Liquidity standards were discussed in the 2010 consultation. Few countries had liquidity requirements in place before the crisis and there were none in international or European standards before Basel III and its transposition. Liquidity standards apply essentially on the assets side of banks' balance sheets: They require banks to hold reserves of 'liquid' assets, that is, assets that can be sold for cash immediately, even in times of crisis, without incurring any significant loss. While the liquidity coverage ratio aims to ensure that banks maintain a liquidity buffer sufficient to withstand a one-month-long market stress, the net stable funding ratio requires banks to match their long-term lending commitments with corresponding long-term funding sources.

In relation to the liquidity coverage ratio, the main issue was listing the assets liquid enough to be included in the buffer, the so-called 'high-quality liquid assets' (HQLAs). Initial proposals essentially restricted eligibility to government bonds and stable deposits, a position supported by the UK and Estonia, but opposed by most other responding Member States (Austria, Czechia, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, and Sweden), who called for the larger inclusion of additional assets. This conflict can easily be understood by looking at levels of liquid asset holdings across countries (Table 4). The British and Estonian banking sectors were still in 2014 (earliest data published by the European Central Bank) the ones with the highest share of liquid assets in total banking sector assets (above 30%), and Estonia—unlike the other countries—already had tight liquidity requirements in place before the CRD-IV reform. Conversely, almost all the proponents of a more inclusive HQLA buffer (Austria, Czechia, Denmark, Finland, France, Germany, Hungary, Ireland, and Sweden) had ratios of liquid assets to total assets below 20%, and some far below (Austria). For those countries, a liquidity coverage ratio with a narrow HQLA definition would force banks to massively shift assets away from less liquid but productive assets, typically those funding the real economy.

For the pro-inclusion countries, HQLAs should notably include more covered bonds. Covered bonds are a particular form of securitisation where the pool of securitised assets is, in most cases, restricted to mortgage loans. These market-based assets developed at an exceptional rate across Europe since the early 2000s to supplement insufficient deposits in meeting mortgage lenders' funding needs (Johnson, Isgrò, & Bouyon, 2016, p. 7). Denmark and Sweden were the most vocal on this issue, stressing the stability of covered bonds

Table 4. Covered bonds and liquid assets.

	Outstanding covered bonds (% of total banking sector liabilities)			Liquid assets (% of total banking sector assets)
Country/Year	2008	2012	2018	2014
Denmark	28.7	41.8	50.3	10.5
Sweden	10.5	14.1	18.8	12.4
Spain	9.7	12	7	13.4
Germany	8.3	7.2	5.6	13.11
Slovakia	6.2	7.8	6.6	23.9
Czechia	5.9	5.6	5.5	NA
Hungary	5.7	5.1	3.4	16.37
Ireland	4.8	5.6	6.0	26.39
France	3.8	5.6	4.8	15.46
UK	2.5	1.9	1.1	31.11
Austria	2	4	6.6	5.6
Finland	1.6	4.6	5	16.6
Italy	0.6	4.8	6.9	11.8
Poland	0.3	0.3	1.3	18.5
Estonia	0	0	0	39.22

Sources: European Central Bank (2021); European Covered Bonds Council (2020); author's calculation.

through the financial crisis, their importance for (mortgage) banks' funding and the likely destabilising effect on covered bond and mortgage markets should they be excluded. In Denmark, the entire mortgage credit system—the defence of which in CRD-IV was "absolutely central" for finance minister Brian Mikkelsen ("Minister diskuterer," 2010)—relies on covered bonds. The fact that the EC specifically asked about covered bonds in its consultation is already evidence of their importance in European banking. As can be seen from Table 4, covered bonds constitute an important source of funding for banks, upon which they increasingly relied through the crisis years. Germany's stance on the issue should, for instance, be seen in light of the fact that their reliance on the stable *Pfandbriefe* market enabled German savings and cooperative banks to maintain lending levels through the crisis (Hardie & Howarth, 2013a). The Basel-proposed cap on covered bonds in HQLAs would have depressed market demand for these assets, drying up an important source of refinancing for mortgage loans. By contrast, Spain's large covered bond market, which made possible the *Cajas*' frenzy of real-estate lending (Royo, 2013), was bound to adjust, which may explain the *Banco de España*'s silence regarding their inclusion in HQLAs.

Countries with important non-joint stock banking sectors also called for different types of preferential treatment for them. Germany called for the inclusion of "debt securities fully guaranteed by sovereigns or…securities of promotional banks under public ownership" (Bundesministerium der Finanzen, 2010, p. 2; see Supplementary File), that is, securities issued by its *Landesbanken*. Austria, Poland, and Slovakia, which all have cooperative or savings banks' central institutions among their systemically important institutions, asked for cooperative banks' deposits in their central institutions to be recognised as 'stable,' therefore contributing more to these institutions' stock of HQLAs.

On the net stable funding ratio, only Estonia defended a more conservative treatment than that proposed by the EC. All the other respondents to the 2010 consultation warned of its potentially destabilising effect on lending. Indeed, since it requires banks to balance the maturity of their liabilities and assets, it effectively forces banks to either reduce their reliance on short-term wholesale funding or limit their lending to and investments in long-term assets, notably loans to corporates and households, that is, the real economy. The UK authorities (HM Treasury & Bank of England, 2010, p. 7; see Supplementary File) thus warned that the ratio "could significantly disadvantage SME and retail loans relative to lending to large highly-rated corporates." It then sided with Austria, Germany, and Slovakia in calling for more favourable treatment of retail lending in terms of the stable funding required. Regarding the provision of stable funding, countries with important networks of independent cooperatives (Austria, Germany, but also Hungary, Poland, and Slovakia) called for preferential treatment of these banks' deposits with their central institutions. Calls for preferential treatment of covered bonds were also made, in particular by Austria, Denmark, France, and Germany.

The choice of the level of application (entity-level or consolidated level) and the proposal to shift the supervision of cross-border branch liquidity to the home-country supervisor were two issues marked by opposition between CEE Member States plus the UK, and the other governments. While the latter supported shifting decision-making power to the home-country supervisor (supervising the group) on liquidity issues, the former insisted on preserving the freedom of the host-country supervisor (supervising a subsidiary) to impose the respect of liquidity coverage ratio and net stable funding ratio at the level of branches and subsidiaries. Observing the varying degree of foreign ownership in national banking sectors (Table 5) helps make sense of

Table 5. Foreign ownership of national banking sectors.

Country	Foreign-owned assets in total banking sector assets (2009, %)	Foreign O-SIIs to total number of O-SIIs (2016, pure numbers)
Estonia	99	2/2
Slovakia	88	4/5
Czechia	86	5/7
Poland	68	9/12
Hungary	64	5/8
Ireland	56	4/7
Austria	20	1/7
Denmark	20	1/6
UK	15	12/16
Germany	12	2/14
France	6	0/6
Italy	6	0/3
Spain	2	0/6
Sweden	0	0/4

Source: Claessens and van Horen (2012, p. 34); European Banking Authority (2016).

this divide: CEE banking sectors are characterised by a dominance of foreign banks, which own between a third and nearly all of total banking sector assets, and foreign banks constitute a major source of systemic risk in those countries, where they represent the majority of O-SIIs. The British banking sector is in a similar situation of exposure to foreign banks' systemic risk, with 12 out its sixteen O-SIIs being foreign-owned. By contrast, those countries supportive of home-country supervision are predominantly—Ireland being the exception—home to internationalised banking groups and little exposed to foreign banks.

4.4. Leverage Ratio

A leverage ratio requirement was a novelty introduced with Basel III: It is intended to act as a complement to risk-based capital requirements by setting a maximum nominal amount (not risk-weighted) of assets that a bank can acquire with its capital base. The most controversial issue was whether the new requirement should be a binding minimum (Pillar 1) or an indicator upon which supervisors could impose additional capital requirements if necessary (Pillar 2). A binding leverage ratio was expected to particularly affect undercapitalised banks, but the risk-insensitiveness of the measure was also expected to put relatively safer banking activities, notably traditional deposit-taking and retail lending, at a disadvantage: under the leverage ratio, they would 'cost' as much capital as riskier activities through yielding less income. The Swedish authorities (Regeringkansliet, Finansinspektionen, & Sveriges Riksbank, 2010, p. 4; see Supplementary File), for instance, thus considered it "important that a leverage ratio is not designed and calibrated so that it endangers the supply of mortgage credit to Swedish households."

Table 6. Leverage (2011).

Country	Total assets to total equity ratio (pure numbers)
Finland	26,09
Germany	25,70
Sweden	24,14
Denmark	21,12
France	21,08
UK	20,54
Ireland	17,67
Spain	17,39
Italy	14,91
Austria	14,71
Hungary	13,53
Czechia	11,81
Poland	9,90
Slovakia	9,38
Estonia	8,12

Of the respondents to the 2010 consultation, only the UK unambiguously argued in favour of a binding ratio. At the other extreme, France and Germany forcefully rejected the proposal, denouncing its likely unintended effects on bank lending. All the other respondents (Austria, Denmark, Estonia, Finland, Hungary, Poland, Sweden) argued for an introduction in Pillar 2. Beyond average leverage levels across countries (Table 6), understanding the opposition requires one to consider the parallel effect of proposals on the definition of capital, notably the deduction of minority interests and investments in insurance subsidiaries (see above) that would reduce the capital base of continental European banks more than that of their British competitors.

4.5. Treatment of Mortgage Loans

The 2009 and 2010 consultations contained proposals to reform the prudential treatment of mortgage loans (loans that are guaranteed by commercial or residential real estate) and in particular the conditions for granting them a preferential treatment under the form of a reduced 35% risk weight to part of the loan (i.e., only 35% of the amount would count towards the bank's risk-weighted assets). The pre-crisis framework gave Member States an important degree of discretion to decide which loans could benefit from the preferential treatment. The EC proposed setting a harmonised condition under the form of a maximum loan-to-value ratio: The preferential risk-weight could be applied to the lent amount only up to a certain threshold relative to the value of the mortgaged real-estate property (40% in the 2009 proposal, 80% in 2010); the remaining amount would be applied a much higher risk weight (1,250%) in order to discourage lending to highly leveraged clients.

Respondents to the 2009 consultation unanimously rejected the proposed 40% loan-to-value ratio, denouncing its likely impact on mortgage credit supply. Indeed, the proposal would have led to most mortgage loans being more costly for banks (more regulatory capital), who would pass the extra cost to clients. In 2017, across the sample of countries, mortgage loans represented on average 42.82% of all bank loans and advances (European Central Bank's Statistical Data Warehouse), ranging from 18.35% (France) to 61.62% (Estonia). The emergence of mortgage lending in Europe since the 1990s owes a lot to favourable legislation (Johnson et al., 2016) and has become an essential instrument for home ownership. In 2017, more than a third of homeowners had a mortgage in Denmark, France, Finland, Sweden, and the UK, with CEE markets are quickly catching up (European Mortgage Federation, 2019, p. 40). The cost increase would then affect the masses, which may explain why even in a country like Spain—where a real-estate bubble brought about a banking crisis—was reluctant to increase requirements on all mortgages (Banco de España, 2009, 2010; see Supplementary File). In 2009, the EC also suggested tightening specifically

the treatment of mortgage loans denominated in a foreign currency. The issue was taken up only by the three responding CEE countries: Czechia, Estonia, and Hungary, who criticised the harshness of the proposals, whereas Austria welcomed them. Estonia and Hungary notably called to differentiate loans denominated in euros from loans in other currencies, the exchange rate risk being lower with the former.

The 2010 proposal for an 80% loan-to-value, more in line with industry practices, was more welcome. However, all respondents rejected the proposal to align the treatment of residential real-estate mortgages on that, more demanding, of commercial real-estate mortgages. The heterogeneity of European real-estate markets sparked calls from Denmark, Germany, Poland, Sweden, and the UK to maintain a certain degree of national discretion. The German government (Bundesministerium der Finanzen, 2010, p. 24; see Supplementary File) thus invoked the "particular importance of RRE [residential real-estate] financing" in its call to retain existing options. Only France, whose banks rely comparatively less on mortgages and which have large foreign retail activities, explicitly welcomed full harmonisation.

4.6. Supervisory Arrangements

Proposals regarding the degree of freedom granted to national authorities—legislator and supervisor—to adapt EU standards to banks active in their jurisdiction saw a clear opposition appear between 'home' and 'host' countries. The EC notably consulted in 2008 on 'colleges of supervisors' for cross-border banking groups. Czechia, Hungary, Poland, and Slovakia (the four 'host' countries; see Table 5) responded: First, by forcefully defending guaranteed rights for host-country supervisors to participate in colleges, against the proposal to leave the home-country supervisor to decide on the composition and, second, they called for the limiting of colleges' decision-making powers, not to impinge on host-country supervisors' competences. Among these 'home' countries the positions varied: Austria and Finland agreed on the issue of composition, while France called for granting a strong decision-making role to colleges and an important role for the consolidating supervisor within them. In 2008, the criteria for designating branches of foreign banks as 'systemically important' were also discussed. The EC proposed additional rights for host-country supervisors, which Slovakia and Poland explicitly welcomed, although Poland called for a lower threshold (branch deposits to total banking sector deposits) for considering a branch as systemically relevant. Conversely, Germany opposed shifting additional branch supervision powers to host-country supervisors, and Finland and Sweden opposed any threshold lower than 5% of a national banking sectors' total deposits.

The 2009 and 2010 consultations furthermore suggested the removal of most of the existing options and national discretions in the CRD and the maximum harmonisation of Pillar 1 requirements across the EU. This move to maximum harmonisation would deprive national authorities of the possibility to adapt European standards to local circumstances. France was the most vocal supporter of maximum harmonisation, which Denmark, Finland, and Germany also welcomed. Austria and Ireland equally supported the removal of options and national discretions, with the exception of real-estate. Conversely, Estonia, Hungary, Poland, the UK (which I consider as a 'host' country due to the importance of foreign O-SIIs in its banking sector), but also Spain and Sweden rejected maximum harmonisation for the sake of financial stability, doing so both individually (in their responses to public consultations) and collectively in a letter to Commissioners Michel Barnier and Olli Rehn (Djankov et al., 2011).

As with liquidity requirements and large exposures, CEE countries' and the UK's opposition to transfers of supervisory competence and reduction of national discretion appear motivated by the need to ensure against the systemic risk posed by the important operations of foreign banks within their jurisdictions. The link that CEE responses establish between national discretion and national responsibility for financial stability (e.g., Ministry of Finance of Estonia, Bank of Estonia, & Estonian Financial Supervisory Authority, 2010, p. 13; Hungarian authorities, 2008, p. 1; Polish Ministry of Finance & Polish Financial Supervision Authority, 2008, p. 2; see Supplementary File) illustrate Spendzharova's (2012, p. 319) observation that these governments "were not apprehensive about transferring power to the supranational level per se. They did worry, however, about the fiscal and accountability consequences." Czech finance minister Miroslav Kalousek thus stated in May 2012: "There was a danger that the bank's regulator abroad would have more power over banks than the Czech supervisor….This could mean that parent banks could vacuum the Czech branches" ("EU: Na banky," 2012). Spain and Sweden, conversely, are among the countries least exposed to foreign banks, and their particular opposition to maximum harmonisation (but not to home supervision) finds its roots in their respective choice to increase capital requirements nationally to fight off domestic banking crises (in Sweden in the 1990s and in Spain with the *Cajas* from 2009).

5. Discussion of Results

We can already see governments' will to find a compromise between reducing bank leverage and preserving retail lending in the French and British attempts to impose retail-lending targets in exchange for bailouts (Jabko & Massoc, 2012; Macartney, 2014). A review of finance ministers' public statements around the time of the CRD-IV negotiation further reveals their fear that Basel III "risk[ed] threatening the financing of the economy" ("Christine Lagarde," 2010). Already in July 2009, Germany's Peer Steinbrück advocated a relax-

ation of Basel II rules so that banks could increase lending to avoid a credit crunch ("Regierung und," 2009) and Austria's Josef Pröll reformed national taxes on banks to make retail lending a comparatively more attractive business ("Neuer Zwist," 2010). For Italy's Giulio Tremonti "Basel 3 [was] the direct way to produce a credit crunch" ("Banche: Tremonti," 2010) and Germany's Wolfgang Schaüble summed up the general mood stating: "We want a tightening of the rules [but] the financial sector must be in a position to continue to carry out its business" ("Highlights-Comments," 2010). As we could see in the previous section, this general will to find a compromise between strengthening financial stability and preserving lending however led Member States to adopt contrasted positions, which reflect the 'varieties of financial capitalism' (Howarth & Quaglia, 2013; Story & Walter, 1997) that persist in Europe.

Across the issues examined above, we could thus see the importance of the qualitative composition of national banking sectors—in terms of the legal form of banks that dominate them and whether they adopt the form of large, consolidated groups or decentralised networks—in shaping Member States' wish list. Indeed, the presence of (systemically) important cooperative, savings or public banks in countries such as Austria, Germany, France, but also Hungary or Poland is reflected in their insistence on exemptions and exceptions tailored to those particular types of bank, which have been shown to constitute important sources of finance for the local economies where they are established (Ayadi, Llewellyn, Schmidt, Arbak, & De Groen, 2010; Groeneveld, 2014). In June 2010, Austria's finance minister Josef Pröll explicitly linked his call for favourable treatment of cooperative banks to avoid a credit crunch ("Bankenabgabe kommt," 2010). Similarly, countries whose banking sectors are concentrated on a few large, internationalised national champions responsible for a major share of retail lending (e.g., France and Sweden) were keen to support these champions.

The particular instruments banks use to provide credit to corporates and households also appeared as key factors. The unanimous rejection of a sharp tightening of the treatment of mortgage loans reflected the importance of that particular form of credit in all sampled Member States, with those Member States where a majority of loans are mortgages (Estonia, Denmark, Sweden) making the most critical comments. Similarly, the strongest defence for covered bonds came from the countries where covered bonds markets are the most developed and stable (e.g., Denmark, Sweden, Germany). The particular defence of covered bonds may be interpreted in view of the fact that these instruments are specifically designed to support mortgage lending—hence help maintain lending levels—and were resilient through the financial crisis, so their inclusion would not jeopardize the pursuit of financial stability.

Finally, on issues related to the distribution of competences between home—and host-country supervisors and to harmonisation vs. national discretion, we can see a divide among Member States that reflects the varying importance of foreign bank operations across national banking sectors. The general reluctance of host countries (countries where foreign banks dominate the banking sector in terms of total assets or systemic importance; see Table 5) to give up national discretion reflect their exposure to the risk that foreign parents repatriate resources to the home country in times of crisis to benefit from nationally-oriented bailout schemes (Roubini & Setser, 2004), closing local subsidiaries or forcing them to deleverage rapidly, both resulting in a sharp decline of local credit supply. Host countries' insistence on national discretion can then also be interpreted as reflecting the general will to balance banks' contribution to the growth of the national economy with the systemic risk they represent.

6. Conclusions

In this article, I sought to examine the detailed positions of EU Member States on the post-crisis reform of capital requirements and to suggest factors that may explain these positions. In so doing, I have shown the importance of a series of structural features of national banking sectors (diversity of banking sector compositions, types of instruments used for retail lending, and varying degrees of foreign ownership) for Member States' assessment of policy proposals. I find that in most of the examined cases these factors explain the particular positions expressed by Member States. As such, my findings confirm the relevance of 'varieties of financial capitalism' (Howarth & Quaglia, 2013, 2016a; Story & Walter, 1997) for our understanding of conflict between EU Member States on issues of financial regulation: the particular institutional setting on which each national banking sector relies to supply credit to the real economy mediates governments' double preference for stability and growth, resulting in sometimes conflicting positions.

Covering only a subset of EU Member States and CRD-related issues, this analysis is necessarily limited and the explanation it provides for positions should be seen as complementary to other international political economy accounts. Further research is likely to uncover additional dimensions of Europe's 'varieties of financial capitalism' that shape Member State positions in important ways. Furthermore, since 2010, important events have occurred with major consequences for the setting of capital requirements. Banking Union, first, redistributed banking supervision and financial stability responsibilities, affecting perceived trade-offs between stability and growth (Epstein, 2017; Howarth & Quaglia, 2016b). Second, if after Brexit the UK adopts a deregulatory agenda on finance, the goal of promoting the competitiveness of their national champions may regain importance for the remaining Member States home to internationalised banks.

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Conflict of Interests

The author declares no conflict of interests.

Supplementary Material

Supplementary material for this article is available online in the format provided by the author (unedited).

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Article

European Financial Governance: FTT Reform, Controversies and Governments' Responsiveness

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Abstract
The Eurozone crisis exposed the incompleteness of the Economic and Monetary Union's governance framework thereby prompting the promotion of a multitude of reform packages and proposals. This simultaneously induced conflict among EU governments on both design and content of such reforms. In case of the financial transaction tax (FTT) proposal, which failed to garner consensus among member governments, it illustrates Ireland's disapproval clashing with favorable German and French stances. While these governments aligned on the necessity to reform, the process of harmonizing EU financial governance proved rather difficult. In analyzing governments' variation of reform support or opposition, the societal approach to governmental preference formation is employed. This is considerably conducive in directing academic attention to the role of two explanatory variables, domestic material interests and value-based ideas, in shaping governments' reform positions. This article encompasses a comprehensive comparative account of domestic preference formation and responsiveness of three EU governments (France, Germany and Ireland), in the case study of the FTT, and demonstrates that the two societal dynamics are prone to have played a role in shaping financial reform controversies. By building on and contributing to Eurozone crisis literature, this approach seems appropriate in analyzing financial governance reform due to the crisis' domestic impact resulting in increased public salience, issue politicization and an advanced role of elected politicians.

Keywords
domestic politics; financial regulation; financial transaction tax; France; Germany; government preferences; Ireland; political argumentation

Issue
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1. Introduction

The outbreak of the financial and Eurozone crisis in 2010, highlighting the deficiencies of the Economic and Monetary Union (EMU) governance framework, led to a swift consensus amongst the heads of state and government of the European Union (EU) "to restore the soundness and stability of the European financial system" (European Council, 2010, p. 6). Although the necessity to act sparked immediate response, in the form of the European Commission proposing multiple reform packages and proposals, Burns, Clifton, and Quaglia (2018, p. 372) argue that no considerable alterations have been undertaken at reforming financial regulation: "EU post crisis financial regulation underwent only incremental change, rather than transformation." While the financial and Eurozone crisis immediately increased financial regulation's salience and called for prompt substantial action, considerations on financial reforms' acceleration and design oftentimes induced controversies between individual member governments (van Loon, 2018). Due to the unanimous decision making procedure several governments acted as veto players in delaying or blocking reform proposals on the EU level. One considerably

contested reform proposal, which failed to garner consensus among member governments and still lingers in the reform pipeline, the financial transaction tax (FTT), serves as a case in point. The FTT, as an instrument of regulating the financial market, will have an influence on the banking sector in the EU in particular, and shape the overall outcome of the banking union (Högenauer, 2021). It was disapproved by Ireland (Hardiman & Metinsoy, 2019) clashing with favorable German and French stances (van Loon, in press). Consensus and desirability for financial regulation reform have thus, at times, been severely constrained.

In explaining governments' variation of reform support or opposition, a turn to the domestic level of European financial governance demonstrates that these governments equally faced potential veto players *within* their countries' societies. Pursuing the line of reasoning that the urgent, uncertain threatening crisis situation advanced political contestation, a so-called politicization (De Wilde, Leupold, & Schmidtke, 2016) created a particular change from quiet to noisy politics inducing (1) an increase of governments' responsiveness to citizens' demands, which simultaneously led to (2) a decrease of interest groups' ability to shape a government's position (Culpepper, 2012). This mirrors a process leading away "from permissive consensus towards constraining dissensus," while spilling "beyond interest group bargaining into the public sphere" (Hooghe & Marks, 2009, p. 5). Heated public discussions, generated by the immediate spotlight on EMU's weaknesses, paired with its increased issue salience, induced a broad actor plurality, ranging from business associations and trade unions to non-governmental organizations (NGOs) and voters, favoring or opposing reform proposals during EU level negotiations (Kastner, 2018). Assessing domestic level societal dynamics shaping governments' preference formation, and thus reform positions, is a vital preceding component in comprehending how and why these positions were pursued at the EU level. Examining domestic preference formation is hence of importance when accounting for past, current, and future governments' positions towards EU reforms.

