Explaining the Creation of the EU Banking Union: The stability culture, the vicious circle, and the limits of power and interests

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Abstract:

The establishment of the EU banking union presents two major shortcomings of explanations focusing exclusively on material interests and bargaining power: first, they fail to explain the preference formation of the most important actor – the German government. The banking sector was divided between public and private banks, and there is no clear-cut pattern about whose interests the German government promoted. Second, material bargaining power cannot account for Germany's concessions despite favourable power asymmetries. This article demonstrates that an ideational frame can fill the gaps. Ideas explain Germany's preferences on the basis of beliefs about the 'stability culture'. The use of ideas as strategic resource by Germany's opponents explains why Germany made significant concessions. Germany's government publicly acknowledged breaking the 'vicious circle' between banks and sovereigns as key objective of the banking union. This became a rhetorical trap used by the Southern coalition to force the German government to concessions.

Introduction

The EU banking union is the most recent grand bargain of European integration. Both decision-makers and observers describe it as the most significant EU agreement since the Maastricht Treaty (Schäuble, 2014; Howarth and Quaglia, 2014, p. 125) with a remarkable transfer of sovereignty to the European level. The bail-out of Cyprus in May 2013 that went along with a profound restructuring of the country's financial sector has demonstrated that the resolution of a bank potentially involves dramatic consequences for the economic model of a country and the living standard of the population.

A banking union consists of four parts: The first component is a common rulebook on bank capital and liquidity that unifies the regulatory standards in the financial sector.[1] The second component is the Single Supervisory Mechanism[2] (SSM). It establishes a joint banking supervision for the euro zone and potentially other EU member states willing to join. The supervision tasks are conferred to the European Central Bank (ECB) whose powers are confined to 'significant'[3] banks with a systemic relevance. The banks of a non-systemic relevance remain under control of national supervisors, notwithstanding the right of the ECB to assume supervision powers at any time. Supervisory decisions are made with simple majority by the SSM's Supervisory Board (Verhelst, 2013, pp. 23, 32–33). The third component of the banking union is the Single Resolution Mechanism[4] (SRM). In case the solvency of a bank with systemic relevance is at risk, the SRM restructures or resolves the bank. The Single Resolution Board adopts a resolution scheme that enters into force within 24 hours unless the European Commission or the Council object to the Single Resolution Board's decision for specific reasons. If a bank resolution is put into place, private investors have to 'bail-in' and bear the resolution costs of up to 8% of the bank assets. After reaching

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[1] The latest legislative acts for a common rulebook are the Capital Requirements Directive (Directive 2013/36/EU of the European Parliament and of the Council), Capital Requirements Regulation (Regulation (EU) No 575/2013 of the European Parliament and the Council) and Bank Recovery and Resolution Directive (BRRD; Directive 2014/59/EU of the European Parliament and of the Council).

[2] See Regulation 1022/2013 of the European Parliament and of the Council and the Regulation 1024/2013 of the European Parliament and of the Council

[3] More precisely, a bank is 'significant' if one of the five criteria is satisfied: (1) the value of the bank assets exceed 30 billion euro, (2) the value of the bank assets exceed 5 billion euro and simultaneously 20% of the GDP of the host member state, (3) the bank is among the three 'most significant' banks in the country, (4) the bank has 'large' cross-border activities or (5) the bank receives direct financial assistance from the European Stability Mechanism (ESM) and/or the European Financial Stability Fund (EFSF) (Art. 6 (4), Regulation 2013/1024/EU).

[4] See Regulation (EU) No 806/2014 of the European Parliament and of the Council and the BRRD.

this threshold the bank gains access to the Single Resolution Fund (SRF) for up to another 5% of the bank's assets. The SRF is a joint fund of 55 billion euro financed by contributions from banks into national compartments which are progressively mutualised over eight years (Council of the European Union, 2014, p. 3). If banks without systemic relevance require access to the SRF the Resolution Board automatically assumes decision-making powers (European Commission, 2014, p. 2). The fourth element of a banking union is a joint deposit guarantee scheme. Negotiations on this were less ambitious and the member states opted for a mere harmonisation of national schemes.[5]

How do we explain the outcome of the banking union negotiations? The 'baseline theory' (Moravcsik and Schimmelfennig, 2009, p. 67) of European integration with a particular strength in explaining grand bargains is liberal intergovernmentalism (Moravcsik, 1999). Nonetheless, applying it to the banking union negotiations results in two major puzzles. First, liberal intergovernmentalism explains the preferences of the member states with domestic interest groups who shape the government's preferences. However, Germany's preferences do not match the interests of the domestic banking sector. As we will see more in detail below, either the sector was divided between public and private banks or both groups were standing together opposing the government's position. Considering Germany's impact on the outcome, clarifying the origins of its preferences is a crucial element of any explanation of the banking union.

Second, liberal intergovernmentalism applies an intergovernmental bargaining theory to interstate negotiations. It suggests that the outcome of the negotiations on the banking union is likely to reflect Germany's preferences because of its superior bargaining power as reflected in its vast financial resources. The preference intensity was low because of the perceived benefits of the banking union being rather low due to Germany's financial ability to bail-out or resolve its banks autonomously leading to no-agreement as a feasible alternative (Howarth and Quaglia, 2014, pp. 130–131). In contrast, the preference intensity of the counter-coalition was high due to the sovereign debt bank nexus. Nonetheless, Germany made significant concessions, such as an 'emergency clause' extending the ECB's supervisory powers, the creation of a joint resolution fund, or delegating the core decision-

[5] See Deposit Guarantee Scheme Directive (DGSD; Directive 2014/49/EU of the European Parliament and the Council)

making power on bank resolutions to an independent body. Liberal intergovernmentalism cannot account for these concessions.

The article argues that an ideational frame solves the two puzzles that the banking union negotiations present for liberal intergovernmentalism. This theoretical framework sees ideas[6] as both source of preferences, such as in the works by Hall (1993) and McNamara (1998), and strategic resource in negotiations, hereby following Schimmelfennig (2001) and Jabko (2006). First, against the background of a strong division of the banking sector in Germany, not material interests but ordoliberal ideas of the stability culture were the primary source of the government's preferences. Second, I argue that instead of material power, the strategic use of ideas by Germany's opponents explains its concessions. The most important idea was the 'vicious circle' that identifies the cause for the euro zone's problems in the 'deadly embrace' (De Grauwe, 2013, p. 3) between banks and sovereigns. Contagion spreads from one to the other and impedes a return to growth (see below). It suggests a joint liability for bank failures to break the circle. I argue that since these causal claims were acknowledged by Germany, the need for argumentative consistency made the German government vulnerable to demands for further mutualisation and forced it to make concessions despite commanding superior material bargaining power.

To be sure, I do not claim that material interests or material bargaining power were irrelevant in the banking union negotiations. Material interests persuasively explain the preference formation of the Southern European member states[7