Whereas some studies put the positions of member *states* at center stage in explaining Euro crisis decision making (Degner & Leuffen, 2019a; Schoeller, 2018), other research involves positions of member *governments* in EMU reform, whereby these largely reflect single country case studies on France (Rothacher, 2015), Germany (Degner & Leuffen, 2019b), Italy (Bull, 2018), Ireland (Hardiman & Metinsoy, 2019) or the UK (Kassim, James, Warren, & Hargreaves Heap, 2020). These studies examine whether governments' preferences are mainly determined by so-called structural economic factors or by political considerations (Tarlea, Bailer, & Degner, 2019), or by a "battle of the systems" and a "battle of ideas" (Van der Veer & Haverland, 2019, p. 1399). Through application of the societal approach to governmental preference formation (Schirm, 2011, 2016, 2020), this article contributes to the literature by examining both material and ideational considerations towards the FTT from a domestic level perspective stemming from a cross-country comparison of three EU governments' preference formation processes. It argues that the Euro crisis may genuinely have enhanced the legitimacy of governments' position taking, particularly during the first phase of EU decision making, governmental preference formation (Degner & Leuffen, 2019b).

Contemporary Eurozone crisis literature points to the aspects of issue salience and actor plurality usually through employment of competing European integration theories such as liberal intergovernmentalism (Rehm, 2021; Schimmelfennig, 2015), neofunctionalism (Niemann & Ioannou, 2015), or post-functionalist approaches (Puetter, 2012). Csehi and Puetter (2020, p. 17), having reviewed these theoretical perspectives, identify government autonomy as a common line of argument and conclude that most have lost their "'liberal angle"…with decisions "decoupled from domestic influences."' A particular focus on domestic preference formation is therefore of importance as, in post-crisis European financial governance literature, imbalanced views have emerged that crisis management solutions were criteria of output legitimacy rather than input legitimacy (Kreuder-Sonnen, 2016). Due to the Euro crisis generating high uncertainty and unknown consequences, Lodge and Wegrich (2012, p. 1) perceive this output legitimacy as a specific "hour of the executive," leading to a democratic deficit in decision making, leaving reform initiatives thus falling short of democratic legitimacy. This is in line with Bauer and Becker (2014) who argue that the European Commission gained more influence in implementing governance rules, while Schmidt (2015) underlines that reforms were initiated and applied without public input. This contrasts with the new intergovernmentalism literature, which states that "de novo bodies" increased autonomy, primarily through intergovernmental coordination within the European Council framework, resulted in less empowerment of supranational institutions, such as the Commission partly departing from the Community method (Bickerton, Hodson, & Puetter, 2015, p. 705). This article aligns with the latter and argues that the uncertain threatening crisis situation advanced a so-called "particular environment of democratic citizenship in flux" (van Loon, 2021, p. 66), with a variety of domestic actors being well informed and highly concerned about their governments' positions in EU reform negotiations. Literature underlines the importance of governments' responsiveness to voters during times of political contestation (Hobolt & Klemmensen, 2008, p. 310), or to business associations' efforts in delaying the FTT (Kalaitzake, 2017; Kastner, 2017). Considering governments' responsiveness relating to decision makers prioritizing different actors with wide-ranging issues, especially during times of crisis, this article contributes to examining a wide range of actors situated within three different domestic societies (Ireland, France, and Germany) and instantly

affected by revamping the EMU framework, in shape of the FTT. Considering actor plurality and issue salience, which domestic actors did these governments respond to during FTT reform discussions and why?

By paying particular attention to the impact of issue salience and actor plurality, which led to political conflicts of a broad range of stakeholders in the domestic sphere, this study's analysis encompasses business associations, trade unions, NGOs and voters having shaped the French, German, and Irish domestic preference formation processes. The principal aim is to ascertain who determined these governments' responses during the FTT debate and why, as well as under which circumstances some domestic actors were either paid attention to, or largely ignored in informing these positions. By applying the societal approach to governmental preference formation, two explanatory variables, material interests and value-based ideas, dominant in these countries' domestic politics, are investigated to account for when each of these mattered, how they interacted and which of these prevailed in the French, German, and Irish governments' positions. By means of political discourse analysis (PDA), a methodological framework is employed in which a practical argumentation scheme highlights the broad public FTT debate. By using several premises (circumstance, goal, concern/value, and target), governments' responses to and dealing with the specific reform proposal, are linked for correlation purposes to diverse material interests and value-based ideas of particular domestic actors (Fairclough & Fairclough, 2011, 2012a, 2012b).

The article proceeds in the following four steps. The next section, and while touching on several domestic politics approaches, presents the societal approach to governmental preference formation. This includes defining the variables and formulating the core hypotheses. Subsequently, the PDA framework and operationalization of the variables is explained. This is followed by the empirical case study examining whether the FTT positions of the governments under scrutiny correspond to domestic material interests or value-based ideas, or both, in a cross-country comparison. The last section concludes with a brief comparative summary on the theoretical and empirical findings.

2. Analytical Framework

Due to its distinguished emphasis on endogenous societal dynamics, material interests and value-based ideas, dominant in countries' domestic politics, preceding an intergovernmental or international bargaining context, the societal approach to governmental preference formation (Schirm, 2011, 2016, 2020) allows for an explicit unfolding of the black box in explaining variation in governments' reform positions (van Loon, 2020). A third explanatory variable applied in this approach, domestic institutions, is due to space constraints not part of this analysis. For an elaborative explanation on all variables and conceptualization of hypotheses, see Schirm (2020). While employing and augmenting domestic politics theories such as IR liberalism (Moravcsik, 1997), domestic sources of economic policies (Goldstein & Keohane, 1993), as well as varieties of capitalism (Hall & Soskice, 2001), this approach engages in a unique advancement of these. Similar to these theories is its core assertion that elected governments in democratic political systems aspire to remain in office, ergo their positions mirror societal actors' preferences (Schirm, 2013, p. 690). Yet, contrary to hailing the importance of either societal interests or ideas, this analytical instrument embraces both societal dynamics in explaining governmental preference formation as the dependent variable.

The interrelationship of these societal dynamics has been endorsed by Hall (1997), Goldstein and Keohane (1993, p. 25) and Milner (1997, p. 16), yet enthusiasm to truly explore this interdependence has been lacking and awaits further theoretical development. The societal approach to governmental preference formation caters for a systematic examination of the individual role of both societal interests and ideas, in supporting or opposing each other, their interplay and plurality in shaping governments' positions. It is essential in "refining" existing domestic politics approaches both theoretically and empirically (Schirm, 2020) and consequently, a theory-guided empirical investigation is solely complete when it has been determined which of these explanatory variables accounts for variation across governments' positions, and why they do so. Schirm (2018, p. 65) states that "the conditions for the relative prevalence of either ideas or interests" has not been anticipated in previous domestic politics approaches. Through application of these variables, this article addresses the controversies around the FTT debate triggering an active involvement and engagement of domestic actors such as voters and NGOs. With European financial governance increasingly touching domestic politics, thereby 'catalyzing' a range of materially and ideationally motivated societal stakeholders, who aim to shape their respective governments' positions, justifies employing this approach.

The societal approach to governmental preference formation, in reflecting previous scholars' research outputs, connects domestic actors' specific attributions: Encompassing and furthering Milner (1997) and Moravcsik (1997), the material interest variable is delineated as economic sectors' distributional calculations adjusting swiftly to changes in the European (international) economy through FTT introduction. Furthermore, while connections with Goldstein and Keohane's (1993) as well as Moravcsik's (1997) work are echoed, the variable value-based ideas is defined as voters' enduring joint expectations on apt government FTT management. As this article expands its examination to a broad array of stakeholders, supplementary domestic actors are involved in the analysis (van Loon, 2021; van Loon, in press): Trade unions complement the domestic materially motivated business associations as sources for

material interests, while NGOs enhance the ideationally motivated voters' examination as sources for value-based ideas. The variables' precise characterization supports three individual hypotheses' articulation on the conditions for prevalence in shaping governments' positions. These central hypotheses explain the impact of economic sectors (material interests) and societal expectations (value-based ideas): When economic sectors face meaningful distributional calculations, material interests predominate in shaping governments' FTT positions, due to intense lobbying; and when fundamental questions on the role of politics in managing the economy are affected, ideas will prevail in shaping governments' FTT positions (Schirm, 2016, p. 69). A third hypothesis accounts for the variables' interplay: When both cost-benefit calculations for economic sectors as well as fundamental societal expectations on governments' apt role in managing the economy are affected, then these either compete and weaken, or reinforce and strengthen each other in shaping governments' FTT positions.

3. Operationalization

Fairclough and Fairclough's research in political responding to and dealing with the financial and Eurozone crisis views PDA mainly as a type of "practical argumentation" which "demands systematic analysis" of arguments for or against particular types of governments' actions (Fairclough & Fairclough, 2012a, pp. 1–2). Such governments' responses shed light on the broad public debate on the causes of the crisis in general, as well as particularly on reforms proposed. In arguing practically in support or opposition of reform proposals, these are linked to the diverse concerns/values of domestic actors. Arguing practically over particular types of actions, in the crisis context of uncertainty and risk, is designed to lead to a reasonable and legitimate outcome precisely in the absence of consensus:

> In a modern democratic state, people expect politicians to be bound by the promises they make, and expect the institutions of the state to act justly and treat them as equals. Action based on such reasons is legitimate both because a concern with doing one's duty or fulfilling one's obligations enjoys public recognition, but also because these reasons can be argumentatively and publicly justified as institutional facts, regardless of whether agents *want* to act in accordance with them or not. (Fairclough & Fairclough, 2012b, p. 26; see also Fairclough & Fairclough, 2012a, p. 177)

In this sense, PDA is attached to domestic individual and collective actors (interest groups, trade unions, voters, NGOs, and governments) involved in political processes within institutional contexts, in which these actors can engage, in an environment of uncertainty, risk and disagreement on decisions on matters of common concerns/values. According to Fairclough and Fairclough (2012a, p. 34), giving primacy to practical argumentation means:

> Carefully weighing a variety of relevant considerations…in a democratic setting where a wide range of viewpoints can be expressed and taken into account, will not only produce a legitimate decision…but will also enhance the rationality of the decision-making process.

In applying PDA, the authors establish a framework, analyzing a claim for action (action to be pursued) which is distinguished from the premises illustrating the circumstances of action (current context) from premises expressing the goals of action (future state of affairs)—which, in turn, are explicitly informed by values and concerns (Fairclough & Fairclough, 2012a, p. 15). Fairclough and Fairclough (2012a, p. 44) propose practical argumentation which, inserted within the context of this study of the FTT, can be applied by taking the following systematic steps: (1) in accordance with material interests (*concerns*) and/or value-based ideas (*values*), and (2) given the actual problematic context of action (*circumstances*), as well as (3) the desired future state of affairs (*goals*); (4) the solution to the problem is the action to be pursued (*target*). Therefore, concluding that the action to be pursued will be the right means to achieve the goal, the link from the premises to conclusion is done by a presumptive means-end relation that goes from the actual circumstances to the future current state of affairs.

This empirical analysis examines whether the three governments' FTT positions, expressed in statements of responsible elected politicians (finance minister and head of government), correlated with either (1) interest-related indicators articulated by business associations' and trade unions' demands in the form of position papers and representatives' statements, or to (2) ideational-related indicators such as voters' and NGOs' attitudes as indicated by public opinion polls and positions papers, or if in fact (3) a correlation occurred between interest and ideational-related indicators. Concerning public opinion surveys, societal attitudes from the Eurobarometer are highlighted, as well as one dyad of value-based ideas on the role of the government in steering the economy: trust in government's regulation versus trust in market forces (Schirm, 2011, p. 50).

4. The Proposed European FTT

After the failure of the 2010 G20 Toronto Summit in reaching agreement on globally coordinated action to tax the financial sector, President of the Commission, José Barroso, proposed a Directive in September 2011 to create a harmonized broad-based FTT in response to the global financial and Euro crises. To serve as an example of potential global implementation, the FTT was to be

installed by member governments. This tax was "to make the financial sector pay its fair share [and] to reduce competitive distortions in the single market, discourage risky trading activities and complement regulatory measures aimed at avoiding future crises" (European Commission, 2011). Many member governments contested the FTT mainly due to the risks of hindering growth and financial sector relocation. Once unanimity to pass the proposal proved difficult to achieve, the most reluctant governments such as Ireland, the Netherlands and the UK were bypassed primarily by Germany and France in requesting the Commission to introduce the enhanced cooperation mechanism. This would permit those favorable FTT member states to participate in implementing the tax. The mechanism was supported by 11 EU member states representing more than 90% of Eurozone GDP and was approved by the European Parliament in December 2012 and the Council of the EU in January 2013. However, FTT introduction still lingers in uncertainty. Statements of support mainly come from Germany and France, regularly putting the FTT on the ECOFIN agenda to advance the issue and renew the political commitment of the remaining member governments. Contemporary developments seem to slightly accelerate this process, as Brexit and the subsequent exclusion of the UK as a 'foot-dragger' (Quaglia, 2017, p. 1) in blocking FTT negotiations, and the current COVID19-pandemic crisis, have initiated the German Council Presidency, to call on EU members' "solidarity, cooperation and joint solutions" to fund the EU's budget and "manage the economic effects" in response to the corona virus (German Federal Ministry of Finance, 2020).

4.1. German, French, and Irish Governments' Positions

From the perspective of the French and German governments, the political context of action (*circumstances*) was similar in their basic features. At the beginning of the crisis Christine Lagarde, French Finance Minister, stated in the Assemblée Nationale that it was "the result of a deregulation of liberalism" (Assemblée Nationale, 2009). Her successor François Baroin added, referring to international structures, that "if we wait for a consensus and a global agreement, this tax will not be introduced" (Assemblée Nationale, 2012b). Referring to the lack of regulation of the financial markets identified, Lagarde stated as a solution to the problem (*target premise*) "to rebuild the rules that ensure the smooth functioning of the markets" (Assemblée Nationale, 2009). Baroin also demanded that "the financial system should contribute to repairing the damage it has itself caused by developing a financial industry that got carried away with subprime mortgages and Lehman Brothers" (Assemblée Nationale, 2012a).

Similarly interpreting the *circumstances*, German Chancellor Angela Merkel stated in the Bundestag that the "financial crisis could only have arisen because the regulation of the financial markets was insufficient" (Deutscher Bundestag, 2012). German Finance Minister Wolfgang Schäuble estimated the "chances of us achieving a global financial transaction tax…very small" (Deutscher Bundestag, 2010c). Schäuble added that the "lack of regulation of the financial markets" was one cause, but the main cause was the "excess of public debt in the national budgets" (Deutscher Bundestag, 2011) and thus gave higher priority to reducing public debt. Merkel's *target premise* was again similar when she stated that "there is no way around the fact that the financial sector is sharing the costs of the crisis" (Deutscher Bundestag, 2010b). In addition, Merkel exceeded Lagarde's regulatory ideas with her demand that "every financial center, every financial market player and every financial product should be subject to regulation, if possible not only in Germany, if possible not only in Europe, but if possible everywhere in the world" (Deutscher Bundestag, 2012). This should "restore the primacy of politics over the financial markets" (Deutscher Bundestag, 2010a).

The Irish government's position is in stark contrast to the German and French positions in terms of the political context of action (*circumstances*). In the discussion in the Dáil Éireann on the introduction of a European FTT, Prime Minister Enda Kenny emphasized that the financial sector was a "very important sector for Ireland" (Houses of the Oireachtas, 2012a), as "32,000 people are directly employed in the International Financial Services Centre in Dublin, which is the location of more than 5,000 firms" (Houses of the Oireachtas, 2012a). The International Financial Services Centre (IFSC) is thus not only "an important part of the economy" (Houses of the Oireachtas, 2012b), but "vital to the Irish economy" (Houses of the Oireachtas, 2012c), as the financial sector contributes "€2.1 billion in corporate and payroll taxes to the Irish Exchequer" (Houses of the Oireachtas, 2012a). Accordingly, the Irish government primarily focused on the relevance of its financial sector. Kenny expressed the *target premise* of "continuing to adopt, articulate and implement a clear vision for the future of the IFSC and demonstrating Ireland's commitment to the promotion and growth of this sector" (Houses of the Oireachtas, 2012a). This *target premise* of the Irish government, by focusing on promoting the national economy, contrasts with the German and French stances, bearing in mind that Ireland also opposed the FTT due to the UK's resistance (Hardiman & Metinsoy, 2019).

4.2. German, French, and Irish Domestic Material Interests

As a representative of the German credit institutions, the Deutsche Kreditwirtschaft (DK) warned that a FTT "because of possible evasive reactions, is fiscally justifiable—if at all—only if it is introduced globally or at least EU-wide (EU-27)" (DK, 2011, p. 2). From the DK's perspective, the financial sector is "not undertaxed compared to other sectors of the economy" and "even if it

were introduced at the international level, many problems would still arise" (DK, 2011, pp. 6, 10). In addition, the association stressed:

> That the introduction of a Financial Transaction Tax would have negative consequences not only for financial institutions, but also for companies and citizens in general, as well as for the economy and financial locations of the affected states as a whole. (DK, 2011, p. 2)

The Fédération Bancaire Française (FBF), equal to the DK, argued that "the financial sector, and in particular the banking sector, contributes as much and perhaps even more than others to public charges in the broadest sense" and that "in this context the…financial transaction tax (FTT) is not legitimate" (FBF, 2011). The FBF similarly argued that "a tax on financial transactions can only be conceived on a global level to maintain the competitive conditions of the financial centers and not to penalize the market financing of European companies" (FBF, 2011). The rejection of the FTT, whether national or regional, highlights the *concerns premise* of these national business associations clearly reflecting the national locational advantage in international competition and the relevance of this, as it would harm the financial sector. Thus, the interests of the German and French financial sectors conflicted with the respective government positions that advocated FTT introduction. The Irish Banking Federation, in cooperation with Financial Services Ireland (FSI), commissioned a study on the advantages and disadvantages of an FTT. The aim of the study was "to independently review and distil the main points…on the European Commission's initial…and the subsequent authorized proposal for an FTT…to provide an indication of the expected impact of the FTT across the financial services sector and its constituent product groups" (PWC, 2013). Based on this report, Brendan Bruen, Director of the FSI, concluded that "Ireland has made the right decision to stay out of any FTT" as it "harms any country that introduces one" and "is ultimately paid by the real economy, in increased costs for business, lost jobs and lost payroll" (FSI, 2013).

With the Confederation of Trade Unions (DGB) and the Confédération française démocratique du travail (CFDT), the largest trade union federations in Germany and France spoke out in favor of the introduction of a European FTT. The CFDT supported a campaign by the European Federation of Public Service Unions, which focused on the demand for "fairer and more progressive taxation" in the form of a "European financial tax" as it believed it to be "high time that the financial sector also paid its share" (CFDT, 2011). The DGB contradicted the view of the German financial sector that a FTT "must be introduced worldwide" and supported "the introduction of a Financial Transaction Tax in the EU…even if the rest of the world community does not follow suit," so that "financial speculators, as the cause of the financial and economic crisis, to share in its consequential costs" (DGB, 2011). This echoes the view of the ICTU, the Irish Congress of Trade Unions, while adding that the FTT contributes:

> To state revenue at a time when the state finances are under unprecedented pressure and it shows citizens that the institutions which were the main culprits in our economic collapse are making some contribution towards a recovery. It will alter economic behaviour by making risky transactions more costly, while in turn allowing a more rational allocation of economic resources. (ICTU, 2012)

The trade unions' demands (*concerns premise*) for a European FTT correlates with the German and French governments' positions. The financial sector is to be held accountable through stronger regulation and the responsibility for the costs of the crisis is accompanied by a sense of justice, which the German and French governments also emphasized, yet diverged from the Irish government's stance.

4.3. German, French, and Irish Domestic Value-Based Ideas

To illustrate the increased issue salience, the importance the public attached to the FTT reform proposal and its subsequent politicization, media analyses from Kastner (2017) and Degner and Leuffen (2019b) confirm that public attention increased instantly, particularly during the years 2011 to 2013. Concerning the question of an apt government's role in managing the economy and trust in governments regulation versus trust in market forces, highlighting the *values premise*, weak governmental regulation of the financial sector enjoyed support among the Irish population. In a Eurobarometer survey recurring since 2010, respondents were asked to indicate whether they support or oppose specific EU measures. In Ireland, on average 44% supported the introduction of a FTT, compared to 43% who opposed it. These figures are very different from the results in Germany (75% pro/16% contra) and France (64% pro/24% contra; see EUOPD, 2014–2018). The enforcement of the EU Troika's bailout program, including conditions of austerity measures imposed on the Irish society to decrease government expenditure, might have contributed to this difference in Irish attitudes towards FTT introduction. The German and French governments' *target premise* of having the financial sector share the costs of the crisis is reflected in a Eurobarometer survey recurring since 2013. When asked whether the EU is ensuring that the financial sector pays its fair share, 21% of French and 37% of German (as well as Irish) respondents surveyed felt that the financial sector is paying its fair share. A majority of 55% of French respondents felt that the EU was not holding the financial sector sufficiently accountable. In Germany and Ireland, 50% each shared this view (EUOPD, 2014–2018). In the FTT debate, the emphasized

value of fairness (the financial sector must pay its fair share) can be correlated to the values equality, justice, and freedom. In the question of whether "[we need] more equality and justice, even if this means less freedom for the individual" (EUOPD, 2014–2018), an absolute majority of respondents in Germany (62%), Ireland (63%) and France (64%) voted on average for the values of equality and justice, whereas in contrast, 31% (France), 25% (Ireland), 34% (Germany) preferred the value freedom.

The internationally active NGO Tax Justice Network, which maintains partnerships with the Tax Justice Network Germany and Attac France, contributed to the debate on the introduction of a Europe-wide FTT. The Tax Justice Network advocated "the introduction of a Financial Transaction Tax because only this is suitable for financing current crisis management measures and for preventing or at least mitigating future crises" (Netzwerk Steuergerechtigkeit Deutschland, 2010). In addition, the Network for Tax Justice was one of 100 other sponsors of the German nationwide campaign 'Tax against Poverty' (*Steuer gegen Armut*). An open letter, which forms the basis of the campaign, states: "[We want] to ensure that the financial sector contributes to overcoming the consequences of the crisis" (Steuer gegen Armut, 2009). Attac France viewed the introduction of a FTT as a service to social justice, as it would "shift the burden of the crisis from the citizens to the financial sector" (Attac France, 2010). It celebrated the Commission's proposal for a pan-European FTT as a "victory for Attac's ideas" but regretted that "the proposed rate is only 0.01%" and that "the scope of the proposal…is limited by the exclusion of taxation of transactions on the foreign exchange market" and hence, the proposal is "too little, too late" (Attac France, 2011). The NGO Financial Justice Ireland called for an "EU-wide financial transaction tax" (Financial Justice Ireland, 2014) "to reclaim what we have paid out to banks and 'bail-outs"' (Financial Justice Ireland, 2013b). "Part of the FTT revenue should be used to repay part of the bank debt in the global North and South" (Financial Justice Ireland, 2013a). The positions of the NGOs show a strong consensus on the demands (*values premise*) for a Europe-wide FTT and reveal that the planned FTT introduction not only affects the material interests (*concerns premise*) of the financial sector but also societal expectations about the role of the government in managing the financial market. The positions of the German and French NGOs are consistent with their respective government positions in their *claim for action* to demand a European FTT and in their *target premises* of making the financial sector share in the costs by regulating the financial system and the associated values of equality and justice. On the other hand, the rejection of a FTT in the Irish government's *claim for action* correlates neither with the position of Irish NGOs nor with the widespread demands in Irish society for equality and justice in the financial markets.

5. Conclusion

Both the German and French governments' context of action (*circumstances*) to introduce a FTT at the European level is in line with the demands of the voters, of NGOs and trade unions, and runs counter to the material interests of the financial sector, which considered the introduction of a FTT at the European level to be harmful to the economy. These governments' *target premises* of using the FTT to regulate the financial sector and make it share the costs of the crisis can be plausibly explained by the high approval rates for a European FTT and the widespread view, expressed by the trade unions and NGOs, that the financial sector has not been held sufficiently accountable. In the analysis of the Irish government's position, it deviates from the German and French governments' stances, correlating in its *circumstances* with the material interests of the financial sector, as well as with the expectations of the Irish voters, which, unlike in the German and French cases, did not support the introduction of a FTT at the European level with an absolute majority.

Reflecting these empirical results, the hypotheses of the societal approach to governmental preference formation and its explanatory variables, material interests and value-based ideas, account for when these mattered, how they interacted, and which prevailed in shaping these governments' FTT positions. The first formulated hypothesis focused on the prevalence of business associations and trade unions in shaping the governments' FTT positions. Strengthening EU financial regulation would directly affect specific economic sectors, leading to cost-benefit calculations instigating these domestic actors to engage in vocal lobbying efforts, thus dominating domestic preference formation. The comparative empirical analysis on material interests reveals that these actor types were divided regarding their FTT demands. Due to the role they play in the national economy, contributing to employment, exports and GVA, more so for Ireland than for France and Germany, business associations were highly opposed to strengthening financial integration. Trade unions, specified as material interests due to the importance of labor to the national economy, were supportive of the FTT as they blamed the finance sector for the dire economic situation, which had induced unemployment and immense costs for the taxpayer. The FTT, in punishing the financial sector, would raise revenues and contribute to political stability, economic prosperity, and social security.

The second hypothesis turned attention to voters' and NGOs' concerns if strengthening EU financial regulation involves fundamental and salient enduring societal expectations on apt government's role in steering the economy. The cross-country comparison illustrated that all NGOs had a unified position towards FTT introduction. French and German public opinion were more in line regarding pro-regulation versus pro-market attitudes, while in Ireland trust in market forces reflected

the negative correlation to strengthening financial market regulation. This equally corresponds to the large percentage of French and Germans in favor of the FTT, yet also complies with the Irish public opinion being largely divided over this tax issue.

So far, this article has highlighted the importance of both domestic explanatory variables, whereby it has become clear that not only competition took place within these variables in the three country case studies (material interests: finance and business industries versus trade unions) or in Ireland only (value-based ideas: NGOs versus voters) but competition took also place between these societal dynamics, hence they can also reinforce each other. The third hypothesis concentrated on the variables' interplay: The strengthening of financial regulation would directly affect cost-benefit calculations as well as fundamental enduring societal expectations on the apt government's role in steering the economy. The comparative empirical examination has supported that trade unions' demands collided with these from finance and industry associations, thus a certain weakening of the latter demands took place in the domestic preference formation processes. This weakening occurred more so since, particularly in France and Germany, trade unions were joined by both voters and NGOs in their support for the FTT, thereby reinforcing each other. Hence, an interaction between the societal dynamics took place. In Ireland's domestic preference formation process, business associations' opposition was most likely reinforced by the public's divided opinion. Not having been able to form a solid positive attitude towards the FTT, the regulation-adverse attitudes reinforced the material interests opposed to financial strengthening. Hence, in France and Germany trade unions, voters and NGOs were able to circumvent the business associations' interests and were thus more decisive in shaping its government's position towards supporting the proposed reform, whereas in Ireland these domestic actors were ultimately not able to counter a unified financial industry overwhelmingly opposing the tax. In sum, this article has illustrated that, even in an uncertain crisis situation in which governments have to act prompt, a broad range of directly affected domestic stakeholders were able to voice their concerns in shaping the governments' responsiveness, hence public input in the FTT reform negotiations genuinely enhanced the legitimacy of governments' FTT position taking.

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Conflict of Interests

The author declares no conflict of interests.

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Article

Scrutiny or Complacency? Banking Union in the Bundestag and the Assemblée Nationale

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Abstract
The financial and eurozone crises highlighted the inadequacy of the original governance structures of the eurozone. In response, a range of reforms were launched, including the creation of a European banking union. In practice, some elements of the banking union were delayed by division among member states and the breakdown of the Franco-German motor, such as the question of the operationalization of the single resolution mechanism and fund or the deposit insurance scheme. In addition, eurozone governance—which would once have been regarded as a technocratic issue—became increasingly politicized. The aim of this article is to study the extent to which the banking union was scrutinized by parliament and to what degree this reflects material interests and ideas. For this purpose, it focuses on salience (i.e., how much attention the issue received) and polarization (i.e., the divergence of positions). The analysis of the resolutions and debates of the German Bundestag and French Assemblée Nationale, i.e., the parliaments of two key states in EU decision-making on banking union, finds that the German government was indeed closely scrutinized, whereas the French government was relatively unconstrained.

Keywords
banking union; European deposit insurance scheme; France; Germany; parliament; single resolution fund; single resolution mechanism; single supervisory mechanism

Issue
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1. Introduction

The financial crisis of 2007 created high costs for taxpayers and led to a hike in sovereign debt when EU member states stepped in to recapitalize banks. The resulting frustration motivated policymakers to create a banking union. The goal was to stabilize the European banking system through stricter rules and capital requirements for banks, a more centralized banking supervision on the European level, a European approach to bank restructuring and resolution that would limit the burden on taxpayers, and a European deposit guarantee scheme that would protect savers (Howarth & Quaglia, 2016b).

Despite broad agreement on the desirability of protecting savers and taxpayers, there were substantial disagreements on the details. Not all member states had been affected by the financial crisis to the same extent: some were able to bear the burden alone, while others could not. There was a risk that the costs and benefits of banking union would be unevenly distributed across member states, and that risk-averse banks might end up paying for risk-taking banks. Questions relating to the mutualization of risk, the inclusion of small and local banks in the scheme, and also the correct decision-making bodies became disputed. Franco-German leadership broke down as the two countries were on opposing sides on most questions (Schild, 2018). The two countries were nevertheless important in the negotiations due to their sheer size and economic weight (Cassell & Hutcheson, 2019; Howarth & Quaglia, 2013). This is

particularly obvious in Germany's veto of the creation of a European deposit guarantee scheme, which is generally attributed to high domestic pressure (Schild, 2020).

In line with the aims of this thematic issue (Högenauer & Rehm, 2021), the article aims to analyse the domestic politics of the banking union in France and Germany through the positioning of their parliaments and parties. To what extent did the two governments face parliamentary pressure to defend specific positions? To what extent did the parliamentary politics reflect the material interests of the country and/or public attitudes towards the issue? The analysis will focus on the Lower Houses, i.e., the Bundestag and the Assemblée Nationale (AN). The Lower Houses perform the main function of representing the national electorate. By contrast, the Upper Houses, the Bundesrat and the Senate are not directly elected and the Bundesrat's primary function is not to represent the electorate but the state governments. They are extremely diverse in their composition and powers.

The first question relates to literature that shows that Eurozone governance has become more salient and controversial among parliamentarians (Auel & Raunio, 2014; Closa & Maatsch, 2014; Högenauer, 2019; Wendler, 2014). As a result, national parliaments have become more assertive in their scrutiny of key EU and Eurozone decisions. The German Bundestag is particularly active on eurozone crisis policies and has extensive powers (Auel & Höing, 2014; Auel, Rozenberg, & Tacea, 2014; Höing, 2013; Moschella, 2017). The question is to what extent these dynamics led to a close scrutiny of banking union that could potentially constrain governments (Donnelly, 2018). This is highly relevant, as EU crisis policymaking has often been criticized for lacking democratic input and debate (e.g., Sebastiaõ, 2021). An answer to this question requires an examination of the parliamentary salience of banking union, the timing of debates and resolutions, and the polarization of debates. By parliamentary salience, we mean how frequently the issue is raised in debates (Hutter & Grande, 2014; see also De Wilde, 2011; De Wilde, Leupold, & Schmidtke, 2016). Polarization captures the extent to which actors adopt different positions on an issue. In this multi-level context, it can refer to either disagreement between different groups of MPs or the disagreement of national politicians with European proposals.

In addition, the timing of activities matters: If parliaments hope to influence European negotiations or to control the government's position, the debates would have to predate the adoption of the policy. If plenary debates occur after the decision, they are reactive and can at most comment on the performance of the government or indicate (dis)agreement with the policy, but they can no longer shape the policy.

The question about the extent to which the debates reflect ideas and economic interests will draw upon the societal approach as used by Schirm (2011, 2020) and Van Loon (2021). Schirm (2011, 2020) defines ideas as values held by the public. Material interests are determined by the relative weight of economic sectors. So far, existing studies often emphasize the importance of material interests or structural economic factors in explaining government positions in eurozone crisis decision-making (e.g., Tarlea, Bailer, & Degner, 2019), for example, whether banks are largely domestically or foreign-owned (Spendzharova, 2014), on the role of bank capitalization levels and bank-industry ties (Howarth & Quaglia, 2016a), and on the qualitative composition of the banking sector in terms of whether there be large national champions or decentralized networks of cooperative and savings banks (Commain, 2021). The qualitative composition is particularly important in the context of France (large champions) and Germany (networks of savings and cooperative banks) as it fuels different views on what type of bank should be covered by European mechanisms and how much they should contribute financially to the stabilization of the European banking sector. However, Van Loon (2021) shows that ideas and interests do not necessarily pull in opposite directions, but can potentially work to reinforce each other.

In this vein, the following sections will first provide a short overview of the main elements of banking union and the positions of the French and German governments. Then French and German ideas and interests with regard to banking union will be analysed based on existing surveys, the literature on the politicization of banking union, and structural economic factors. This is followed by a discussion of the data collection on parliamentary scrutiny and an analysis of the findings in terms of the salience and polarization of banking union in the Bundestag and the AN.

2. Banking Union and Franco-German Divisions

The decisions on banking union represent one of the biggest steps forward in European integration since the launch of EMU (Degner & Leuffen, 2019; Epstein & Rhodes, 2016).

In 2013, agreement was reached on the Single Supervisory Mechanism (SSM) for Eurozone banks: Located within the European Central Bank (ECB), it is responsible for the direct supervision of systemically relevant banks and banks with substantial cross-border activities, while other banks are supervised by national supervisors under the responsibility of the ECB (Gren, Howarth, & Quaglia, 2015; Kern, 2014).

In 2014, the Single Resolution Mechanism (SRM) was established in order to reduce the costs of bank resolutions for taxpayers. The Single Resolution Board takes decisions for those banks supervised directly by the ECB. In the event of a resolution, the bank's shareholders and creditors are first bailed-in, then the national compartment of the Single Resolution Fund (SRF) steps in. The national compartments are financed by levies from national banks and are backed up by national credit lines from the member state. By 2023, the

national compartments will be merged (Howarth & Quaglia, 2016b).

In 2015, the European Commission planned the creation of a European Deposit Insurance Scheme (EDIS) with the aim of merging national deposit insurance schemes. However, this proposal was ultimately blocked by division in the Council (Cassell & Hutcheson, 2019).

In European decision-making on banking union, the established pattern of Franco-German leadership on monetary policymaking was disrupted. The two countries were often on opposing sides of the argument (Schild, 2018). They disagreed on the purpose of banking union and the costs and benefits of banking union generated distributional conflict. In the absence of a Franco-German agreement, EU institutions filled the gap and provided supranational leadership (Nielsen & Smeets, 2018), but some elements of banking union were delayed or blocked.

Disagreements emerged largely along two dividing lines: the extent of risk-sharing across member states and the centralization of decision-making (Cassell & Hutcheson, 2019; Schild, 2018). France, Italy, and Spain pushed for a rapid move towards banking union to disrupt the feedback loop between banking crises and sovereigns: States tend to rescue national banks with public funds thereby potentially entering a public debt crisis, which then affects national banks, which hold public debt. Germany, on the other hand, wanted to avoid sharing the risks of bailouts in other Eurozone states and preferred to focus on avoiding future crises (Schild, 2018).

As a result, whereas France wanted the European banking supervision and resolution to cover all Eurozone banks, Germany wanted it to cover only on systemically relevant banks, rather than its smaller savings and cooperative banks. Domestically, there were doubts about whether the ECB was the ideal banking supervisor given the potential conflict of interest with its role in monetary policy (cf. Högenauer, 2019), but the government ultimately agreed that the ECB should take on this role. Where France wanted the European Commission to play a key role in the restructuring and resolution of banks, Germany preferred a network of national resolution authorities (cf. Degner & Leuffen, 2019). On this issue, Germany ultimately got its way in the form of a Single Resolution Board consisting of a Chair, four full-time members, and a representative of each national resolution authority. The Commission and Council of the EU would be able to veto Single Resolution Board decisions (Schild, 2018).

In addition, unlike France, Germany wanted to limit the use of public funds—and especially European funds—in the recapitalization of banks. As a result, whereas France favoured the use of the ESM to recapitalize banks with bad assets, Germany insisted that legacy assets should be a national responsibility and that the ESM should be used only for future crises. It also insisted on a recapitalization sequence: first private shareholders, creditors and large depositors, then national resolution funds financed via bank levies, then national public capital, and then as a last resort, European capital from the ESM. The bailing in of private capital would reduce the burden on the taxpayer, and by asking for national recapitalization first, European risk-sharing would be limited. Germany also wanted to reduce the contribution from small banks, whereas France tried to limit the contributions from large banks, and there was disagreement on whether there should be a single resolution fund or a network of national funds. Finally, for the same reasons of aversion against the mutualization of risk, Germany vehemently blocked the creation of a EDIS using the argument that risks to bank's balance sheets would have to be reduced first (Schild, 2020).

3. French and German Ideas and Interests on Banking Union

The financial crisis harmed trust in the ECB. According to the 2010 Eurobarometer (European Commission, 2010), 45% of French and German respondents distrusted the ECB, but in Germany distrust was growing particularly fast. The same survey showed that support for European banking supervision, European supervision when public money was spent to rescue financial institutions, and regulation of the financial sector was higher in Germany (80%, 80% and 77% respectively) than in France (73%, 68% and 71%). As the eurozone crisis dragged on, German attitudes towards EU banking supervision became less positive, as did French attitudes: Eurobarometer 81 (European Commission, 2014) shows that 75% of German and 67% of French respondents were in favour of banking supervision.

Thus, the German public is actually more strongly in favour of the fundamental idea of a banking union, despite the negative debate in the media. These surveys do, of course, only capture very general attitudes and cannot provide information on the kind of banking supervision citizens want. Nevertheless, it is interesting that there is a disconnect between the reluctance of the German government in decision-making on banking union and the overwhelming support of Germans for the idea of European banking supervision.

In addition, the fact that there were only 4% of 'don't knows' by German and 13% by French respondents on the question on banking supervision (European Commission, 2010) is an indication that the public considered this issue quite important. Schild (2018) argues that the German government—unlike the French parliament—was under particular pressure due to the high public salience of European policies, the predominantly negative attitudes towards solidarity between countries, and the emergence of a Eurosceptic right-wing party, the AfD. The public salience of EDIS was particularly high in Germany (Cassell & Hutcheson, 2019). Kriesi and Grande (2016) also argue that politicization of eurozone crisis policies was particularly high in Germany,

whereas politicization in France only reached 40% of the German level.

This is likely to influence parliamentary scrutiny: Baglioni and Hurrelmann (2016) argue that there are different arenas of politicization, such as the citizen arena, an intermediary arena for business groups or other specialized actors, and an institutional arena (e.g., a parliament). The different arenas are connected, in that public salience can raise the salience for politicians, and the strategies of politicians in parliaments can contribute to the (de)politicization of an issue (cf. Gheyle, 2019; Wendler, 2019). According to Gormley (1986), the complexity and public salience of an issue interact to create different policymaking dynamics. When complexity is high (as is the case with banking union) and public salience is low, politicians operate in 'board room' mode: Affected business groups can influence politics and politicians are free to make compromises as the media and public do not take much interest. However, in such a situation politicians deal with complex issues as little as possible, due to the absence of electoral incentives. When complexity and salience are both high, politics take place in 'operating room' mode: politicians are not free to make compromises, as the public has strong expectations and the media reports on the issue (although Gormley suggests that reporting is likely to be faulty). The problem with this typology is that its description of the dynamics does not entirely fit the European context, as there is an underlying assumption that difficult decision-making is delegated to agencies. In the EU context, however, the most contentious decisions often have to be taken at the level of the European Council or at least the Council of Ministers. As a result, high salience and complexity do not necessarily lead to delegation to bureaucrats. Banking union in practice corresponds better to Gormley and Boccuti's (2001) typology of issues based on conflict and public salience, where they argue that issues that governments insist on staying in control of issues that are salient and conflictual, whereas they involve stakeholders in issues that are high in conflict and low in salience. In the US case, the absence of conflict and salience results in the federal level having little interest in tightly controlling the state level. In our case, we assume that the incentives for parliamentary scrutiny are low. This is also in line with the argument by De Wilde et al. (2016) that politicization is driven by the critics rather than supporters of an issue. If we take conflict to mean the opposition to the European plans and/or conflict between domestic actors, this would mean that:

H1: Politicians take business interests on board when the public salience of the issue is low, but the conflict on the issue (e.g., between businesses and the EU) is high (expectation: Germany on SSM, SRF);

H2: When both conflict and public salience are high, politicians take control of the decision, but have limited political room for manoeuvre (expectation: Germany on EDIS);

H3: When public salience and conflict are low (expectation: France, especially on the SSM, SRF, EDIS), parliamentarians will have no interest in the close scrutiny of executives;

H4: Parliaments are more likely to be proactive in the face of high public salience.

However, the precise powers of the parliaments could be considered a mediating factor. While national parliaments have no direct influence over EU policymaking, they can put pressure on their national governments to represent the 'correct' position in the Council of the EU via committee and plenary debates (Raunio, 2009) and resolutions. In this context, a high level of activity is usually used to signal that the parliament considers the issue important. However, the AN has moderate scrutiny powers over EU affairs and is usually less active while the Bundestag has strong scrutiny powers and tends to be quite active (Auel et al., 2014). The Bundestag has control over the plenary agenda, whereas the French government had almost complete control over the plenary agenda of the AN until 2008/2009 (Auel & Raunio, 2014). However, following constitutional amendments, the AN now controls roughly one-third of its agenda and can hold plenary debates on EU affairs if it sees fit. Indeed, it tends to schedule at least one EU debate per month (Thomas & Tacea, 2014). In addition, the opposition has the right to table motions in both parliaments. In the case of the AN, there is a specific tool, 'European resolutions,' which can be adopted by the European Affairs Committee on virtually any EU document and which become final if the relevant sectoral committee does not counteract them (Thomas & Tacea, 2014). In the case of the Bundestag, one-quarter of MPs can force the government to publicly explain why it deviated from a previously passed Bundestag resolution (Höing, 2015). Thus, while a lower number of AN plenary debates is to be expected given the influence of the government, the AN is not substantially weaker than the Bundestag with regard to resolutions. Substantial differences in activity have to be ascribed also to different levels of motivation. For example, Högenauer and Howarth (2019) have shown that the AN scrutinizes the Banque de France more actively than the Bundestag scrutinizes the Bundesbank, despite the fact that the Bundestag is also considered stronger than the AN outside EU affairs: Because it *chooses* to take an interest.

In terms of material interests, there are arguably two factors at play, the general divide between creditor and debtor states, and the composition of the banking sector. Thus, Lehner and Wasserfallen (2019; see also Wasserfallen, Leuffen, Kudrna, & Degner, 2019) studied government positions on 47 issues of the Economic and Monetary Union (EMU) reform and found that the

predominant dimension was between fiscal transfer (led by France) and fiscal discipline (led by Germany). This dimension had very strong explanatory power for several banking union-related issues, such as banking supervision, the build-up and mutualization of the SRF and the fiscal backstop for the SRF. The findings make sense in light of the high exposure of banks to domestic sovereign bonds. Both Ongena, Popov, and Van Horen (2016) and De Marco and Macchiavelli (2016) find that there is a 'moral suasion' mechanism whereby banks that are publicly owned or influenced by politicians (e.g., via the board of directors) collude with national governments and buy larger quantities of domestic sovereign bonds than would be in their interest. In the eyes of Germany, their high exposure to Spanish, Greek, and Italian banks could affect their stability and therefore the chances of other European banks having to step in with 'their' contributions to the proposed SRF or EDIS. For France, which started to experience rising public debt during the crisis, there was a correspondingly greater willingness to be more open to solidarity and transfers between countries.

Secondly, the banking sectors of France and Germany are structured differently, which also generates different material interests. The German banking sector is organized around three pillars (private banks, corporate banks, and savings banks) that often consist of smaller banks that focus on risk adverse operations and SMEs. The three pillars already had their own deposit insurance schemes in place, which reduced the perceived need for a European scheme (Zimmermann, 2013). In addition, the aim was to avoid the situation in which small, risk-averse banks might have to cover the losses of large risk-taking foreign banks. The situation was different for France, where it was attractive to place large national champions under a European scheme rather than to risk having to bail them out nationally (cf. Commain, 2021, on the French banking sector). On the whole, Zimmermann (2013) concludes that the existence of strong embeddedness of national deposit insurance schemes into different varieties of financial capitalism means that a common deposit insurance scheme is unlikely to emerge. The strong connections linking the banking sector to politicians in key countries such as Germany increase the ability of economic interests to influence policymaking.

4. Data Collection

The article analyses plenary debates and proposed resolutions from 1 January 2012 to 31 December 2016 covering the adoption of the first three pillars of banking union (SSM, SRM, SRF) and the blocking of EDIS. This period starts before the Commission proposal on the SSM and ends after a natural break in the data: There were no debates after February 2016 until 2018.

The analysis focuses on the plenary debates and proposed resolutions. Plenary debates fulfil a communication function: As they are more likely to attract media attention, parties and parliamentarians can use them to demonstrate to voters that they take a close interest in a certain topic and to communicate their stance on that topic. The minutes of Bundestag and AN plenary debates are published in full and are broadcast live on the internet and/or TV. Resolutions also make the parliament's or a party's position visible. By contrast, committee meetings tend to be much less visible (cf. Raunio, 2016). In addition, the finance committee of the Bundestag does not publish minutes and meetings are closed to the public.

Due to the different archival systems of the AN and the Bundestag, the relevant debates had to be selected following different strategies: In the case of the Bundestag, a keyword search of all plenary debates in that period was used to identify all debates where the SSM, the SRM, the SRF, or the deposit guarantee scheme were mentioned at least once. The German names of these policies were used as a search term. In a second step, plenary debates specifically on banking union were filtered out through a manual analysis of the titles and contents. This allowed us to identify 18 debates on banking union. The electronic archive of the AN does not allow for a keyword search of plenary debates but publishes the topics of the debates in an easy-to-browse format. Therefore, all debates that could potentially be on banking union were preselected. Then a manual analysis of the debates showed that only four were specifically on banking union. In both the Bundestag and the AN, one debate can cover several pillars of banking union.

In addition, a keyword search was used to identify relevant resolutions.

In order to measure the degree of polarization, i.e., the extent to which opinions diverge (De Wilde, 2011; De Wilde et al., 2016; Hutter & Grande, 2014), three German debates on the SSM, the SRM/SRF, and EDIS were analysed in depth. In light of the limited number of French debates (and the fact that two were transposition debates), a debate on banking union is used to analyse the general position on the SSM and EDIS, while a second debate covers the SRF. The SRM and SRF are discussed together, as parliamentary debates usually treat them as linked. The selected debates are the earliest debates on the issue.

5. Banking Union in the Bundestag and the Assemblée Nationale

5.1. Salience and Timing

Figure 1 shows that banking union was indeed a salient topic for the German Bundestag from an early stage and that the interest was sustained over time and across the different policy elements: Banking union was discussed in 18 plenary debates, 13 of which were specifically on banking union and five of which were debates on Commission work programs or reports on the European Council that focused on banking union.

By contrast, in the AN, only four plenary debates focus on banking union. Two were implementation

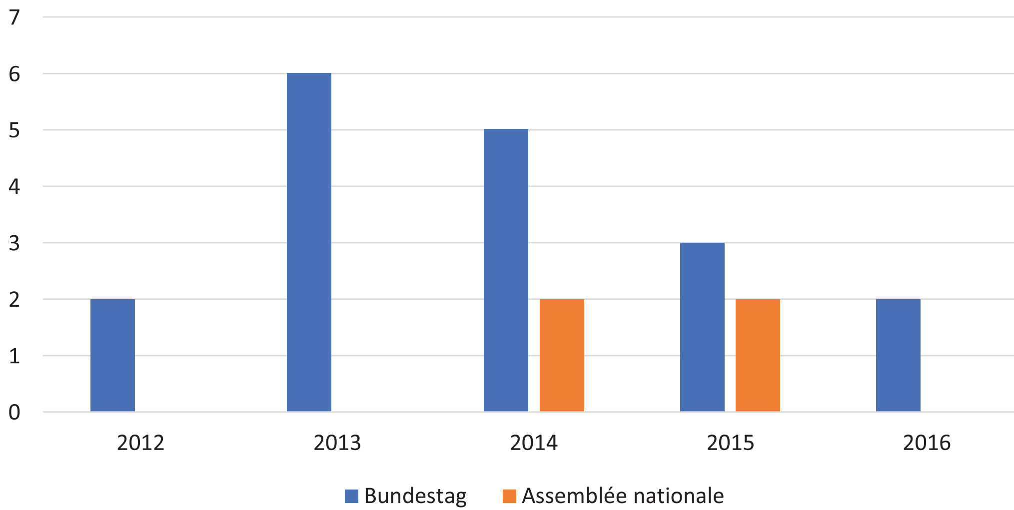

Figure 1. The number of plenary debates on banking union.

debates, one on banking union in general and one on the SRF. This is in line with H3 that public salience and parliamentary salience are linked and that low public salience provides low incentives for parliamentary scrutiny.

In addition, the AN's approach was reactive: Only AN debate 20140152 of 30 January 2014 on banking union contains a discussion of the SRF/SRM that predates the European decision (of July 2014). The other debates follow European decisions and comment on the government's and EU's performance after the facts. The Bundestag was far more proactive: The first EDIS debate of 5 November 2015 *preceded* the official Commission proposal of 24 November. Three SSM debates and four SRM/SRF debates predate the respective European decisions. There is thus a mix of German debates that formulate positions and debates that comment on outcomes. This confirms H4 that high public salience encourages politicians to be proactive (especially in the case of EDIS, where the Bundestag opposed faster than the European Commission could propose).

In addition, the AN adopted one cross-party resolution in January 2014 encouraging the creation of the SRM and SRF, the use of the ESM as a backstop, and the creation of a European deposit guarantee scheme in the long run. There was one further tabled resolution that was not adopted. By contrast, there were 19 tabled resolutions in the Bundestag, 15 failed opposition resolutions and four adopted government resolutions, confirming H2, H3, and H4 about the connection between public salience and parliamentary scrutiny (see Figure 2).

Figure 2. Proposed resolutions on banking union.

5.2. Framing and Polarization

In order to gain greater insight into how the issue was framed by MPs, all plenary debates were analysed manually. Five representative debates are presented below: the two French debates on banking union and on the ratification of the SRF, and three Bundestag debates on the SSM, the SRM/SRF, and on EDIS.

This analysis shows two things: Firstly, the governing parties defend the European decisions and MPs praise the achievements of their governments—even in the case of Germany and the SRM/SRF, where the government was originally concerned about the mutualization of risk. The German opposition is prone to point out the flaws of decisions, such as the small size of the SRF. In France, where the government was eager to reach an agreement and public salience was low, in line with H3, there is no clear government-opposition divide on the European policies. Instead, government-opposition arguments focus on the national question of whether the size of the French banks should be reduced. H2 is correct in that the German government parties did assume an active role on the highly salient EDIS, which was disliked by the public and stakeholders, and rejected it even before the European Commission officially proposed it, leaving themselves little room for compromise. In line with H1, for the SSM and SRM/SRF, where German public opinion and economic interests were sceptical towards the EU's plans, but public salience was lower, the government parties took on board the interests of stakeholders and argued that these measures clearly should not apply to savings and cooperative banks. This is broadly in line with a survey of the preferences of French and German MPs on reforms to the EMU by Blesse, Boyer, Heinemann, Janeba, and Raj (2019) where French MPs were found to be more strongly in favour of new Eurozone competencies.

In addition, it is interesting to note that intra-party unity was extremely high in Germany across all parties and that the governing coalitions (CDU-FDP, then CDU-SPD) also spoke consistently with one voice. The German government did thus face a clear majority position that largely reflected its own demands, but also made it potentially difficult to compromise. The French government did not face comparable pressure: while all French parties wanted decisions as close as possible to the Commission proposals, the low number of debates and resolutions before decisions meant that the pressure was in practice much lower.

5.2.1. The Positions on the Single Supervisory Mechanism

AN debate 20140152 of 30 January 2014 on the progress of banking union and economic integration shows that all MPs welcomed banking union and the creation of the SSM, while criticism was limited to details and was not organized in a strong block of MPs. In line with H3, this positioning did not constrain the government. Among the most positive voices are Christophe Caresche (PS) who defended the choice of the ECB as supervisor and argued that the in-house separation would work and that the ECB had a vested interest in the success of banking union to maintain its credibility. Éric Alauzet (EELV) emphasized that banking supervision by the ECB would increase transparency. He only deplored that not all EU member states and banks were covered, and he would have liked to see a better involvement of the European Parliament to improve the democratic legitimacy of the process. Pierre Lequillier (UMP) also believed that the ECB would add clarity and independence to banking supervision, but would have liked national specificities to be taken into account. Valérie Rabault (PS) would have liked banking supervision to go further and to impose higher capital requirements in some cases.

However, Annick Girardin (Radical party of the left) criticized the complexity of the four different criteria to determine whether a bank falls under ECB supervision. Like Éric Alauzet, she wondered why banking supervision and banking resolution were not dealt with by the same institution, but she felt that the ECB was the wrong choice, due to crisis resolution having little to do with monetary policy, and that this new function could have undermined the independence and credibility of the ECB. Danielle Auroi (EELV) also opposed the appointment of the ECB as supervisor.

The Bundestag debated the SSM on 17 May 2013 (protocol 17241). The principle of European banking supervision was not particularly controversial. In fact, almost all speakers with the exception of Axel Troost (Die Linke) were in favour of European banking supervision. Troost also agreed in theory but felt that there were not enough guarantees that supervision would become stricter and better than the German Bafin. He also questioned art. 127 TFEU as a legal basis for banking union.

Polarization mostly existed on whether the ECB was an appropriate choice as banking supervisor and whether it would be able to neatly separate banking supervision and monetary policy in-house. As Manfred Zöllmer (SPD) argued, the ECB would be a business partner and creditor. By contrast, the MPs from the governing parties defended the ECB's ability to separate its two functions (e.g., Volker Wissing, FDP; Peter Aumer, CDU/CSU). Although Ralph Brinkhaus (CDU/CSU) did question the ability of the European Parliament to scrutinize the ECB in its role as banking supervisor. Institutionalized ideas about the importance of central bank independence thus played a role.

The other German plenary debates also show that the opposition (the Greens and Die Linke) questioned the choice of the ECB as supervisor, that the SPD maintained scepticism towards the ECB after it entered government in 2013 and that even CDU MPs argued, as late as 2016, that the ECB should eventually be replaced by a separate body. There was also broad agreement that European banking supervision should focus only on

system-relevant banks, i.e., both government and opposition parties defended the same structurally relevant economic interests in line with H1.

5.2.2. The Positions on the Single Resolution Mechanism and Single Resolution Fund

In AN debate 20150219 of 5 May 2015 on the SRF agreement, all speakers supported the SRM and SRF's goal of breaking the feedback loop between bank failures and sovereign debt problems and of protecting the taxpayer from the costs of bank resolutions. As with the SSM, criticism focused less on the principle, but rather on the execution, and especially the German influence on the SRM and the SRF. It is clear that all speakers would have preferred a solution closer to the European Commission's proposals. Thus, Danielle Auroi (EELV) and Jacques Krabal (Radical party of the left) questioned the complexity of the SRM procedures and the multiple actors involved. Jérôme Chartier (UMP) questioned whether the resolution of a crisis within 48 hours was realistic given that systemic banks might have to produce 1,800 pages of resolution plans. Jean-Paul Dupré (Groupe socialiste, républicain et citoyen), wondered whether the non-participation of the UK and Sweden would weaken the positive effects of the SRM and SRF. The pressure on the government was again low.

A common theme taken up by almost all speakers is the size of the SRF, with the target of €55 billion being considered laughably small, unlikely to be able to support the failure of large banks and thus unable to truly protect taxpayers from the fallout of bank resolutions. Danielle Auroi (EELV) also demanded a faster mutualization of funds and criticized the national compartments. These two arguments reflect the importance of material interests, as France has a number of large banks that might be too big for the SRF, and the resolution of which would still have been costly for French taxpayers in a system based on separate national compartments. Similarly, several MPs specifically criticized the size of the French contributions to the SRF, which they regarded as too high given the low level of deposits (e.g., Jérôme Chartier, UMP; Jean-Christophe Fromantin, UDI). An exception was Éric Alauzet (EELV), who found that the high contributions of the French banks reflected the risks they took and their size. He argued that banks that are too big to fail have a responsibility towards the community.

The Bundestag debate on the SRM and the SRF of 14 March 2014 (protocol 18021) also shows that all speakers supported the basic principle of an SRM and SRF. The most critical speaker was Axel Troost (Die Linke), who liked the general idea but doubted that this specific system would be able to protect taxpayers. He questioned the ability of the SRF to handle a systemic crisis or even just the failure of a very large bank. He also argued that the current contributions to the national funds (including the German fund) were too small to add up to the target of the SRF. Another opposition MP, Gerhard Schick (Bündnis 90/the Greens), criticized the complex decision-making structures of the SRM and SRF and the creation of national compartments within the SRF. He also questioned the use of an intergovernmental agreement as opposed to EU law.

By contrast, government MPs such as Klaus-Peter Flosbach (CDU/CSU) and Manfred Zöllmer (SPD) argued that the current set-up with national compartments and a longer period during which the fund would be filled struck a healthy balance, as very high levies on banks might choke off the supply of credit to the economy. Both Flosbach and Hans Michelbach (also CDU/CSU) argued that the absence of national compartments would lead to the communitarization of debt. This reflected both the material interests of German banks by preventing 'their' contributions to be used to bail out foreign banks and Germany's perspective as a creditor state wary of risk-sharing and financial transfers.

The SRF experiences moderate polarization along government-opposition lines: while all parties agreed on the basic idea of an SRF, the opposition (the Greens and Die Linke) would have preferred a much larger fund that would become operational far sooner. All German parties defended the savings and cooperative banks against forced participation in this scheme, though, which also reflects the importance of sectoral interests in line with H1.

5.2.3. The Positions on European Deposit Insurance Scheme

In AN debate 20140152 of 30 January 2014, MPs from virtually all parties demanded the creation of a European deposit insurance scheme. Valérie Rabault (PS) further specified that the Cypriot crisis showed that a mutualization of national guarantees was crucial for the avoidance of bank runs.

In the case of the Bundestag, the European Commission's musing on the possible introduction of a European deposit insurance scheme was first discussed in the debate of 5 November 2015 recorded in protocol 18133. The debate was short (25 minutes long) but heated. The first speaker, Antje Tillmann (CDU/CSU), praised the progress made in moving towards banking union and the European initiatives to stabilize the banking system and reduce the risks for taxpayers. But she also pointed towards the non-transposition of key elements by numerous states, e.g., the fact that only 17 states had implemented the Directive on bank resolutions despite a deadline of late 2014, or the fact that only about half of the member states had transposed the Deposit Guarantee Directive. In addition, she pointed out that the first payments into the SRF were only due in 2016, and that banks had until 2024 to feed funds covering 0.8% of deposits into the system. She also felt that states still posed a risk to banks and vice versa. She concluded that the proposal for EDIS came too early and that national systems had to be fully operational first. This

criticism was shared by Alexander Radwan (CDU/CSU), Manfred Zöllmer and Christian Petry (both SPD), who also opposed the communitarization of deposit insurance and suggested that the Commission should first control the national transposition of existing rules before it creates a new European system. They saw a risk that German savers would have to pay for mistakes in other countries. Radwan and Petry also argued that the risks across member states had to become more comparable. This reflects Germany's material interests as a transfer-adverse creditor state.

The fact that savings and cooperative banks should not be covered by EDIS was a concern shared by all politicians, even those in favour of EDIS. For example, Axel Troost (Die Linke)—usually not an ally of CDU, agreed that the local saving and cooperative banks should not be part of EDIS, because of the risk that their contributions would be used to save *Zockerbanken* (gambling banks) or large risk-taking banks abroad. However, he stated that he would be open to EDIS covering the same type of bank, and in that case, national funds could be used to support banks abroad. He also argued that a European system would be more effective to combat future crisis and that the larger German banks—like Deutsche Bank—might well require such a system themselves at some point. Gerhard Schick (Bündnis 90/the Greens) agreed that EDIS was the only means to avoid taxpayers having to cover the costs of bank failure if the national deposit guarantee system was insufficient, but he too would exclude savings and cooperative banks due to their distinctive features. Thus, sectoral interests were again strongly defended by both government and opposition parties in line with H1.

6. Conclusion

Overall, in line with our expectations, the higher public salience of banking union was reflected in a more proactive scrutiny in the Bundestag compared to the AN. While the AN only held four debates, two of which were concerned with implementation, the Bundestag organized 18 debates on banking union, with 19 tabled resolutions compared to two in the AN.

In addition, the polarization of banking union was higher in the Bundestag, where a government–opposition divide existed especially in the case of the SRF. There was also some polarization on EDIS, but the importance of savings and cooperative banks meant that opposition MPs were also partially critical of EDIS. French MPs were generally highly supportive of banking union and most of their criticism was that integration did not go far enough. Differences between parties were comparatively minimal, and, in line with H3 and H4, the parliament was reactive and did not put much pressure on government.

The support for the position of the German government and the pressure to stick to it were both much higher compared to France. This is the result of the more proactive approach of the Bundestag with far more tabled resolutions and early debates. On the one hand, the government could lean on a cohesive majority, but on the other, the opposition closely scrutinized the government's performance and was quick to point out, for example, that the European decision to allow the ESM to recapitalize banks was a departure from the government's and parliament's previous line. The numerous (failed) tabled resolutions also hammered home certain points such as the opposition to the use of taxpayer money (e.g., the ESM) for the recapitalization or rescuing of banks, or the need to exclude the savings and cooperative banks from European banking supervision, the SRM/SRF, and EDIS.

Finally, it is clear that sectoral interests had considerable influence in both parliaments: In Germany, the interests of cooperative and savings banks were defended by both government and opposition parties. In addition, the material interests of Germany as a creditor country wary of financial transfers shaped its opposition to the mutualization of risks across states. Similarly, French support for a larger SRF and the mutualization of risk can be interpreted as a concern with the potentially high costs to the French taxpayer of resolving a large French national champion. The article thus agrees with the literature on the importance of structural interests in the creation of banking union. Ideas played a minor role, for example with regard to the importance of central bank independence in Germany. However, the debates do not reflect the fact that the German public is in fact more open towards the principle idea of European integration in this policy area than the French public.

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Conflict of Interests

The author declares no conflict of interests.

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Article

German Politics and Intergovernmental Negotiations on the Eurozone Budget

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Abstract
This article examines selected political party positions on a Eurozone budget and fiscal transfers between 2018 and 2021. It posits that German government positions on common European debt and fiscal policy have undergone a significant but fragile shift. It must contend with continued domestic hostility before it can be said to be a lasting realignment. A great deal with depend less on the Social Democratic Party that is largely responsible for bringing it about with the support of German Greens, and more on the willingness of the Christian Democratic Union, their Bavarian sister party the Christian Social Union and the German voting public to adopt a more interventionist fiscal policy as well, generating shared commitments to economic policy at home and in Europe. That has not happened yet.

Keywords
competitiveness; Economic and Monetary Union; European Stability Mechanism; European Union; Eurozone budget; fiscal union; Germany; public finance

Issue
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1. Introduction: Puzzle

How much of a shift has taken place in Germany's policies on the structure, rules, and institutions of the Eurozone? What kind of impact have German preferences had on the 2020 negotiations over the EU budget and the complementary Recovery and Resilience Facility (henceforth, the Rescue Plan)? How should its collaboration with France over these issues best be understood? And how is Germany's stance likely to evolve into the future?

Germany's relaxation of its role as anchor of the single currency and proponent of fiscal discipline was significant in mid-2020, bringing it closer to France and Southern European positions supporting common debt and fiscal capacity. One notable result of this relaxation was support for a joint initiative with France for temporary intergovernmental financial transfers designed to offset some of the costs of fighting the Covid-19 pandemic. The plan envisaged five hundred billion euros of grants to be distributed across the EU, financed through the issuance of common debt, a measure that previous German governments had refused to contemplate on principle. This borrowing and redistribution would come on top of another €250 billion raised by the European Commission and lent to the member states, as well as loans organized by the European Investment Bank which were already earmarked for investment in greener and more cohesive economic activity (European Investment Bank, 2021). Finally, in this context, the European Stability Mechanism (ESM) also stood ready to loan money in addition to the EU's budget and borrowing capacity. All told, the €750 billion increase in the EU's budget significantly increased EU capacity from just over €1 trillion to over €1,8 trillion, not including funds available through the European Investment Bank.

This development is striking in light of Germany's unwillingness to contemplate either borrowing or transfers, or even a contribution-based increase of the EU's

budget as recently as early 2020, and well into the first few months of the Covid-19 pandemic. Although the volume of grants was negotiated down to €390 billion in July 2020 and transfers came into question, this opposition came from a small coalition led by the Netherlands rather than Germany itself. While these developments cannot be considered German support for a Hamiltonian moment of European fiscal federalism, they cross the Rubicon of fiscal transfers between states and common debt for the first time. This makes it a significant change in Germany's Economic and Monetary Union (EMU) policy.

Given Germany's historical opposition to transfers and common debt, I ask whether this constitutes a transformation that will outlast the Covid-19 crisis, or a temporary deviation similar to that of 2004–2005. Although Germany is not the only country that matters in the trajectory of the Eurozone, it is decisive in which directions EMU can develop in response to challenges. EU agreements on Covid-19 response, and their budgetary implications pose more than one puzzle. How was a shift in Germany's position possible? How do we account for the timing, specifically the rapid shift in May 2020, given the continuity of Germany's stance on EMU rules beforehand? And how much of a change is this likely to entail?

This article seeks to answer these questions by focusing on the ideational positions of the Social Democratic Party (SPD) and the Christian Democratic Union/Christian Social Union (CDU/CSU) parties, with attention to selected leadership and public opinion allies in particular, supplemented by public opinion data. It focuses on the opportunities and constraints in Germany for the Finance Minister to bring about a shift in the country's macroeconomic policy stance on EMU, including the issue of EU financial transfers. The implications for the durability of Germany's rapprochement with France over the basics of EMU membership and its overall priorities after a longer period of estrangement between the two countries will then be considered. The article's primary conclusion, which it demonstrates below, is that Germany's voters and popular CDU/CSU parties will remain significant forces for fiscal restraint in the future, both at the national and European levels. This is seen in the parameters and conditions attached to the Rescue Plan, and in discourse over what happens when the existing plan expires. Depending on broader EU economic and political developments (whether the Eurozone comes under tremendous strain once the Rescue Plan expires), Germany can be expected to either block its extension (assuming little stress) or attach further conditions to its lending programs (if stress resumes). This article contributes to the literature on German preferences in EMU and its role in EMU politics. It begins by assessing the state of the literature regarding German preferences and negotiation strategies in EMU, which largely matches the record through March of 2018, and then moves on to assess how much change has occurred since then and why.

2. Framework and Case Design

Within the literature on EMU development and EU integration, large innovations naturally attract neofunctional analyses in which form follows need (Niemann & Ioannou, 2015), guided by EU institutions. It also attracts intergovernmental analyses that emphasise disparities in national positions and bargaining power coupled with lowest common denominator voting systems to explain the EU's institutional output (Howarth & Quaglia, 2020). The intergovernmental literature on EMU incorporates not only distributional conflicts between haves and have-nots, but also ideational divides that strengthen the differences between them (Schäfer, 2016). In other words, conflicts are not only about the transfer of resources, but also whether such transfers are appropriate. This article builds on the ideational analysis of EMU negotiations by examining whether and to what degree German policy ideas have changed as a result of the Covid-19 crisis.

This article hypothesises that national governments able to reach stable international agreements are those that hew closely to public preferences (Carrubba, 2001). This prioritisation of domestic political preferences forms the foundation of both liberal intergovernmentalist literature on institutional supply (Howarth & Quaglia, 2016, 2020) post-functionalist accounts of the impact of identity, ideas, political saliency and constraining dissensus of EU affairs (De Vries, 2007; Down & Wilson, 2008; Hooghe & Marks, 2009) and the kinds of outcomes they entail, particularly weak de novo institutions (Hodson & Puetter, 2019) or weak institutional architectures and endogenous cycles of institutional improvement (Jones, Kelemen, & Meunier, 2016; Kleine & Pollack, 2018). Similarly, it shows up in analysis of the impact of fiscal transfers on support for EU policy, and for supranational agreements in general (Chalmers & Dellmuth, 2015; Tallberg, Bäckstrand, & Scholte, 2018).

This leads to the expectation that heads of government as political entrepreneurs will promote and protect positions that reflect political demand at home over the medium to long term. In the case of German EMU policy, this is reflected in strong promotion of institutions that reduce risks at the national level, at the same time that financial assistance mechanisms across countries remain underdeveloped (Donnelly, 2018a; Schoeller, 2020). At the same time, we look to determine how much short-term policy entrepreneurship takes place in the absence of strong domestic political demand, driven by policy expertise and attempts to coordinate solutions that manage the country's interdependence with others on a mutually voluntary basis. This domestic, national orientation can be falsified by looking at the actions of a German Finance Minister who is broadly in agreement with a classic neofunctional network of supranational (EU, IMF, OECD) and transgovernmental institutions and actors.

To answer the questions posed above, this article focuses on Germany's domestic politics and its approach to Eurozone budget negotiations in the period stretching

from March 2018 until the fall of 2020. This start of this time frame is chosen to coincide with the installation of a German Finance Minister from SPD with sympathies for fiscal union between the Eurozone member states, who simultaneously is embedded in a Grand Coalition with conservative CDU/CSU. It is broken down into three moments in which economic and political conditions are markedly different: pre-Covid-19 crisis (March 2018–March 2020), early Covid-19 crisis (March 2020–May 2020), and advanced Covid-19 crisis (May 2020–). Each period then analyses German positions on common Eurozone responses to economic and political need, through existing institutions and programs (national structural adjustments buttressed where necessary by ESM emergency loans), or through common debt and cross-border transfers. Contributions to German policy are broken down into the positions of policy entrepreneurs (as elites), political parties, and voters, taking into account domestic, transnational and intergovernmental inputs.

The study starts by looking at the policy preferences and initiatives of the SPD Finance Minister of Germany and his second in command to advocate common debt and transfers within the Eurozone, together with the French and EU counterparts who supported such a shift. It then looks at the policy preferences and actions of the (CDU/CSU) party fraction which led the government and opposed any movement in this direction until mid-2020. Finally it covers the degree of public support for change or continuity over common debt and transfers. Through this, we can map German policy change, and ascertain the ability of the various parties to effect lasting change in EMU policy, and therefore institutions.

The literature on EMU development, German positions regarding fiscal transfers and the negotiations dynamics between France and Germany show consistencies over a longer period of time that underline Germany's deeply-seated domestic preferences for conservative monetary and fiscal policy (Hodson, 2017; Howarth & Verdun, 2020). This pattern remains consistent despite two concessions to French preferences for more interventionist and activist fiscal policy that can be attributed to the cognitive frameworks of individual German Chancellors. Helmut Kohl is known to have ensured that EMU proceeded despite concerns about the enforcement of fiscal membership rules due to Germany's historical duty to support European integration. Later, Gerhard Schröder worked together with France to introduce a relaxation of those rules in 2005. In addition to these two cases, Angela Merkel is known to have blocked attempts to push Greece out of the Eurozone in 2012 and 2015 to preserve the unity of the currency bloc. However, the original design of EMU, including the Stability and Growth Pact, and analyses of EMU negotiations since then rightly underline that political parties, public opinion and interest groups remain consistent in their rejection of common debt and cross-border transfers.

The frame for analysing Germany's domestic political attitudes toward EU budgets, transfers, emergency aid and repayment conditions starts with the question of whether Germany's parties and public respond favourably to them or not. If we witness a broad shift in thinking, then we should expect the new German position to remain stable over time, and for Germany to support similar Franco-German compromises into the future. If not, then we should expect the agreements to be of a one-off nature that applies only to a singular crisis situation, to expire after the crisis has passed, and for preferences from the Schäuble era to reassert themselves after the expiration of the current European Rescue Plan.

This article's working hypothesis is that a meaningful shift in German economic principles has taken place from ordoliberalism to neokeynesianism at the level of the German Finance Minister, his senior staff and his political party, and made visible by collaboration with French and European officials in the introduction of the 2020 Rescue Plan. At the same time, this shift is not fully shared by CDU/CSU politicians, or in domestic society. They remain committed to fiscal conservatism and expect Europe to return to the pre-Covid-19 economic rules after the crisis has abated. The weight of German political and public opinion is felt further in the absence of any increased public support for the SPD as a result of this policy shift. Overall, this speaks more to a temporary life span of the 2020 agreements, based on the expected tendency of major political parties to reflect societal demands unless a more fundamental disruption of the economy leads public opinion to review its ideational commitments.

This article proceeds as follows. It first reviews briefly the pre-2018 configuration of people, doctrines and institutions for the single currency to lay out the political and institutional landscape inherited by the actors around the table. It then moves to examine plans and negotiations in the period between March of 2018 and March of 2020, covering the rise of mutually supportive French and German finance ministers dealing with the prospect of a Eurozone budget. This is the potential neofunctional moment which did not come to fruition. In the penultimate section the article examines the period from April 2020 onward to underline the impact of Covid-19-induced changes on German, French, Dutch and Italian politics, and therefore the prospects for a Eurozone budget. We then conclude with observations about the dynamics involved that explain these developments.

3. Pre-2018: People, Interests, Doctrines and Institutions

Germany's politicians, voters and key opinion makers have been fairly consistent about their ordoliberal macroeconomic policy preferences since the planning days of the single currency. The exception was 2004–2005, when the Schröder government moved with the Chirac administration in France, and then the entire ECOFIN Council, to set aside the Excessive Deficit

Procedure and introduce medium-term budgetary objectives. Even then, however, the hold of ordoliberal principles is visible in Germany's SPD government instituting harsh structural adjustment reforms (Hartz IV) that counteracted any notion of broader political 'wetness' on social and fiscal policy. After the Schröder government left office in November 2005, three coalition governments followed under Angela Merkel that restored and pushed for the export of orthodox/ordoliberal macroeconomic principles across Eurozone member states, and EU budget oversight mechanisms to strengthen those demands (Otero-Iglesias, 2017). This owed a great deal to the shift of SPD under Finance Minister Peer Steinbrück (2005–2009) away from Keynesian demand stimulus and toward bipartisan consensus on budget retrenchment. This position left the German Green Party as the only champion of a more social macroeconomic policy, and intergovernmental transfers within Europe. With agreement between the CDU/CSU and SPD that Germany should reject fiscal union for EMU, Finance Minister Wolfgang Schäuble (2009–2017) could uphold this position throughout the next grand coalition (2009–2013), and the conservative-liberal coalition (2013–2018) that followed it. At the European and national levels across Europe, budgets were to be balanced (*Schuldenbremse*), and economies (re)structured to ensure price levels remain stable or move downward (focus on external competitiveness rather than domestic demand). Similarly, the EU budget was to remain limited. The strength of this imperative was tested after the Brexit referendum of 2016 led some other member states and EU institutions to call for a larger EU budget ("Schaeuble eyes," 2016). Throughout this long period of stewardship, Schäuble's steadfast position on European questions was rewarded with unwavering support from party and voters alike ("Politico poll of polls," 2020). Bremer (2020) also notes that the SPD unreservedly adopted the same positions on fiscal conservatism from that period on.

Schäuble's hawkish positions on EU budget size and on fiscal transfers set the tone for conditional cooperation with French politicians during his tenure. France had no meaningful impact on this stance. Rather, French governments varied in their willingness to work together with their German counterparts on EMU. France's politicians, voters and key opinion makers have consistently supported a more interventionist macroeconomic policy strategy, although each administration chose its own tactics on how to engage with Germany. The conservative Sarkozy government (2007–2012) worked together with Germany to establish macroeconomic policy surveillance and downplayed the fiscal union demands of its predecessors, while the socialist Hollande government (2012–2017) lobbied hard for fiscal union and relaxation of surveillance in the European Semester without much effect (Schild, 2013). Even a joint statement between French Finance Minister Emmanuel Macron and German Minister for Economics and Energy Sigmar Gabriel supporting transfers at the zenith of the 2015 conflict between Germany and Greece within the Eurozone (Gabriel & Macron, 2015) fell on barren ground as Schäuble pressed the imperative of national budgetary and structural adjustments, and the destructive moral hazard effect of transfers on necessary reform efforts (Schild, 2020). The liberal Macron government (May 2017–) found its own mix of supporting ordoliberal macroeconomic surveillance and structural reforms with more Keynesian proposals to establish a Eurozone budget. This proposal hoped to secure a transactional quid pro quo between French demands for greater collective budgeting, and German demands for greater structural reforms at the national level.

Howarth and Schild (2017) contend the Banking Union era from 2012 allowed France to advance proposals for embedded liberalism, in which market forces are softened with state intervention mechanisms. The successes they point to were the establishment of the European Financial Stability Facility as a crisis management tool (already from 2010) and the establishment, albeit formally, of a more symmetric macroeconomic policy recommendation framework in the Macroeconomic Imbalances Procedure in 2011. Certainly there is German and French collaboration on these institutional innovations under France's Sarkozy government, but if we were to try to measure embedded liberalism as the presence of macroeconomic shock absorbers, or of countercyclical macroeconomic intervention (fiscal stimulus during downturns, whether broad or targeted to promote sunrise industries, inclusivity and greening of the economy), we would not find evidence to support any meaningful influence of French ideas about macroeconomic policy along the lines of an EU budget or a new rule structure that gives national governments more fiscal room to manoeuvre. The European Financial Stability Facility, and the ESM that followed it, provide loans attached to conditions stipulating budget retrenchment and structural adjustments. They act as an emergency intervention to keep the single currency from falling apart, but have impacts that are incompatible with the mainstreaming of social protection that we understand under embedded liberalism.

Rather, the ESM is better understood as an institution that balances Chancellor Merkel's concern to hold the Eurozone together and Schäuble's concern for fiscal responsibility—a balance that is visible in the Eurozone's relationship to Greece in 2015. Pressure on national governments was increased, but not allowed to eject a member state. Similarly, the Macroeconomic Imbalances Procedure adopted in 2011, while opening the door to hypothetical critique of large current account surpluses in Germany and the Netherlands, or wildly inflated private debt levels, remains asymmetrical in application, focusing on country-specific recommendations for countries with public budget deficits and current account deficits, along with attention paid to the enforcement of such recommendations through the introduction of the

reverse qualified majority vote for the Excessive Deficit Procedure. These institutional innovations are indeed best understood as the product of selective Franco-German cooperation during the Sarkozy administration that focused on Eurozone system maintenance, rather than on Franco-German compromises on the budgetary and fiscal matters that France supported (Brunnermeier, James, & Landau, 2018; Degner & Leuffen, 2020; Lehner & Wasserfallen, 2019; Notermans & Piattoni, 2020). Degner and Leuffen (2020) underline that this was not dual leadership, but German. The limits were visible in France's failure to secure German support on a series of support mechanisms, including a more robust financial intervention role for the European Financial Stability Facility, and subsequently the ESM (Howarth & Schild, 2017, p. 185).

German imperviousness to French and other European demands were also visible in the outright hostility of Franco-German relations during the Hollande administration, which advocated directly for fiscal union and tried to gather together a coalition of countries to support its demands, but to no avail. 2011–2013 was a period in which Italy's technocratic Monti government and Spain's conservative Rajoy government were adopting ordoliberal prescriptions for budget cuts, structural reforms and toning down long-standing interest in fiscal union creation to secure renewed access to financial markets (Donnelly, 2018a). It was also a period of polarisation between Germany and the governments of Cyprus and Greece, in which the latter's demands for fiscal transfers poisoned the well for French and Italian arguments then and thereafter (through mid-2018: see the centre-left Italian Letta, Renzi and Gentiloni administrations, as well as the Conte administrations that followed). This growing gap is mirrored by strong support for Germany's stance by successive Dutch coalition governments led by Liberal Prime Minister Mark Rutte from 2011. As in Germany, budget discipline and rejection of EU budget enlargement or fiscal union enjoyed sustained and unquestioned cross-party support, with the exception of the Dutch Greens. In sum, the situation Olaf Scholz inherited in March 2018 in no way supported the development of a Eurozone budget, even if his reported preferences lay in that direction.

4. March 2018–March 2020: People, Interests, Doctrines and Institutions

March 2018 is a relevant inflection point to contrast with the time periods preceding and following because it is the moment that brings a German Finance Minister into office with sympathies for fiscal union of some sort, and with links to counterparts in the French government with the potential to support and shape his proposals. And yet, a new political desire to introduce a larger Eurozone budget failed to translate into concrete achievements on this front, given the lack of support from conservatives, and voters and his own SPD, which remained divided and focused on internal German politics at the expense of EU affairs. Olaf Scholz, mayor of Hamburg and member of the party's technocratic/conservative wing, took up the position of Finance Minister within Angela Merkel's grand coalition government between the SPD and CDU/CSU.

Scholz's position within his own party, as well as the electoral fate of the party, and internal party politics proved relevant for shaping what kind of proposals were worked on and brought forward during this period. As outlined above, the SPD up until this point had rejected the idea of a sizeable EU or EMU federal budget, and had hewed to Germany's mainstream conservative voters in their rejection of such proposals rather than adopting a profile distinct from that of the CDU/CSU (Bremer, 2020). But this strategy had not resulted in electoral success—the party remained persistently weak in the polls—and over time, led to increasing divisions within the party and voter migration to other parties as well. Advocates of greater European cooperation moved to the Green Party, which advocated a fiscal union of some kind and grew in importance in the Bundestag, but was relegated to the political opposition through this entire period. Conservative opponents of economic assistance to financially fragile Eurozone member states, meanwhile, launched judicial challenges to the European Central Bank assistance for Southern Europe (Saurugger & Fontan, 2019).

This centrist position led to problems within Scholz's own party, and hence hampered any ambitions he may have had to reshape domestic or European institutions. This was not just a question of uncertainty, but rather of internal division. In response to the Party's continued electoral decline, the membership's left wing began demanding a stronger domestic and European policy shift which the centrists found untenable, and even troublesome for legal reasons, given the country's constitutional ban on deficit spending (Karremans, 2020). Until August 2020, left and right cohorts within the party collided over the question of whether the 2005 decision to adopt ordoliberal prescriptions for austerity and structural adjustment in search of mainstream electoral support was a good move (in the sense of being a necessary evil to restore and maintain economic competitiveness and stable state finances) or not. To this question was added whether Germany should share financial burdens with other countries in Europe by supporting EU-level transfers and schemes. Younger party members and activists supported a shift away from ordoliberalism and the *Schuldenbremse* domestically, but remained relatively silent on European economic policy (Grunden, Janetzki, & Salandi, 2017).

This division was felt in December 2019 when the extra-parliamentary party, which is responsible for overall policy and strategy, moved to the political left. At the time, the SPD rejected Scholz as (non-parliamentary) party leader, and refused to name him as the party's (parliamentary) candidate for Chancellor in the next

election. The party selected instead a duo representing the centre- and left-wing cohorts of the party: Norbert Walter-Borjans, the centrist, was the former premier of North-Rhine Westphalia, and Saskia Esken, the left-wing leader, agitated for a break with the CDU, a shift to a more pro-social stance, an alliance with the Green Party, and possibly with anti-capitalist and anti-EU party Die Linke (The Left Party; "SPD candidate," 2019). This strong pull from the party leadership and membership for a sharp shift to the left raised important questions as well regarding the SPD's commitment to the EU overall, including a larger Eurozone budget. While this shift to the left might have given Scholz support for a common budget in principle, the manner in which the SPD was tearing itself apart over economic and European policy did not result in either policy wins or electoral gains. Public support for the SPD, which had been in steady decline for years, did not recover as a result of this shift. CDU voters remained loyal to their party, even as an evolving leadership contest to succeed Chancellor Merkel faltered with declining support for her designated successor, Annegret Kramp-Karrenbauer. She led the party from 2018 but resigned in February 2020.

At the same time as this conflict was playing out, Franco-German interaction on the prospect of a fiscal union for the entire EU or a Eurozone budget for those member states progressed quietly and slowly at the transgovernmental and intergovernmental levels. At the transgovernmental level, Scholz's right hand man, Jörg Kukies, worked with his counterpart in the French Ministry of Finance, Odile Renaud-Basso to devise plans for a workable improvement of the EU/Eurozone fiscal framework (Florence School of Banking and Finance, 2020).

Not much is known from transgovernmental documents about how far the overlap between the two sides went, but the intergovernmental level between President Macron and Chancellor Merkel tells us a great deal. The Meseberg Declaration of June 2018 was the result of a bilateral discussion between the two leaders, in which the topic of an EU budget was recognised as a topic of negotiation, without explicitly committing to such an outcome. But the negotiations did not favour France. This is demonstrated in the whittling down of Macron's Eurozone budget and fiscal union proposals into the Budgetary Instrument for Convergence and Competitiveness on the basis of German objections, which reinforced the structural adjustment and fiscal responsibility mantras of the existing European financial stability architecture, and the central role of the ESM in holding that system together in emergencies rather than EU funds (Schoeller, 2020). Later, in mid-2020, information from the two Finance Ministry representatives (below) will demonstrate that the negotiation is one of how to establish common measures that will satisfy financial markets (Florence School of Banking and Finance, 2020).

Outside of the central Franco-German relationship, the increasingly loud demands for fiscal union from Italy and the contrary demands for national responsibility from the Netherlands seemed to cancel each other out. This is visible as the Netherlands led a New Hanseatic League of small, Northern, fiscally conservative states afraid of Germany relaxing its insistence on EU frugality in its talks with France, and as the populist Conte I government in Italy insisted on transfers, each hewing to their own national publics (Hix, 2018; Matthijs & Merler, 2019).

Discussions at the 17–21 February 2020 Council meeting, before the pandemic spread across Europe, proved inconclusive. French and German negotiations had progressed under the radar, but their own domestic and international environments remained unchanged. Within the CDU, which had just lost an interim leader committed to the EU's status quo, none of the contenders to succeed Annegret Kramp-Karrenbauer yet envisaged moving toward a Eurozone budget.

5. April 2020 and the Aftermath

The Covid-19 lockdown drove Germany's government to introduce successive rounds of targeted domestic economic stimulus funded by borrowing with bipartisan support (Kluth, 2020), and provided an opportunity for the Finance Ministry to discuss a common position on EU budgetary instruments with France through May, and then take those plans to the European level. Temporarily breaking the sanctity of the *Schuldenbremse* domestically made these other initiatives possible, but the consequences for Europe remained contested within German parties, particularly within the SPD and the CDU/CSU.

In promoting EU stimulus, the government enjoyed tenuous but sufficient support. The SPD's Walter-Borjans supported EU assistance arrangements to be made swiftly and practically, while dealing with more fundamental problems later. This meant starting with the ESM as an existing instrument of solidarity among equals, but without 'humiliating' conditions that imposed hardship typical of ESM loans in the past (Carbajosa, 2020). The Greens went further, arguing that the ESM's tainted history demanded EU initiative based on grants instead (Hill, 2020). The SPD's Esken chimed in to support the Green proposal (Esken, 2020; Fritz, 2020). In other words, the SPD remained divided on the issue of support for grants to other member states, and a larger EU budget to do that. Bremer (2020) describes this as the party lacking a policy paradigm to bring to voters and apply to policy.

From within the CDU meanwhile, Armin Laschet, governor of the country's most populous state of North-Rhine Westphalia and then candidate to replace Merkel in the party's upcoming leadership elections, announced in April the necessity of a larger EU budget financed by contributions (rather than borrowing), akin to a Marshall Plan to combat the crisis, coupled with measures to repay once the crisis was over ("Laschet verlangt," 2020). Although Laschet would only be confirmed as Chancellor candidate in January 2021, this statement is meaningful

for the resonance it gained with party members and the broader electorate, which found the position appealing. Ironically, it placed the CDU in a more pro-Europe, pro-EU-budget and interventionist position than the SPD could definitively claim at that moment.

The CDU/CSU finally showed full support for grants and borrowing in mid-May, after Chancellor Merkel and President Macron proposed a €500 billion program of grants to be borrowed by the EU during the 2020–2027 budget and repaid collectively by the EU in the 2027–2034 budget. Insisting that Germany only prospers when Europe prospers, Merkel won support from CDU/CSU parliamentarians at home and in the European Parliament, and from Wolfgang Schäuble as well to set aside rejection of deficit spending, and grants at the EU level (Hill, 2020). Only Friedrich Merz, who unsuccessfully competed to succeed Merkel as CDU Chancellor candidate with support from the right, neoliberal wing of the party, railed against transfers along with the opposition liberals (Free Democratic Party) and the xenophobic, anti-EU right-wing party Alternative for Germany (Rinke, 2020).

Once the announcement had been made, Kukies and Renaud-Basso outlined the details of their project in an online event on 22 June 2020 with the European University Institute's Florence School of Banking and Finance (2020). They outlined their common strategy of targeted economic stimulus aimed at improving future economic performance. Collective European investments would be subject to these conditions, both through EU grants and loans backed by collective debt and ESM loans, with the former used more frequently for the first time. This reflected their shared domestic imperatives to ensure money supported a greener, more inclusive and more productive economy in the process. While Renaud-Basso underlined strategic investment, Kukies stressed that the plan had been designed in such a way as to underline the credibility of spending strategies to financial markets (Florence School of Banking and Finance, 2020). This meant that in tune with previous critiques of crisis-driven public spending in Greece and elsewhere, that a significant portion of the money would be spent on transforming the economy to meet future needs and generate future income, rather than spending it on income support without any further plans for economic development. The concrete implications of this can be seen in Commission and Council agreement that alongside investments in health care systems which required upgrading in light of the shortcomings revealed during the pandemic, that money would also be directed toward future growth in digital transformations and environmentally-friendly retrofitting of economy, society and public administration.

Kukies acknowledged that the plan ducked the question of the Hamiltonian moment of European fiscal capacity, noting that their plan shelved that question to a later date (Florence School of Banking and Finance, 2020). Instead, the focus would remain on the present, and designing the Rescue Plan to promote a more highly developed, productive, and resilient Europe in the near future. The overall construction was designed to ensure the EU could help badly hit economies, promote future recovery, assuage Italian rejection of loans with conditions attached, and push off Dutch (and more critical German domestic) concerns about an EU federal budget (below).

At the European level, the Franco-German announcement preceded Commission proposals, but was intended to be incorporated into them in combination with the Multiannual Financial Framework. In Council, the Frugal Four (the Netherlands and Austria, with support from Denmark and Sweden) supported the continued use of the ESM for emergencies and opposed grants and collective borrowing. They squared off against Germany, France and the other member states until the last hours of the 17–18 July summit, which they forced to extend to 21 July (Rose & Nienaber, 2020). During this time, the Four rejected grants outright until Sweden dropped its opposition on 20 July, followed by Denmark and Austria, leaving the Netherlands isolated. It achieved fewer grants and more loans with (undefined) conditions, and underlined the one-time nature of the measure. In the Netherlands' domestic justification of its eventual support for economic assistance, these elements of productivity enhancement and conditionality played significant parts of the government's reasoning that everything had been done to avert wasting money, laying the groundwork for a future crisis and prevent making future transfers permanent. The plan would be a one-off measure (Tweede Kamer, 2020).

While the German and French proposals had not been fully realised, the European agreement provided a precedent for a shift on domestic and European budgetary policy on which future German politicians could build, both on policy and on the basis of parliamentary support. Here the statements of various CDU/CSU politicians and opinion leaders shed light on where German policy is likely to stand, given the party's consistently strong standing in voter opinion surveys, ahead of the Green Party and the SPD in third place (Infratest Dimap, 2021). The party is also diverse in its views, but the favoured policies remain clearly outlined.

The most positive support for the Rescue Plan came from the former finance minister. Wolfgang Schäuble took the position that the Plan was a good step to keep the Eurozone together, and that a temporary relaxation of the budget rules was appropriate, given the high levels of debt required to stave off disaster. He also supported some reform of the rules before reinstating them. This put him in line with the European Commission, which announced the use of the escape clause in the Excessive Deficit Procedure. He did not go as far as to support the European Fiscal Board's call for a thorough discussion and overhaul of the pact, particularly their strong critique of the 60% of GDP ceiling on public debt (Fleming & Khan, 2020). Focusing on the effects of the fund,

Schäuble maintained that a common strategy would be crucial to whether the Fund works: How governments spend would be bound to determine success or failure of stimulus. The EU should discuss common strategies for funnelling investment into future productivity through digitalisation, artificial intelligence, greening the economy and the like (Chazan, 2021a).

This was as far as the rest of the Party was prepared to go in rethinking economic policy and law. Top Merkel aide Helge Braun proposed scrapping the country's debt brake (*Schuldenbremse*) or shifting from annual to multi-year exemptions in January 2021 (Braun, 2021). He reaped strong opposition within the CDU, starting with the CDU's General Secretary, Paul Ziemiak and the party's new Chancellor candidate Armin Laschet. Zemiak demanded the debt brake be reinstalled by 2022 rather than later as Braun had suggested (Chazan, 2021b). Outside the party proper, Lars Feld, conservative economist and member of the country's Council of Economic Experts, attacked a constitutional amendment required to repeal or change the *Schuldenbremse* as a slippery slope to hollowing out the deficit brake. Special exemptions would multiply and be hard to control (Seibel, 2021). Markus Söder, leader of the CDU's Bavarian sister party CSU, also rejected touching the law (Finke, 2021). This animosity to changing economic policy principles extended equally to the EU's plan. CSU MEP Markus Feder railed against the inclusion of grants entirely, expecting Italy to disregard conditions on loans (Finke, 2021).

Meanwhile, the CDU's candidate for Chancellor in the 2021 elections (Armin Laschet) demonstrated support for targeted, temporary assistance but also a need to return to pre-Covid-19 economic governance norms. Laschet himself had made a point domestically that state support for hospitals could only be used for corona-related deficits, and had to be repaid as soon as the pandemic was over. He also insisted on future budget cuts and minimizing transfers out of Germany to protect future generations from the burden of debt ("Laschet fordert," 2020). The fact that Laschet was responding to deficit hawks in the state SPD party underlines the conservative position of the centre in Germany's most populous state ("Laschet: Schulden für Rettungsschirm," 2020). Given these policy positions, plus the fact that the SPD show no sign of taking votes from either the CDU or Greens (Infratest Dimap, 2021), there is reason to believe these positions will dominate into the future. Even advice from the European Central Bank to amend the debt brake and the thinking behind it, most recently from Isabel Schnabel, has fallen on deaf ears (Arnold, 2021; Donnelly, 2018b).

European policy, both within the EU and the Eurogroup appear to follow this German concern with repayment and return to 'normal' as well, also with regard to timing. In early 2021, Scholz declared that the EU should not rush to a decision while there was still so much Covid-19-related uncertainty. Meanwhile, Eurogroup President Donohoe simultaneously called for a faster rollout of national plans to spend money, and also to discuss the re-introduction of budget rules, and the European Commission would consider a finite date for returning to the Excessive Deficit Procedure, but not until 2022 (Fleming, 2020, 2021). This hewed closer to Germany's position rather than that of France, which argued that an exit date would damage the recovery. Finance Minister Le Maire underlined that the Recovery Fund was already proving too slow and complicated to use to its full potential due to the requirement that national governments draft plans on how to use the funds and receive Commission approval before disbursement (Mallet & Abboud, 2021).

6. Conclusions

This article demonstrates the politics of introducing EU budgetary instruments and their alternatives to German voters and party members in three time periods: during the tenure of Wolfgang Schäuble, during that of Olaf Scholz before the Covid-19 lockdown, and that of Scholz in the context of the economic disruptions of 2020. Covid-19, combined with Merkel's leadership, has made it possible for the Germany and France to propose the Rescue Plan together by changing German political discourse from scepticism to acceptance of a larger EU budget, at least through 2024. Agreement on joint borrowing to finance this is more tenuous however, as the inclinations of the CDU/CSU's red lines on the EU budget demonstrate, and support for that party confirm. The freshly anointed CDU Chancellor candidate campaigned in 2021 on a program that envisaged a larger EU budget in the future (presumably from 2027, once the current Multiannual Framework runs out), but with greater restrictions on borrowing, and greater insistence on repayment of loans once the Fund has expired in 2024. This would mean a reversion to the prior fiscal oversight architecture, coupled with ESM-centred loan facilities and oversight mechanisms for emergencies that EMU inherited before the crisis started. Changes are made in an incremental fashion (Jones et al., 2016).

While the positions of France and Germany appeared deadlocked even in the early days of the Great Lockdown imposed by Covid-19, by June of 2020, the two countries had united on a temporary, but financially significant fund for the EU as a whole that some would like to see evolve into a more permanent set of fiscal transfers within the EU. However, there are clear signs that future German governments seek to return to the pre-Covid-19 architecture that reinforces norms of national fiscal responsibility and budget retrenchment, with the ESM as the lender of last resort (Rehm, 2021; Zagermann, 2021) rather than the EU, given the Commission's reluctance to enforce fiscal policy rules (Sacher, 2021). While an extension or expansion of the Rescue Plan and the principle of transfers cannot be ruled out, much as the European Financial Stability Facility became the ESM to combat

long-term financial market speculation against the borrowing capacity of individual member states, negotiation will not be easy, and the prospects for a Hamiltonian moment based on mutual debt and transfers should be measured with caution.

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Conflict of Interests

The author declares no conflict of interests.

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Article

The European Central Bank and the German Constitutional Court: Police Patrols and Fire Alarms

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Abstract
In May 2020, a ruling of the German Federal Constitutional Court (FCC) questioned the legality of the Bundesbank's participation in the European Central Bank's (ECB's) Public Sector Purchase Programme. Applying elements of a principal-agent analysis, this article analyses how the FCC ruling presents us with a new understanding of the relationship between the ECB, other EU institutions and Eurozone member states. Existing principal-agent analyses of the ECB focus upon its relations with other EU-level institutions and point to the limited ex ante control mechanisms and efforts to reinforce ex post control mechanisms—notably European Parliament oversight. The FCC ruling and the ECB's reaction demonstrate the relative importance of national level controls over the ECB agent. This article understands the role of private plaintiffs in Germany as a form of 'fire alarm' on ECB policymaking against the background of weak ex post controls at the EU-level.

Keywords
accountability; Bundesbank; Bundestag; Court of Justice of the European Union; European Central Bank; European Parliament; German Federal Constitutional Court; monetary policy; ordo-liberalism; principal-agent analysis

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1. Introduction

On 5 May 2020, the German Federal Constitutional Court (FCC) presented a ruling (*Weiss and others*, 2020) that put into question the legality of the Bundesbank's participation in the European Central Bank's (ECB's) Public Sector Purchase Programme (PSPP). The ruling created an intense backlash at the EU-level for its potential economic, legal and political implications. In the midst of an unprecedented crisis created by the Covid-19 pandemic, the FCC's ruling threatened to undermine, if not eliminate altogether, the most important macroeconomic response to the crisis implemented by the ECB at the EU-level—the Pandemic Emergency Purchase Programme (PEPP). The FCC's ruling is the latest episode of a long-term jurisdictional struggle between the German Constitutional Court and the EU Court of Justice (CJEU) over the operation of the ECB in particular, and EU integration more generally (Davies, 2012; see also Table 1).

Indeed, a group of German private plaintiffs has challenged before the FCC all the ECB's asset purchase programmes launched since 2010 (Arnold & Chazan, 2020a; De Cabanes & Fontan, 2019). Yet, judging the legality of ECB monetary policy falls primarily within the CJEU's jurisdiction. Hence, the FCC has passed on the cases to the CJEU through the preliminary ruling procedure but reserved the right to review the latter's

decisions. For example, when the European Court ruled against the complaint introduced by Peter Gauweiler—a former Bundestag member of the Bavarian Christian Social Union party—against the Outright Monetary Transactions (OMT) in 2016, the FCC judges recognized the primacy of the CJEU jurisdiction but they also expressed their dissatisfaction with the content and form of the CJEU ruling.

On 5 May 2020, the FCC judges found that the CJEU's *Weiss and Others* (2018, 2020) ruling was ultra vires as it failed to provide an adequate assessment of the proportionality of the ECB's PSPP. The FCC required the ECB to justify its programme to the German government and parliament within three months. More specifically, the FCC required the ECB to demonstrate that the economic impact of its bond purchases was proportionate to the objectives set out in the EU treaties—the Maastricht Treaty and the Lisbon Treaty (TFEU). Following the FCC ruling, if the German federal government and Bundestag (the lower house of the German federal parliament) had reached the conclusion that the ECB was exceeding its prerogatives, then the Bundesbank would have been obliged to withdraw from the PSPP and all German government bonds purchased by the Bundesbank under the PSPP would have had to be sold (Fazzini & Urbani, 2020). The FCC ruling does not disentangle the responsibility of the two institutions: "The Federal Government and the Bundestag are required to take steps seeking to ensure that the European Central Bank conducts a proportionality assessment" (*Weiss and Others*, 2020).

The ECB initially announced that it was subject exclusively to the jurisdiction of the CJEU, which had found the PSPP legal (Mersch, 2020). Several Governing Council members even argued that the ECB should not respond to the FCC ruling as it would create a legal precedent that could undermine the efficiency of its policies (Arnold, 2020). The CJEU and the European Commission also underlined that the FCC ruling was not in line with the constitutional order in the EU (Von der Leyen, 2020). However, during the two next months, the ECB deployed considerable efforts to prepare a detailed answer to the FCC's ruling. This answer demonstrates that the ECB was cautious to avoid a potential political and economic crisis linked with the ruling from German judges.

Against this background, the aim of this article is to analyse the politics of this new relationship between the ECB and the FCC, and between the ECB and national level fire alarms more generally. We thus seek to answer the following research question: How should we best understand the relationship between the operationally independent ECB and the FCC? Legal analysis provides important insights as to the impact of this issue on the EU constitutional order but limited guidance to explain the ECB's response to the FCC ("Preliminary References to the Court of Justice," 2015; "The German Federal Constitutional Court's PSPP Judgment," 2020; "The OMT Decision," 2014). From a political science perspective, the relationship between two independent institutions operating at the national and supranational level is a good vantage point to analyse power struggles and legitimacy concerns within Economic and Monetary Union (EMU). In particular, this conflict begs the question of who controls the ECB's monetary policy, knowing that the ECB has been granted an unprecedented level of independence from other institutions in its polity (Howarth & Loedel, 2005; Quaglia, 2008).

Applying elements of a principal-agent analysis, we answer this research question by arguing that the FCC ruling was a national level fire alarm—an ex post control on ECB monetary policy—which the ECB was unable to ignore politically. More precisely, we argue that the inability of police patrols and fire alarms to force the ECB to justify its nonconventional monetary policy at the EU level was conducive to the emergence of ex post controls at the national level. In other words, the perceived ineffectiveness of the control mechanisms over the ECB's monetary policy at the EU level increased efforts to hold the ECB to account at the national level.

Existing principal-agent analyses on these questions focus upon the EU-level and underline the considerable autonomy assigned to the bank by its member state principals, the limited ex ante control mechanisms (Elgie, 2002) and efforts to reinforce ex post control mechanisms—notably by improving the oversight of the ECB's monetary policy by the European Parliament (Jabko, 2003). The FCC ruling presents us with a new understanding of the application of a principal-agent analysis to the operation of the ECB agent and its relationship with its member state principals for two reasons. First, the control mechanisms were managed at the national level. Second, the control mechanisms included private plaintiffs. Conversely, studies of the relationship between national governments and parliaments and the ECB focus upon the 'politicisation' of monetary policy usually for domestic political ends (Dyson & Marcussen, 2009; Tesche, 2019). This national-level politicisation has not yet been examined in terms of the focus of the principal-agent analysis upon ex post controls on ECB monetary policy. However, the recent ruling of the FCC demonstrates the need to extend the principal-agent analysis to the national level. We also analyse how ex post mechanisms play out in the case of the ECB's other (non-monetary) policies—notably, banking supervision and the ECB's participation in the Troika—in order to highlight the specificities of these mechanisms when they apply to monetary policy.

The next section in this article examines the relevance of principal-agent analysis to the operations of the ECB and its relations with other EU institutions and national-level bodies. The third section examines the weak ex post control mechanisms at the EU and national levels, prior to focusing on the significance of legal challenges as fire alarms brought by private plaintiffs at the national level. The conclusion considers the likelihood of ongoing legal challenges at the national level.

2. Who Can Control the Independent ECB?

2.1. The Principal-Agent Framework and the ECB

This study employs elements of the principal-agent framework to analyze the surveillance relationships between, on the one hand, EU institutions, member states bodies and individuals and, on the other hand, the ECB. In applying elements of the principal-agent analysis, we recognize the potential validity of the argument that, with regard to the ECB's monetary policy, it is more appropriate to understand the ECB as a 'trustee' of national governments rather than as an 'agent' because monetary policy was delegated to overcome problems arising from time inconsistency (see Delreux & Adriaensen, 2017; Majone, 2001). In particular, the principal-agent framework cannot determine whether the ECB's policies are in line with the principal's preferences because the ECB's objectives were left deliberately vague in the treaty (Elgie, 2002). If this vagueness is interpreted as a commitment to ensure a high level of ECB autonomy, the risk of agency shirking or slippage is highly unlikely because the central bankers define their objectives themselves. By contrast, if this vagueness is interpreted as a mechanism to allow the principals' preferences to evolve, agency shirking or slippage can occur, but the time inconsistency problem remains.

Nonetheless, even as a trustee of governments, the issue of adequate scrutiny of ECB monetary policy remains and the concepts of ex post police patrols and fire alarms are analytically useful (Pollack, 1997). In a principal-agent approach, principals delegate authority, administrative responsibility and tasks to agents because of their organisational capacities and technical competence. Tensions exist because agents often have their own agendas, organisational imperatives, and turf issues that may conflict with those of their principals. Efforts by agents to seek autonomy from hierarchical control contribute to agency loss or slack in the forms of shirking and slippage. Shirking arises from the agent's preference to not fully implement the principals' preferences. Slippage arises when the agent develops distinct preferences from those of the principal as set in the terms of delegation. Slippage can be agent-induced or structure-induced. The latter occurs when the agent's use of its discretion derives neither from its own interests nor those of the principal but as a consequence of the environment in which the principal implements its tasks (Chang, 2020; Delreux & Adriaensen, 2017). Agency slack therefore rests on a continuum (Hawkins, Lake, Nielson, & Tierney, 2006; Heldt, 2017). Agents benefit throughout these relationships from the advantage of privileged information regarding their own preferences, capabilities, and efforts at implementing delegated tasks. This asymmetrical information limits principals from fully understanding and evaluating the activities of their agents (Kiewiet & McCubbins, 1991; Miller, 2005).

Principals attempt to address this information asymmetry and control the risk of agency shirking and slippage through ex post controls, known also as oversight procedures. These ex post controls are conventionally divided into 'police patrols' and 'fire alarms' (Kiewiet & McCubbins, 1991). 'Police patrols' consist of an active surveillance of a sample of the agent's behaviour by the principal with the aim of detecting any of their non-compliance with the principal's policy preferences. These include public hearings, studies, field observations and examinations of regular agent reports (Pollack, 1997). 'Fire alarms' are the principal's indirect ex post controls because in its monitoring of the agents' activities, the principal relies on the support of third parties. 'Fire alarms' are less costly but at the same time, they are also less centralised and tend to be more superficial than 'police patrols.' Classic principal-agent analysis expresses a clear preference for 'fire alarm' monitoring over police patrols (McCubbins & Schwartz, 1984).

All of these dynamics are present in the EU and more specifically with regard to the operation of the ECB, an agent that was granted considerable political and operational independence from both member state government principals and other EU institutions (Howarth & Loedel, 2005). Member state governments, operating as a collective principal (Chang, 2020; Dehousse, 2008) set the terms of delegation for the ECB agent in the Maastricht Treaty. The ECB is characterized by a narrow mandate, centred on the overarching objective of price stability, and a very high level of independence: It has the autonomy to define its policy objectives and instruments. The only meaningful operational restriction enshrined within the ECB mandate is the prohibition of the monetary financing of government debt. This prohibition derived from the influence of the Bundesbank on the ECB template (McNamara, 1998).

In the principal-agent framework, the modification of the mandate of the agent by the principals is the strongest form of ex ante control. Indeed, if principals notice agent slippage, they can modify the agent's objectives as well as its degree of autonomy. Yet, this ex ante control is hardly applicable in the case of the ECB because the modification of its mandate requires Treaty change and, thus unanimous agreement among EU member states (Jabko, 2009). Member states can also exert another form of ex ante control when they appoint the ECB's executive board. Yet, since member states have distinct, and at times opposed, economic preferences, the politics of ECB appointment follow an intergovernmental logic where the nationality of the candidate matters more than policy ideas (Fontan, 2016). Consequently, a change in ECB personnel is more informed by the outcome of power struggles between member states than by the logic of agency control. In sum, the diversity of preferences within the collective principal strongly undermines the ex ante controls over the ECB.

2.2. Weak Police Patrols and Fire Alarms at the EU-level

Three institutions form the police patrols in relation to the ECB at the EU-level. First, the European Parliament monitors ECB activities. The legal basis allowing the European Parliament's surveillance of ECB activities is very weak: The TFEU only requires the ECB to present its Annual Report to the Parliament. The Parliament expanded its monitoring function with the ECB's active cooperation from 1999 onwards with the use of a number of mechanisms including reports, questions addressed directly to the ECB in letter form, and questions to the ECB Governing Council members who attend meetings of the Parliament's Economics and Finance Committee. This voluntary cooperation benefits both institutions: On the one hand, the ECB strengthens its democratic responsiveness—or at least the appearance of this responsiveness; on the other hand, the European Parliament gains a position of privileged interlocutor with the ECB despite its historical weakness on macroeconomic issues (Jabko, 2001). Yet, the lack of coercive legal tools weakens the oversight power of the Parliament. In the rare direct confrontations between the ECB and the Parliament, the latter's position was systematically dismissed by central bankers in the name of their independence. For example, the European Parliament (2014) adopted a resolution criticizing the role of the ECB in the EU Troika expert groups sent to countries benefiting from EU loans. The ECB dismissed the Parliament's criticism and continued to participate in the Troika.

Second, the EU Court of Auditors performs audits on some ECB activities. In 2018, the Court audited the ECB in its role as banking supervisor, but only partially, since the ECB would not make certain documents available during the audit. The compromise found between the two institutions was to sign a memorandum allowing the release of bank-specific data to the Court of Auditors while the latter underlined that it was 'not seeking to audit monetary policy' (Court of Auditors, 2019).

Third, the CJEU has the power to investigate ECB measures when third parties legally challenge it within a period of two months (article 263 TFEU). From a principal-agent perspective, third parties are fire alarms. At the EU-level, they include the European Commission and the European Parliament in that these institutions are not part of the multiple principals and had, at most, a secondary role in determining the original ECB mandate. Both institutions can launch legal proceedings against the ECB. However, since the start of EMU in 1999, neither the European Parliament nor the Commission have ever legally challenged the choice or design of the ECB's monetary instruments. Neither have operated as a fire alarm on ECB monetary policy. However, the European Commission has brought cases against the ECB to the CJEU on other matters including the delimitation of competences between the Commission and the ECB (*Commission v. ECB*, 2003).

Finally, the history of CJEU jurisprudence towards the ECB shows a marked contrast between the legal cases on monetary policy and other issues (De Cabanes & Fontan, 2019). On the one hand, CJEU judges perform a substantive analysis on cases that are not directly related to monetary policy and sometimes rule against the ECB opinion. On the other hand, when CJEU judges have to evaluate the legality of monetary instruments, their judicial review is procedural and they are careful not to second-guess the ECB opinion (Baroncelli, 2016).

2.3. Weak National Police Patrols

Turning to the national level, the Eurozone member states rely on their national parliaments and courts to monitor the ECB's monetary policy. In addition to sending its annual reports to national parliaments, ECB members have appeared in front of national parliaments, albeit only as a voluntary gesture of goodwill. An analysis of Mario Draghi's visits to Eurozone national parliaments shows that these visits were more akin to ceremonial strategies for the ECB to improve its accountability rather than a true form of parliamentary control (Tesche, 2019). By contrast, national parliaments can forcefully invite ECB members to appear before national parliamentary committees on banking supervision issues (Fromage & Ibrido, 2018). However, Gandrud and Hallerberg (2015) argue that no EU member state has achieved a significant level of parliamentary scrutiny of banking supervision—by either national bodies or the ECB—which owes in part to the commercial sensitivity of the policy area.

In sum, while the process of collecting information may produce disciplinary effects through the systematic use of surveillance techniques, the compliance of agents ultimately depends upon the application of meaningful sanctions. Yet, the structural features of macroeconomic governance in the Eurozone allowed the ECB to benefit from an unprecedented degree of institutional autonomy. The legal dispositions enshrined within the European treaties provided no procedural mechanisms to other EU institutions to exert meaningful control over the ECB's monetary policy. Moreover, the deep economic and ideological divisions among Eurozone governments weakened the possibility of such controls. Hence, police patrols at both the EU and national level on ECB monetary policy and other activities have had limited impact. Given the high level of ECB independence and the timidity of police controls, the only form of potential ex post sanction for agency slippage involved the CJEU. However, over the first two decades of EMU, the ECB had avoided CJEU legal sanction that required any significant change in monetary policy. Against this background, private plaintiffs at the national level started to challenge the CJEU by launching cases in the national legal system that, through the preliminary ruling procedure, were pushed up to the EU-level.

3. The Extension of De Facto National Controls over ECB Monetary Policy

3.1. Asset Purchase Programmes and Ordo-Liberalism

The asset purchase programmes implemented by the ECB potentially undermine two core elements of the ECB's mandate outlined in the Maastricht Treaty: the primary focus on price stability and the prohibition of the monetary financing of government debt. Given the relatively low inflation rate over most of the past decade, the topic of price stability is less immediately relevant for those concerned with ECB slippage—although there have been several challenges to the ECB on this matter and the ECB has insisted on the neutralization of its asset purchases (see, for example, Högenauer & Howarth, 2016). Thus, agency loss, here slippage in terms of asset purchase programmes, focuses on the extent to which these programmes involve, de facto, the monetary financing of government debt. The ECB itself has insisted that sovereign bond purchases are necessary to ensure the adequate transmission of its monetary policy throughout the Eurozone and not to fund governments per se (ECB, 2015). In line with this argumentation, the ECB Governing Council delimited the purchase of sovereign debt from different national governments in the Eurozone according to its capital key—that is, the percentage of debt purchased from national governments is determined by the percentage of capital that they have contributed to the ECB. While, de facto, the ECB is engaged in the purchase of sovereign debt, it must demonstrate that these purchases are proportionate to its policy objective—that is, that their benefits outweigh their potential costs (Schnabel, 2020).

From a macroeconomic perspective, this evaluation is rather straightforward. Because sovereign debt forms the bedrock of modern financial markets, its stabilization is necessary to prevent the aggravation of financial crises (Gabor & Ban, 2016). From this perspective, the lines between monetary and fiscal policies are necessarily blurred. However, beliefs on monetary policy and central banking arrangements vary. In Germany, these beliefs are still heavily influenced by ordo-liberalism, an economic doctrine that advocates the strict separation between fiscal and monetary policies and a prioritisation of price stability over other monetary policy objectives as necessary components of a democratic legal order (Young, 2014). Other creditor countries in the Eurozone, such as the Netherlands and Finland, share these monetary preferences, although the salience of monetary issues is lower than in Germany (Frieden & Walter, 2017; Nedergaard, 2020).

In fact, since 2010, the strongest expressions of concern regarding ECB asset purchases came from German politicians and officials at the national level (see also Rehm, 2021). For example, Wolfgang Schäuble, the former German Finance Minister, blamed ECB unconventional monetary policy for the rise of the far-right party, Alternative Für Deutschland (Wagstyl & Jones, 2016). A small number of national central bank leaders, notably the Bundesbank President and Governing Council members have publicly opposed ECB asset purchases (Howarth, 2012). Members of a range of national parliaments have also expressed concern and criticism—notably in Germany and the Netherlands ("Dutch parliament," 2019). Högenauer (2019) shows how ECB monetary policy became politicized in the Bundestag since the start of the sovereign debt crisis. While it is highly unlikely that this criticism forced any real change to ECB monetary policy—given ECB independence and the diversity of views in Eurozone countries—it forced the ECB to respond principally in terms of increasing outreach and communication effort to explain its monetary policy (Tesche, 2019). Draghi visited the Bundestag twice during his term as president and a number of other national parliaments once.

3.2. National Courts as Fire Alarms

The potentially most effective fire alarm to challenge ECB monetary policy involves judicial and administrative reviews. Judicial review by the CJEU is allowed by TFEU articles 263 and 277, while national courts can also engage in judicial review but—through the preliminary ruling procedure (article 267 TFEU)—are expected to push the cases up to the CJEU. There is also administrative review by the ECB's Administrative Board of Review and by national competent authorities on the ECB's role in banking supervision. However, with regard to monetary policy, this review has not been used.

To date, there have been numerous legal cases brought by private plaintiffs against the ECB that national courts have referred up to the CJEU. Most of these cases have focused on the ECB's role in banking supervision (Berger, 2019). However, a number of these cases focused on the ECB's monetary policy, notably on the Greek case (*Accorinti and Others v. ECB*, 2014). All the legal cases brought against the ECB's asset purchase programmes were undertaken by German private plaintiffs, who followed a logic of trial and error (for a full list of cases brought against the ECB asset purchase programmes adopted since 2008 see Table 1). The first constitutional complaint brought by German plaintiffs against ECB programmes was directly filed with the FCC, which found them baseless (2BvR 987/10, 2BvR 1485/10, 2BvR 1099/10). The German plaintiffs filed their second and third complaint directly with the CJEU (T-532/11, C-102/12P, T-492/12, C-64/14P). The latter dismissed their application and indicated to the plaintiffs that they should first address their complaint to the national constitutional court, which would then refer the case to the CJEU (T-492/12, alinea 47). Following the CJEU's indication in its ruling, the German plaintiffs complained directly to the FCC, which then referred to the CJEU for all the subsequent cases.

Table 1. Summary of the legal cases brought against ECB asset purchase programmes.

Case	Plaintiff(s)	Rulings	Ruling summary
Securities Markets Programme/constitutional complaint (2010)	Hankel, Nölling, Schachtschneider, Spethmann, Starbatty, Gauweiler	FCC 2 BvR 987/10 2 BvR 1485/10 2 BvR 1099/10	Constitutional complaints dismissed because unfounded. The Securities Markets Programme respects Article 123.
Securities Markets Programme/action for annulment (2011)	Städter	Tribunal of the EU T-532/11	Action dismissed as manifestly inadmissible as it was filed out of time.
Securities Markets Programme/appeal (2012)		CJEU C-102/12 P	Appeal dismissed as manifestly unfounded.
OMT/action for annulment (2012)	von Storch and 5,216 other plaintiffs (Zivile Koalition)	Tribunal of the EU T-492/12	Action dismissed as inadmissible, as the applicants were not directly concerned by the contested acts.
OMT/appeal (2014)		CJEU C-64/14 P	Appeal dismissed as manifestly unfounded.
OMT/constitutional complaint (2013)	Gauweiler, Hankel, Nölling, Schachtschneider, Starbatty, von Stein, Die Linke Group at the Bundestag, Huber and 12,000 other plaintiffs (Mehr Demokratie)	FCC 2 BvR (2728/13—2731/13) 2 BvE 13/13	The FCC rules that the decision to create the OMT programme is in contradiction with TFEU (Art. 119, 123 and 127 TFEU and Art. 17 to 24 ESCB Statute). Suspension of proceedings, reference for a preliminary ruling to the CJEU.
OMT/prejudicial demand (2014)		CJEU C-62/14	Articles 119, 123 and 127 of the TFEU and Articles 17 to 24 of the Statute of the ESCB should be interpreted as allowing the ESCB to adopt the OMT programme.
OMT/2016		FCC 2 BvR (2728/13—2731/13) 2 BvE 13/13	The FCC follows the CJEU ruling but points out that the CJEU procedural analysis is problematic.
PSPP/constitutional complaint (2015 and 2016)	Weiss, Lucke, Starbatty, Gauweiler, von Stein, Städter, Kerber and 1,700 more plaintiffs	FCC 2 BvR 859/15 2 BvR 1651/15 2 BvR 2006/15 2 BvR 980/16	The FCC rules that the PSPP programme does not respect the TFEU (Art. 119, 123 and 127 TFEU and Art. 17 to 24 ESCB Statute). Suspension of proceedings, reference for a preliminary ruling to the CJEU.
PSPP/Prejudicial question (2018)		CJEU C-493/17	The PSPP programme respects the TFEU.
PSPP (2020)		FCC 2 BvR 859/15, 2 BvR 980/16, 2 BvR 2006/15, 2 BvR 1651/15	The FCC finds the CJEU ruling ultra vires and asks to the German parliament to assess whether the PSPP is proportional to the ECB objectives. If not, the parliament must order the Bundesbank to withdraw from the PSPP.

Source: Authors' own compilation based on De Cabanes and Fontan (2019).

In all these cases, the German plaintiffs complained about the legality of asset purchases in the name of ordo-liberal principles (De Cabanes & Fontan, 2019). According to the plaintiffs, purchases of sovereign debt belonged to the realm of economic policy rather than monetary policy and disrespected the 'no bail out' clause of the TFEU (Articles 119 and 127). These concerns related directly to the strict separation between fiscal and monetary policy in the ordo-liberal doctrine and fears of moral hazard and the fiscal profligacy of Southern Eurozone member states, which had been kept alive by German political and economic policymaking elites since the creation of the Eurozone (Howarth & Rommerskirchen, 2013). These arguments were reiterated by Jens Weidmann, the Bundesbank President, in his 2013 hearing before the FCC (Ewing, 2013), which

incorporated them into its prejudicial question to the CJEU. After the CJEU dismissed these arguments in its final ruling, the FCC expressed its concerns about the lack of both CJEU independent expertise on monetary issues and counter power to the ECB at the EU-level (Gauweiler and Others, 2016). The FCC had laid down the gauntlet on the ECB asset purchase programmes.

The recent *Weiss and Others* case against the PSPP can be seen as a reaction by a group of German plaintiffs to the CJEU ruling on the *Gauweiler* case and their failure to rein in ECB sovereign debt bond purchases (Van Der Sluis, 2019). This was a national level fire alarm in reaction to the perceived inadequacies of both EU-level police patrol/fire alarms with regard to the ECB agent. The FCC set the standard of evidence of proportionality very high requiring potentially a full study of the PSPP and proof that its benefits outweighed possible negative effects across any other sector or part of the economy. This is in strong contrast to the jurisprudence of the FCC toward the Bundesbank: The former never ruled a legal case in relation to the monetary policy implemented by the latter (Van Der Sluis, 2019).

The ECB refused to send proof to the FCC that the PSPP complied with the principle of proportionality. Instead, ECB Governing Council members reiterated through press interviews that the ECB was accountable to the European Parliament and subject to the jurisdiction of the CJEU alone (see, for example, Lagarde, 2020). Despite the ECB's defiant response, there is evidence that the ECB sought to avoid future conflict with the FCC. The ECB took unusual steps to demonstrate that its monetary policy decisions and the unconventional instruments they used were compliant with the principle of proportionality pursuant to Article 4 TFEU (Nicolaides, 2020).

First, central bankers referred repeatedly to the proportionality of their asset purchase programmes during the Governing Council meeting of 3–4 June 2020, the first to follow the FCC ruling (Nicolaides, 2020). The summary of this meeting differs significantly from the previous twenty-one summaries of Governing Council meetings, notably in terms of the use of the words 'outweigh/outweighed' and 'proportionality/proportionate/proportional' (Nicolaides, 2020):

> Not only does the account refer to the positives outweighing the negatives of PEPP but…it also hedges the position of the ECB in relation to critical issues in the judgment of the FCC, such as the weight that could be attached to the various effects, possible unintended effects of monetary policy, the effectiveness and efficiency of monetary instruments and the impact of low interest rates. (Nicolaides, 2020)

Second, the ECB responded to the FCC ruling by passing previously unpublished documents to the Bundesbank, which then passed them to the German finance minister, Olaf Scholz, who in turn passed them to the president of the Bundestag (Arnold & Chazan, 2020b). While these documents were not to be made available to the wider public, they were to be examined by the German Ministry of Finance and the Bundestag's Budgetary Committee operating in camera. On 2 July 2020, the Bundestag officially announced that it supported the ECB, having found that the central bank's PSPP was proportional to its price stability objectives (Arnold & Chazan, 2020c).

The ECB's additional release of information and the modification of the ECB's public justification of its asset purchase programmes are consistent with its overall reputation-building strategy, through which the central bank has tackled public contestation by increasing its communication on controversial issues (Moschella, Pinto, & Martocchia Diodati, 2020). The ad hoc and informal collaboration of the ECB with the Bundesbank and German political institutions without any formal change to the ECB's accountability either through unilateral ECB official clarification or treaty change can be seen as a 'procedural' type of accountability (Dawson, Maricut-Akbik, & Bobić, 2019), which weakens the logic of checks and balances within the Eurozone. In terms of principal-agent analysis, this can be labelled as 'buffering' (DiMaggio & Powell, 1991; Hawkins & Jacoby, 2006). Buffering involves the provision of information and reporting by the agent in its attempt to satisfy the principals without revealing too much information (Hawkins & Jacoby, 2006). The label can also be attached to the ECB's largely symbolic engagement efforts with national parliaments (Tesche, 2019). Indeed, the ECB failed to prove that the benefits from its asset purchase programmes outweighed any negative effects in any other sector of the economy because it lacked a model that could aggregate the effects of these programmes in diverse sectors and add them up in any meaningful measure. The ECB was only able to demonstrate that the positive effects exceeded negative effects for a number of specific sectors, including banking. While ECB buffering can be seen as central to the successful resolution of the difficulties created by the FCC ruling, we lack the space in this contribution to examine in full the role of the ECB agent in this context.

In sum, the substance of the arguments mobilized by German public actors and private plaintiffs and, subsequently, by the FCC, shows that they have acted as a national fire alarm in the fear that the ECB was moving too far away from its original monetary policy mandate, based on the Bundesbank (McNamara, 1998). The FCC argument about the lack of counter-power to the ECB at the EU-level also shows that the increased role played by fire alarms at the national level was linked explicitly with the lack of substantive pressure over ECB monetary policy at the EU-level. While the judicialisation of monetary policy by German private plaintiffs forced the ECB to divulge additional documents and provide additional explanations on its asset purchase programmes, it did not trigger adverse moves from either the German political authorities or the Bundesbank, which had vociferously criticised the PSPP since its inception (Braun, 2016;

Howarth, 2012). Explaining this paradox—specifically the failure of German political and elite economic policymakers to sound the fire alarm in 2020—is likely linked to the severity of the Covid-19-induced macroeconomic crisis in the Eurozone. The aim to avoid a full-blown constitutional crisis in Germany, in which German political authorities would order the politically and operationally independent Bundesbank to withdraw from the Eurosystem of central banks is another potential explanation. Finally, the lack of consistency in the discourse of German elites on ECB monetary policy could be explained by scapegoating tactics, whereby elites score political points at the national level by criticizing ECB policies with ordo-liberal arguments but refrain from assuming the consequences of a German withdrawal from the Eurozone. However, without further empirical research, it would be imprudent to attempt to disentangle these causal explanations: a full explanation of the German politics on the ECB's PSPP must be the subject of another article.

4. Conclusion

We return to the research question posed in the introduction to this article: How should we best understand the relationship between the operationally independent ECB and the FCC? We answer this question by arguing that the FCC functions as a fire alarm and in effect a filter for private plaintiffs with the potential to sanction significantly the ECB through rulings on Bundesbank action. We argue that the efforts of German private plaintiffs and the FCC ruling present us with a new understanding of the application of a principal-agent analysis to the operation of the ECB agent and its relationship to its member state principals because the control mechanisms were managed at the national level. Private plaintiffs challenged the ECB for operating in a manner they believed was contrary to its mandate and, specifically, challenged the participation of the Bundesbank in the ECB's PSPP by filing a complaint before the FCC. The FCC pulled the fire alarm by ruling in favour of the private plaintiffs and explicitly requiring the Bundesbank to end its participation in the ECB's PSPP if the latter failed to justify the wider macroeconomic effects of its nonconventional monetary instrument. Both the private plaintiffs and the FCC sought to uphold what they in effect argued and ruled was the correct understanding of the ECB's mandate as agreed by member state heads of government and state in the Maastricht Treaty and inspired in large part by the German central bank and government (Dyson & Featherstone, 1999). The FCC also intentionally and explicitly sought to highlight the weakness of both EU-level police patrols and fire alarms in relation to the ECB agent and specifically the weakness of the CJEU as a mechanism of control. The indignant response of both the CJEU and the European Commission with regard to the German Constitutional Court's ruling focused principally upon its proclaimed illegality and the assertion of the supremacy of EU law and courts on matters concerning ECB monetary policy. However, the response of the ECB—in passing information to the German government and parliament seeking to demonstrate the macroeconomic proportionality of the PSPP—to avoid a potential constitutional, political and economic crisis shows that the FCC ruling could not be easily ignored.

Stepping aside from the empirical analysis that has driven this article and turning to more normative considerations, we note that the legal and institutional vacuum in which the ECB has operated its nonconventional monetary policy since 2010 can be seen as highly problematic for the balance of powers between the ECB and the other institutions of the EU political system. EU-level ex post controls have been perceived as inadequate. At the same time, we recognise that it is also politically problematic for the FCC to fill the gap by pushing control over the ECB agent to control over the Bundesbank element of that agent. In addition to the legal issues that the FCC's ruling raises, a number of tricky political questions arise. For example, to what extent did the response of the ECB agent reflect the relative economic and political importance of Germany in the Eurozone? Would such a legal challenge in a smaller, less economically and politically important Eurozone country force the ECB to respond in the same way? The unclear answers to these questions raise legitimacy concerns. In the end, the German private plaintiffs did not get their way and the ECB's PSPP was not terminated. However, the ECB's forced response to the FCC ruling combined with the politically timid acceptance of this response by the German government and parliament, sets a clear precedent. The national (German) legal fire alarm highlighted the problematic democratic vacuum in which the ECB operates. A future court case is only a matter of time.

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Conflict of Interests

The authors declare no conflict of interests.

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Article

Covid-19: A Different Economic Crisis but the Same Paradigm of Democratic Deficit in the EU

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Abstract
Based on a normative orientation and an interdisciplinary perspective, this is a comparative study, using the process tracing methodology, between the EU responses to Eurozone and Covid-19 crises to assess if, despite different outcomes, institutional decision-making processes evidence a change. The study concluded that the EU democratic deficit remains, which assumes special features in economic crises, providing a political oversize power to the economically hegemonic states, thus constraining ideological debate and making national interest prevail over politicisation. This perpetuates the conversion of structural economic positions into political power at the expense of political representative power and democracy.

Keywords
democratic deficit; Covid-19; EMU governance; Eurozone crisis

Issue
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1. Introduction

Eurozone debt and Covid-19 economic crises can be considered as 'critical junctures' (Braun, 2015, pp. 421–422; Heinrich & Kutter, 2013, pp. 124–126; Ladi & Tsarouhas, 2020, pp. 1042, 1051–1052; Schmidt, 2020, pp. 1179, 1182), understood as a sequence of abnormal and unexpected events, exogenous to the political system, requiring reactions and answers that may result in institutional change, impacting political institutions and policies (Capoccia, 2015; Stark, 2018). Therefore, they are also opportune moments for assessing the democratic legitimacy of the EU.

Based on a comparative analysis of the EU responses to both crises, this research assesses the importance of the constitutional design to allow politically balanced outcomes and prevent economically biased decisions. The study departs from the hypothesis that the existing institutional design leads to an oversized political power of a few economically hegemonic states, tending to achieve inexpedient outcomes and to reproduce structural economic imbalances. The research is normative-oriented, relying on the importance of the constitutional architecture of the EU in the context of economic crises to grant democratic legitimisation.

The first part of the article presents the methodological approach that is used, the second provides a theoretical review of the democratic deficit in the EU, while the third part presents a short description of responses to crises; finally, the fourth section delivers the empirical analysis supporting the hypothesis and anticipating lines for discussion and conclusions.

2. Methodology and Empirical Analysis

Process tracing (PT) methodology is used for empirical qualitative analysis of the institutional reforms and policy outcomes following the Eurozone and Covid-19 crises. PT is a causal inference methodology based on a diagnosis of causal activities and/or events to build rational arguments for hypothesised explanations of a certain phenomenon (Bennett, 2010, p. 208). An accurate

qualitative analysis to observe causal mechanisms is made (Beach & Pederson, 2016, p. 163; Collier, 2011, pp. 823–824), through a detailed and sequenced method for rational inference, grounded in tracing previous events of a result to argue its causes and provide theoretical hypotheses to the outcomes' causality. It may be a means to both testing and building theories, or to merely explaining an outcome (Beach & Pederson, 2016, p. 2). This research uses theory-testing approach to PT to find evidence that the already theorised democratic deficit is the cause of the hypothesis posed, intending to demonstrate that despite evidences of policy change in Covid-19 crisis, the same democratic perversion happened in institutional mechanisms.

Theory-testing-driven PT takes theory from literature to demonstrate that it is present in the form of causal mechanisms—events/activities observed and subject to inference—fostering a certain outcome. It is viable when a grounded theory already exists from which a plausible mechanism may be deduced and forward-tested in a case study (Beach & Pederson, 2016, pp. 12–15, 29, 164). The further identified causal mechanisms are defined as derivations of the democratic deficit underpinning the rationale of this research. Therefore, X and Y must be present in the PT inference, where X is hypothesised to lead to Y (Bennett, 2010, p. 209). In this research, X is defined as the democratic deficit and Y as the oversized political power of the economically hegemonic states. To prove the correlation, events/activities are described, reasoned and conceptualised as manifestations of X, that is, of the theory on which the analysis is based (Collier, 2011, pp. 824, 825). Primary and secondary sources are used, such as institutional EU documents, political testimonies, news media, and scientific literature, covering the 2009–2015 period, the peak of the Eurozone debt crisis, and the period between February and September 2020, related to the analysis during the pandemic. The PT approach is rooted on a normative orientation, derived from the democratic deficit theorisation of the EU political system, and specifically the EMU institutional architecture.

3. On the Democratic Deficit of the EU and EMU

The EU and the EMU have long been diagnosed by scholars as suffering from democratic deficit and legitimacy. Although these two terminologies may overlap when assessing democracy in the EU, they have differences when considering the criteria and scope of assessment of a political system. While the democratic deficit is based on the principle of a constitutional design corresponding to representative democracy for legitimising the exercise of power, legitimacy, although it may entail premises of democratic procedures, aims at assessing the degree and breadth of recognition by the people of the exercise of authority. For legitimacy to be achieved, people should not only recognise that a government exercises the power, but also that it has the right to have that authority. Even though a democratic based constitution is an important criterion for that recognition, other factors are important, as the governmental outputs, the habit to it, and historical and identity issues (Shively, 2011, pp. 185–188). So, a political system can be democratic deficient but enjoy legitimacy by its people, and the other way around. Whereas the democratic deficit debate deals with the need for democracy to procedurally legitimise the EU's authority, the legitimacy deficit studies deal with the substantive approval of EU governance (de Jongh & Theuns, 2017).

Such assumption helps to understand why in the first decades of integration, outputs appeared to be sufficient to legitimise the EU (Habermas, 2013, p. 2), while lasting peace and economic growth sided by the welfare state pleased the electorate (Sebastião, 2020, p. 139). This permissive consensus (Inglehart, 1970) was propitious for questioning democracy as being inadequate to conceptualise the EU, as it could be alternatively conceived as a regulatory state (Majone, 1996), where the Pareto principle operated. This meets the conceptualisation of results as pertinent criteria to observe legitimacy, as advocated by Scharpf (1999), backed by the systemic approach to political systems: Despite the effective outputs for citizens, the citizens' participation in the governing process, through parties and elections—the inputs—were also important (de Jongh & Theuns, 2017, p. 1286; Scharpf, 1999; Schmidt, 2013, pp. 4–5). Outputs stood out as legitimisers in literature (Caporaso & Tarrow, 2008; see also Menon and Weatherill, as cited in Schmidt, 2013, p. 11), but systemic-based studies even developed throughput as a third criteria (Schmidt, 2013, p. 7), coincident with the institutional procedures of the EU, that should ensure effectiveness, accountability, transparency, inclusion and openness to civil society (Schmidt, 2013, pp. 15–19).

Nevertheless, outputs have been controversial as legitimisers, and the 2008 crisis reinforced this notion, leading some authors to review those presumptions (Scharpf, 2010). For Follesdal and Hix (2006, pp. 543–545), the central question is how to define effective outputs. This is a matter of politics and democracy, requiring competition and opposition, not only to elect the best policy but even more important for choosing an alternative government when policy outcomes have disappointed citizens. When outputs are not satisfactory, what is questioned is not the legitimacy, but rather the effectiveness of a government. However, it is indeed these moments that demonstrate a permanent dialectics between legitimacy and people's expectations regarding the democratic procedures (de Jongh & Theuns, 2017, pp. 1288–1292). Political competition and majority-based institutions are even more crucial when outcomes have not lived up to citizens' expectations and an alternative is needed. In fact, despite the political empowerment of the European Parliament (EP), it has not been proportional to the range of competences transferred from national parliaments to the

EU. Intergovernmentalism weighs too heavily on the balance of powers (Schmidt, 2007, p. 521), and this has remained unchanged even with *Spitzenkandidat* (Moury, 2016, pp. 38–48), making the EU a kind of "imperfect bicameralism" (Moreira, 2017, p. 55).

These claims depart from the premises of representative democracy, underpinning the EU democratic deficit arguments, assumed as the theoretical rationale of this research. Free and competitive elections are the pillar of representative democracy, electing officers, that are mediators of social conflicts, representing the electorate, and holding legislative and executive power. Most representative democracies are parliamentary systems, where government emerges from the party leader, or coalition, winning a majority of votes in parliament through the general election. Parliament and government exert legislative and executive power respectively, with a close interdependent relation. Another model of representative democracy is the presidential one. A president is elected by universal suffrage, assuming both the executive and head of state roles, with great independence from the parliament, that holds legislative power. There's still semi-presidential and semi-parliamentary models, which share characteristics of the former two, with more or less executive or control power by the president vis-à-vis the government (Delwit, 2015, pp. 146–155; Fernandes, 2010, pp. 148–158).

Based on representative democracy premises, this research shares Hix and Hoyland's (2011, p. 131) judgment, that a truly democratic EU would require elections to be the provenience of the main political offices (as the President of the Commission) and the control of the political agenda. Political competition in EP elections would provide voters with policy platforms or candidates for office and allow alternative choices when a mandate defrauded citizens' expectations. The authors have five main arguments for democratic deficit in the EU: (1) The EU decisions are too dependent on executive actors, as the governmental ones, (2) EP power remains too weak, once its empowerment was not proportional to the loss of national parliaments' power, (3) there is an absence of truly European elections, given the 'domestic' logic of EP elections, (4) there remains a distance of the EU from its citizens, considering the complex institutional design and the secrecy features of some institutions and (5) EU policies are not a translation of the majority of European citizens' preferences (Hix & Hoyland, 2011, pp. 132–133).

These claims are flagrant in the EMU architectural design, particularly within the economic governance. Furthermore, when considering the dialects between EMU norm and political economy, democracy is subject to particular perversion.

3.1. EMU and Democracy Constraints in a Multilevel Polity

Institutionalised in the *Treaty of Maastricht*, under the German ordoliberal model (Habermas, 2013, p. 3; Lang, 2004), the EMU operationalises the monetarist ideology (Bellamy & Weale, 2015, p. 259) through two different forms of governance: a 'federal' one, governing monetary policy under the European Central Bank (ECB) political independent authority, and a national coordination for economic policy. This accommodated a supranational monetary policy, but the denial of EU co-responsibility for Eurozone fiscal balances, designing the EMU as a non-optimum currency area. Whereas monetary policy is supranational, under the ECB political independence to maintain price stability (Chang, 2009, p. 68), the economic policy is a national competence, but subject to very strict coordination, preventive, surveillance, and punitive mechanisms by the EU, ensured by a reinforced intergovernmentalism, through the open method of coordination. The Stability and Growth Pact (SGP) is the central instrument of this economic governance, setting limits for national public debts and deficits, as well as margins for inflation and interest rates, to ensure prices stability, credit markets confidence, and thus the soundness of the single currency, on the benefit of all the Eurozone members (Chang, 2009, pp. 124–125; Silva, 2017, pp. 69–73). So, while the EMU deprived national governments of a traditional macroeconomic instrument, as the monetary policy, important to face crisis and asymmetric shocks, the EU did not assume a correspondent competence with supranational instruments to ensure it, leaving it under exclusive national responsibility. Furthermore, given the great economic structural differences between the Member States, a single currency and a macroeconomic policy on the type of one size fits all, was likely to replicate national imbalances and generate economic irrationalities—as the competitive and unfair national fiscal policies with dichotomous effects across Member States (Lang, 2004, pp. 151–157; Ruchet, 1998, pp. 168–177). As fiscal instruments rested to be one of the few national automatic stabilizers, each state would adopt the ones that its structural economic position in EMU is in advantage for, thus engaging in national fiscal competition.

Although this multi-level governance is underpinned by legal constitutional principles conferring normative legitimacy to the EMU (Bellamy & Weale, 2015, p. 259), when considering implications for the normal process of democratic politics, the imposed restrictions to public finances limit ideological competition over political economy, the reason Bellamy and Weale (2015, p. 259) assume EMU represents a kind of neoliberal institutionalization. This is what the German constitutionalist Dieter Grimm (cited in Habermas, 2015, p. 547) identifies as the "constitutional status" of some EU policies, which turn them immune to the normal process of variation in politics, one of the causes for the distance of the EU from the citizens. Such a conditioned EMU tightens the ideological options between the traditional pro-liberal and pro-Keynesian stances of the political economy of European democracies, thus depoliticizing economic options (Parker & Tsarouhas, 2018, pp. 11–12).

This is very clear when considering the clash of formal national and supranational norms in economic governance: If the national parliaments are the ultimate sovereigns on budgetary policy, they are simultaneously limited on political options by the EMU financial criteria. The democratic legitimacy is also weakened by the fact that the EP has neither formal competencies in coordinating and supervising SGP mechanisms nor in the monetary policy. The ECB institutional independence from any political EU organ, not only undermines accountability of the monetary policy, as well as remits a highly influential policy in national politics to a *technocratised* scope of action (Snell, 2016). And the responses to the Euro crisis have strengthened ECB role without modifying accountability processes (Heidebrecht, 2021).

The Eurozone crisis unveiled those institutional dysfunctions, making quite evident the structural inadequacy of the EMU to address international economic downturns, as well as the high systemic risk of the unregulated European banking. Moreover, it was also clear that its political economy consolidated two different and antagonist, but interdependent, models of economic development in the EU—exporting competitive economies/creditor States versus weak and low competitive economies/debtor States (Parker & Tsarouhas, 2018, pp. 5–6; Reis, 2016, pp. 46–48). While the former accumulated liquidity and needed to capitalise it, the latter needed credit for public investment and to boost the economy. Although antagonism could coexist in economic growth scenarios, it proved unsustainable with the crisis (Sánchez-Cuenca, 2017, p. 357).

4. Addressing the Eurozone and Covid-19 Crises

Empirical analysis consists of two parts: a summary of the measures to tackle the crises and the other the argument of the hypothesis. The EU has addressed the Eurozone crisis with emergency financial measures and legal reforms to correct the EMU governance structure. Backed by loans from the IMF and the EU, the first consisted of bailout programmes approved for Greece, Ireland, Portugal, Spain and Cyprus, under conditions for correcting macroeconomic imbalances (Parker & Tsarouhas, 2018, p. 2). Required to be achieved in the short term, it involved a deflationary policy without compensation for securing levels of demand—except for the ECB purchase programme (ECB, 2012), aggravating economic recession and social exclusion to the extent that IMF later recognised the exaggeration of the deflationary policy (Elliot, Inman, & Smith, 2013).

Concerning legal reforms, the six-pack (2011) and two-pack (2013) programmes reinforced the financial criteria with stricter rules for national budgetary policy and new governance procedures to operationalise strengthened coordination and surveillance. The Fiscal Compact (Gouveia, 2018, p. 123) completed this package by requiring a binding national law to make the strengthened SGP provisions effective (art. no. 3(2), TSCG). To address the problem of systemic risk in Eurozone banks, a banking union was launched, still unfinished, ensuring single supervisory and resolution mechanisms (Pereira & Sousa, 2018, pp. 81–96).

Regarding the Covid-19 crisis, the first measure was the adoption of the general escape clause which provided for full flexibility available in the SGP in severe downturns (Council Regulation of 8 November 2011, 2011; European Commission, 2020b; European Council, 2020a; European Parliament Regulation of 16 November 2011, 2011). Additionally, financial funds were made available: a first loan of €200 billion for businesses through the European Investment Bank (2020), and a second temporary loan-based instrument of up to €240 billion by the Eurogroup, through the ESM (Eurogroup, 2020). In March, the ECB announced a €750 billion Pandemic Emergency Purchase Programme (ECB, 2020a), reinforced in June by €600 billion as a result of falling inflation (ECB, 2020b).

The ground-breaking EU response was the approval by the European Council in July of the European Commission's "Next Generation EU" proposal, a €750 billion recovery plan (European Council, 2020b) divided into grants and loans to be made operational through various financial instruments (European Commission, 2020a), framed as an addition to the €1,074 trillion Multiannual Financial Framework (MFF). Although the European Council's approval was only possible after a revision reducing the initial amount proposed for grants from €500 to €350 billion (Boffey & Rankin, 2020; Rankin, 2020), this may be an historical agreement to boost integration, making it a step forward to creating European public debt and fiscal competences (European Commission, 2020a; European Council, 2020b).

5. Hypothesising: Political Oversizing of Economically Hegemonic States

Departing from a PT theory-testing approach, argumentation to the hypothesis is structured along a diagnosis of causal inferences based on three derivations of the democratic deficit: (1) junctural constraints, (2) institutional constraints and (3) constitutional constraints (Figure 1). The first one relates to the influence of critical economic junctures on the increase of political over-power of the richest States, mainly through the financial markets pressure that activate economic path-dependency in the EU; the second one relates to the secrecy of bargaining and discussions, strengthening the political power of stronger economies and depoliticisation. Finally, the third one builds on the status of a de-European Commission.

5.1. Junctural Constraints

This causal event acts as a political power booster of the most powerful economic states in economic crisis, towards the urgency of weaker economies to choose

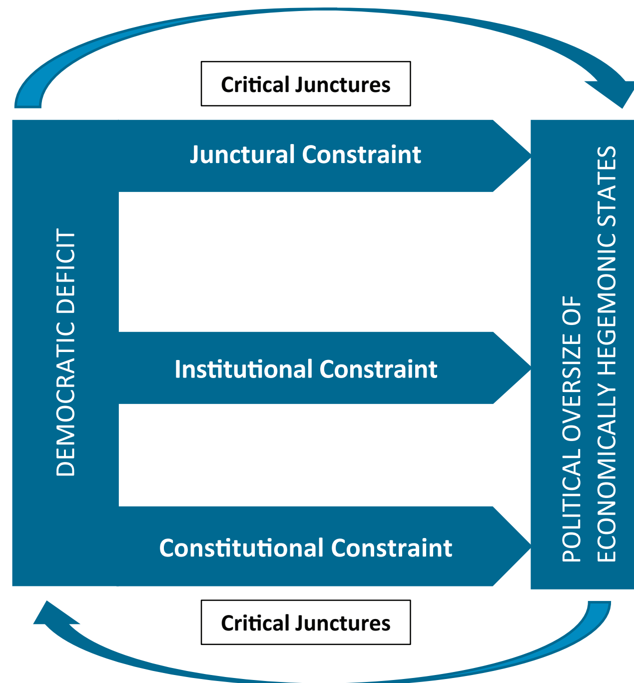

Figure 1. Causal inference supporting the hypothesis: repercussion of democratic deficit into the political power of hegemonic economies happens through junctural constraints (related with the economic and financial crisis features), institutional constraints and constitutional constraints.

the least bad policy (see Figure 2). This relies upon the assumption that Eurozone and Covid-19 crises are critical junctures. Unleashed by the external shock of the 2008 global crisis, the Eurozone debt crisis placed the EMU's historical path-dependencies under instability and threat, posing the need for decisions on emergency financial measures and new institutional arrangements in three policy areas (Braun, 2015, pp. 421–422). As a moment of great uncertainty, avenues for fundamental revision are opened, which can leverage a rupture or just a transitional period, that may not culminate in a de facto change (Heinrich & Kutter, 2013, pp. 123–125).

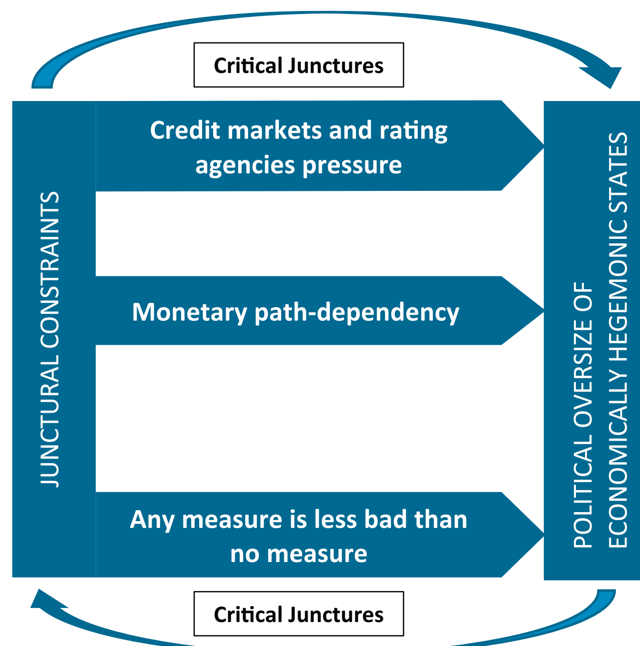

Figure 2. Causal inference of the 1st constraint: Junctural constraints act with financial market pressures or effects of severe economic downturns, external to the EU, but activating other two causal mechanisms internal to EU, with economic and monetary path-dependency and the result of this, the exclusion of a no measure scenario.

The Covid-19 pandemic reached the EU also as an external shock, first in the form of a health crisis, that spilled over to an economic crisis. As long as the economic consequences turned clear, with a symmetric (and not asymmetric, like in 2008) expected impact, Member States perceived they were facing an existential hazard to the single market and the EU itself (Lady & Tsarahouas, 2020, pp. 1041–1043). Both crises required extraordinary responses, but whereas in the former it is generally assumed, despite arguments that ECB made an ideological change (Braun, 2015, pp. 431–436), that there was not a policy paradigm shift—rather an incremental change through the persistence of policies and historical institutional mechanisms (Heinrich & Kutter, 2013; Verdun, 2015)—during the Covid-19 pandemic there appeared to be a learning process that led to substantial policy change (Lady & Tsarahouas, 2020, pp. 144–151).

But if this historical institutionalist approach to critical junctures explains policy change or permanence, it is not sufficient to clarify if the implied institutional trajectories altered (Schmidt, 2020, p. 1181). By relating junctural constraints with answers to both crises, in a comparative perspective, it is intended to demonstrate that the supposed learning process by some political agents in Covid-19 does not suggest evolution on institutional mechanisms, and thus not in the inherent democratic deficit.

Despite the evidence of path-dependency (Capoccia, 2015; Stark, 2018) on economic damage during the Eurozone debt crisis, the financial urgency had the potential for greater losses for weaker economies. The legal and political answers provided did not change the EMU ordoliberal political economy paradigm (Hillebrand, 2015), with deficit economies carrying the burden of a rapid financial adjustment (Hillebrand, 2015, pp. 16–17). While it's true that those States reported historical financial imbalances, the crisis also showed that the economic EMU path-dependency was sustained in two dichotomic models of growth, underpinning a 'federal' currency with which they all capitalise their economic structural position.

The interest of the creditor economies in facilitating credit to the deficit ones expressed that path-dependency, since guaranteeing liquidity to the latter could systematically guarantee liquidity to the banking creditors of the former (Copelovitch, Frieden, & Walter, 2016, p. 828). An alternative argument is that threatened Member States could veto solutions. This is true. But 'junctural constraints' as a causal event answer this. If the Troika memoranda were not accepted and a Member State would leave Eurozone, national economic losses would be higher than the austerity imposed, given the pressure from the credit markets and rating agencies. If in theory they could use the veto, in practice the EMU path-dependency of this crisis, considering the more fragile position of weaker economies, gave no alternative.

Greece is an example thereof. Despite government attempts to renegotiate the memorandum to reduce social consequences and cyclical economic impacts, the alternative bailout plan presented by the finance minister, considered credible by some counterparts, was rejected by the Eurogroup and the European Council (Varoufakis, 2017, pp. 389–422). Even the national referendum that denied the memorandum terms had no impact on intergovernmental bargaining. In view of the worsening of the financial situation, to the extent that the national cash withdrawals and ECB banking liquidity guarantees would be limited, Greece had no choice but to accept severe national solutions (Varoufakis, 2017, pp. 423–431). Even considering the historical self-responsibility of Greek debt and budget deficit (Gkasis, 2018, pp. 95–102), macroeconomic interdependency is a fact in the single currency, and bankruptcy or exit from the Eurozone would not only have dramatic economic effects for Athens, but also a significant impact on surplus economies, like Germany (Moury, 2016, p. 74).

The same political hegemonic influence of the strongest economies applies to Covid-19. Faced with the pressure on health services and the economy, governments had no choice but to increase public spending, leading to general national budget deficits (Arnold & Fleming, 2020; European Commission, 2020c), a background for resorting to the escape clause in the SGP. Although this clause was only introduced in the six-pack amendment following the 2008 crisis, in practice the same solution could have been achieved in the debt crisis. As the European Council is the decision-making body on the correction procedures of deficits, it could have adopted, protected by the SGP regulations which do not define correction periods (Council Regulation of 7 July 1997, 1997a, 1997b), longer time frames for budgetary adjustments, relieving social and economic damage to debtor states.

Furthermore, the different nature of this crisis has made richer economies opt for different solutions. While in the Eurozone the financial systemic risk could be solved with measures directed to debtor countries, when it comes to Covid-19 the situation is different. It has affected all Member States alike, although some do have stronger structures to recover from it (Khan & Arnold, 2020). Secondly, reaching the world market, it has high potential to affect exporting economies in the EU27 (European Commission, 2020d, 2020e). Thirdly, a repetition of the Eurozone austerity could seriously question the benefits of being in the Euro, making it politically unsustainable, because the damages of exiting could be lower than those of a new austerity ("The Eurozone nine," 2020; "The new channel of Eurozone instability," 2020). The perception that the single market was under a symmetric shock, posing a serious existential threat to the EU, led politicians to engage in different institutional answers (Ladi & Tsarouhas, 2020, pp. 1046, 1047).

It is therefore in Germany's interest to support the joint debt. From the moment 'Coronabonds' was on the Eurogroup agenda, while the prominent 'frugal four' (Netherlands, Austria, Denmark and Sweden)

were decisively against it, Germany opted for a discrete stance as the pandemic was evolving and consequences were not quite clear. Later in May, Angela Merkel undertook with France to support the European Commission's recovery plan of €500 billion in grants (Boffey, 2020), and the 'frugal four' accepted it in July (European Council, 2020b).

Path-dependency was thus a driver for the Covid-19 outcomes, but path-dependency was also observed in the Eurozone crisis and, despite emergency financial measures taken, the issue of joint debt as medium/long-term solution for EMU governance was revealed by EU institutions (European Commission, 2011a, 2011b, 2012; European Parliament Resolution of 15 February 2012, 2012) but was not followed up. Germany's support was the element of change in Covid-19, dragging the 'frugal four.' Nevertheless, even the approved solution was not an optimal one, which leads to the second causal event.

5.2. Institutional Constraints

This causal event is based on two institutional decision-making characteristics: unanimous voting, capitalising economic into political 'representative' power, and the secrecy of intergovernmental bargaining, making national interest a driver of debate to the detriment of ideology (see Figure 3).

Unanimous voting makes decision dependent on one or a few Member States, equivalent to a minority of the population. While in the Eurozone crisis this was not a blatant issue, as a group of northern countries around Germany rejected expansionary policies against southern Member States with France (Schoeller, 2019, pp. 131, 132), this situation is clear in the Covid-19. The unanimity rule empowered few Member States (the 'frugal four') to influence the reach of outcomes (Zalan, 2020), with consensus reached only with a significant reduction of the initial proposal and concessions relating budgetary contributions. Obviously, in parliamentary and open debates, negotiation must also occur. The point here is that unanimity oversized the will of few political actors, representing a minority of the population. Even changing their extreme initial position to support the EU public debt, the four States with low population density but strong economies were able to influence the Commission's proposal for a suboptimal achievement in a way that could not otherwise be possible if there had been a majority voting. An alternative institutional argument is that the veto can be exercised by both richer and poorer states to reject a suboptimal outcome. But economic junctural constraints undermine its feasibility, as argued in the previous causal event. For weaker economies, the least bad outcome is preferable to no solution at all.

The second causal event relating to the secrecy and informality of the intergovernmental bargaining is argued to limit or even prevent ideological debate in favour of nationalist arguments, thereby restricting alternative policies and legitimising the institutionalised economic policy through the official press releases and statements following the Eurogroup and European Council meetings. An example is the failed attempt of the Greek Minister of Finance in 2015 to formally present and discuss in the Eurogroup an alternative plan to the Troika memorandum, which was blocked by the Eurogroup president. Given the absence of formal rules

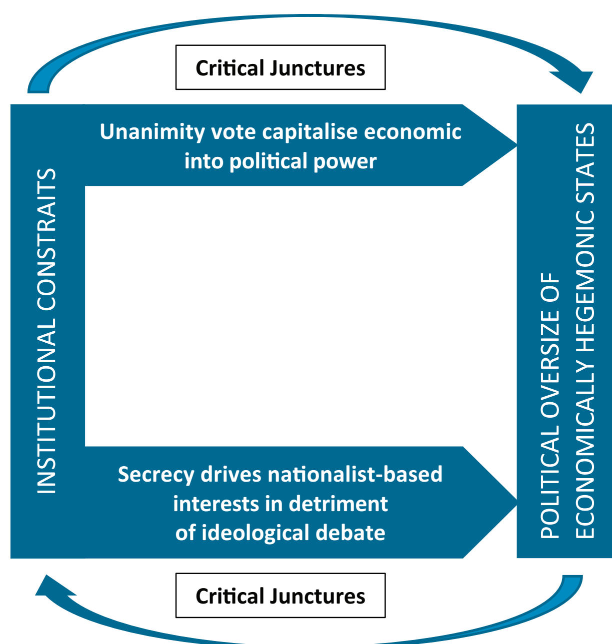

Figure 3. Causal inference for the 2nd constraint: Institutional constraints act with causal effects that may be common to other policy areas, with unanimity vote and secrecy effects on the political transparency and equity of decision-making, which in economic governance translates economic power into political power.

for Eurogroup meetings (Abels, 2018), he was unable to oppose the president's blockades (Varoufakis, 2017, pp. 430–431). Ideological debate on the political economy of the EMU was abolished, which could have resulted in some peers perceiving that different economic policies could achieve equal outcomes. Informality and secrecy, as in European Council meetings, limit or even prevent ideological debate, diminishing the ability to persuade public opinion and peers with alternative policies, turning the process more technocratic than political, one of the causes of democratic deficit (Hix & Hoyland, 2011, p. 132). Political economy, the core of political competition in Western democracies, is reduced to institutionalised technocracy in the Eurozone governance.

This causal event is not a denial of the legitimacy of intergovernmental bodies to defend national interests, or that national interest is not legitimate in a shared sovereignty polity like the EU. The crux of the matter is that when a Member State wants to use ideology to conduct a debate, argue about national interests and envision the EU's future, it is highly constrained by institutional norms. The EP is of course the EU's politicised institution par excellence, and a counterargument is that ideological debate is conducted therein. Nevertheless, in EMU governance, the EP has no formal powers and even in the approval of the Covid-19 recovery plan requiring the EP's decision, it does not have the media impact like the European Council. Moreover, it is as legitimate for governments to use ideological arguments in national competition as it is at the EU level.

This causal event does not presuppose that ideological debate is forbidden or never takes place in the Eurogroup or the European Council. It merely argues that informality and secrecy limits the occurrence and the potential of the political reach of ideological arguments. As Kutter (2020) concludes, despite the discursive politicisation in media and national fora, with alternative narratives about the Eurozone crisis and scenarios for the future of EMU, they did not reach EU policy-making and institutional discourse. Taking into consideration a hypothetical situation in Covid-19, if debate were public there could be arguments explaining that the joint debt does not mean direct transfers of creditor to debtor countries, as the traditional MFF; and that EU fiscal competences could combat tax evasion and regulate the market for the sake of the collective interest. If mediatised, such debate could improve public opinion and counterbalance governmental messages for domestic political competition purposes (Darroch, 2020).

5.3. Constitutional Constraints

The last causal event relies in one of Hix and Hoyland's (2011, p. 131) arguments of the democratic deficit, that an unelected President of the Commission is deprived of the power to use the will of citizens to conduct negotiations. As power depends solely or heavily on intergovernmental structures, and as the president of the EU's executive body does not ensue from a direct representative majority and is not subject to an electoral process after the legislature, she/he is unable to politically use citizens' demands to oppose the European Council's power game and strengthen his/her intermediation role in the bargaining (see Figure 4). As he/she is not entitled to be a political intermediary of the EU's constituencies and a promoter of politicisation, they are trapped within

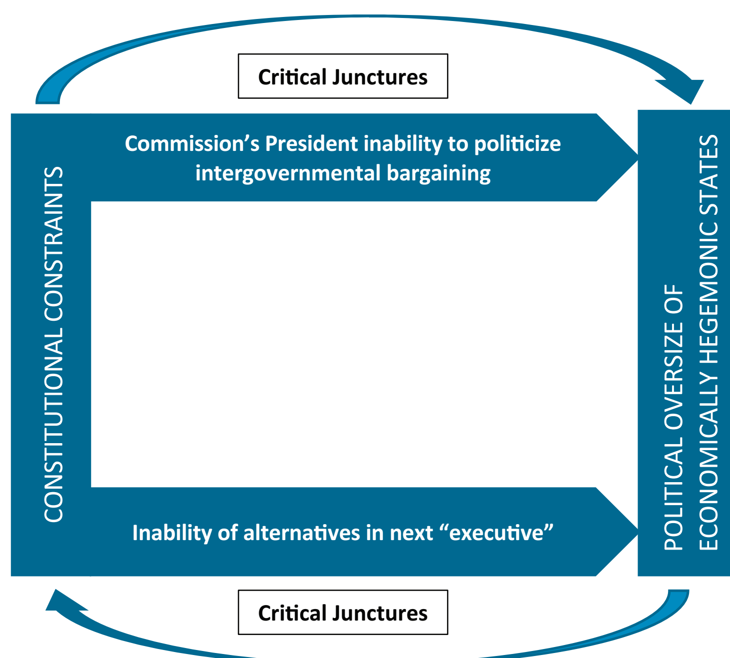

Figure 4. Causal inference of the 3rd constraint: Constitutional constraints derive from the absence of an election-based executive power, which in economic governance perpetuates economic power as the driver of change.

national interests and efforts are mainly channelled to reaching consensus. This, again, contributes to depoliticised outcomes of the EU economic governance.

It is true that even empowered by a majority voting, Commission could not succeed in approving different outcomes, but representative power could have effects in the medium term, influencing a change for the next legislature. We recall that in the Eurozone crisis, joint debt issuance was called for by the Barroso Commission (European Commission, 2011a, 2011b, 2012) and the European Council Presidency (European Council, 2012) as a structural measure for the Eurozone. While literature points to the Commission's lack of leadership to formalise a proposal (Schoeller, 2019, pp. 132–135), the fact is that it faced a status quo headed by the firm German opposition ("Merkel on eurobonds," 2012; Traynor & Wintour, 2012), leading it to weigh the costs of going against it (Schoeller, 2019, pp. 135–141). Even the Juncker Commission did not succeed when making a similar proposal (European Commission, 2015), despite the discussion on a common budget for the Eurozone. The Von der Leyen Commission succeeded in 2020, with the EU's constitutional design remaining the same, only with the shift in German's position being different (Boffey, 2020). But while the Covid-19 responses appear to be more equitable for the EU Member States and trigger a policy change in economic governance, this does not remove constitutional constraints. The shift in Covid-19 outcomes were as much allowed by the hegemonic economy as was restrained by the remaining 'frugal four,' managing to refute the Commission's proposal in a way that a majority rule would have found difficult.

The hypothetical power of a majority-based Commission gains ground when considering the EP adoption, in April 2020, of a resolution calling for a massive recovery package based on the reform of the EU's own resources through enhanced fiscal capacity (European Parliament, 2020), or that the EP had already accepted in 2012 eurobonds could be a medium-term solution for stabilising the Eurozone (European Parliament Resolution of 15 February 2012, 2012), exercising leadership on the issue, but restricted by the limits of constitutional design (Schoeller, 2019, pp. 150–157).

Obviously, in the field of a shared sovereignty polity, the citizens' chamber is balanced with the states' representative power; however, recalling the second causal event, the unanimity rule causes disproportionate power in favour of a smaller group of economically hegemonic states, thus undermining the Commission's ability to push for politicised-based results to the detriment of nationalist-based ones. Of course, the opposite would not be a guarantee that the results would always meet the demands of the citizens, but if this was not the case the electorate could have a say in the choice of the next executive, which would appease the issue of democratic legitimacy (Follesdal & Hix, 2006, p. 548).

6. Discussion and Conclusion

Studies of democratic legitimacy about the EU abound. What this interdisciplinary research aims to demonstrate is that the damage of the EU's democratic shortcoming aggravates, by spilling over into the field of economic governance, tending to permanently convert economic power into political 'representative' power, in the result of the structural national positions in institutional path dependencies of EMU, thus reproducing economic and political inequalities. If responses to the Covid-19 crisis suggest that a policy paradigm shift occurred, this does not translate to a change in this state of affairs.

The research confirms the spillover and path-dependency logic of integration, leveraged by the Franco-German axis at critical junctures. However, this study adds to the debate the conclusion that democracy has been especially perverted in economic critical junctures, when decisions are either blocked or unblocked by the strongest national economies in their interest, and the EU economic governance is a decisive perpetrator of this. If EMU's institutional mechanisms paved the way for two different models of economic growth with antagonist but interdependent interests, economic critical junctures tended to perpetuate the political over-hegemony of previous surplus economies, when one considers their democratic representativeness. Even admitting that the economic policies achieved can also be in the interests of loss-making economies, the problem is that the constitutional design allows the perpetuation of logic of economic power corresponding to political power, disregarding political representation as such.

Nevertheless, it is admissible that the Covid-19 crisis led to different governmental perceptions and a disruptive answer by the EU agents. Its outputs opened avenues for a change in the political economy of the Eurozone, with prospects of a fiscal union, redistribution, and joint debt at the supranational level, as Ladi and Tsarouhas (2020) conclude. But this was again a decision triggered and conditioned by the hegemonic economies, either the decision of advancing for a different solution or the difficulties posed to restrain the original proposal. The literature explains this as a consequence of the structural indeterminism of critical junctures (Braun, 2015, p. 423), boosting the dominant narratives and empowering (even more) the most powerful actors (Heinrich & Kutter, 2013, pp. 124–125). It is plausible that the German position was essential to determine the responses to Covid-19 (Ladi & Tsarouhas, 2020, p. 1052), but such an assumption reinforces our argument on the permanence of institutional mechanisms, allowing the economic hegemonic states to be decisive actors. Despite the different results, the institutional status quo hasn't changed.

Schmidt (2020, pp. 1180–1182) reminds that if the historical tracing of responses to critical junctures based on rational choice and constructivist approaches can provide explanations for policy change, that is only a

partial analysis, insufficient to demonstrate if there was a reframing of institutional mechanisms and constitutional norms by the actors. If we agree that Covid-19 has resulted in policy-learning, we put into question if political ideology was a factor for policy shift and the change of Germany's position, as Ladi and Tsarouhas argue (2020, p. 1045). We tried to demonstrate that it was the particularity of the Covid-19 crisis that posed hegemonic actors in a non-alternative solution, or the possibility of the alternative solution being too dangerous for the survival of the EU, the single market, and thus for national economic growth strategies. Outputs were not the consequence of a voluntary ideological option, resulting from political competition at the EU level. While we acknowledge that from the Eurozone crisis a process of policy learning happened, boosted by the national politicization on the issue, with growing representativeness of Eurosceptic parties, and that such politicization is gradually reaching the EU institutions (Schmidt, 2020, p. 1186), this research argues that the Covid-19 decision-making itself was rather self-interest based than politicized based. Politicization means ideological contestation and competition based on majority dialects of power. If it happens in the EP, in the European Council bargaining, the goal is rather to reach unanimity to meet the consensus.

In Covid-19, path-dependencies and heightened awareness of self-interest dependent on common interest led to a step further in integration, nevertheless the consequent increased EU economic and financial powers can also be a time-bomb waiting to explode anytime a crisis generates junctural conditions to. Considering the new involved scope of EU fiscal competences, in the short term it may address citizens' demands and conceal the democratic issue, but not in the medium/long term. It is placed for the future the need to decide on the levels of taxation and their scope. The fiscal policy is at the heart of the governments of Western European democracies and is a typical element of partisan competition and public discontent. If future decisions are subject to the current constitutional and institutional mechanisms, it will replicate national economic conflicts, and the dialectics of power will remain the same. Van Loon (2021) case-study clarifies the influence of domestic preferences on EU taxation issues. Decisions that should be politically based will continue to be secured by territorial-based preferences. Thus, if the results of Covid-19 mitigate democratic legitimacy for some time, it may just be postponing and enhancing it in the next crisis. The prospects for a redistributive EU should not be at the expense of democracy, putting the competences that should be in the field of politics under a kind of technocratic federalism (Habermas, 2013, p. 5). In future moments of economic downturn, should the EU fail, what would be questioned is not the continuity of the EU executive, since the electorate cannot play a decisive role in choosing an alternative, but the EU itself as a political system. This is at the heart of Eurosceptic claims.

Conflict of Interests

The author declares no conflict of interests.

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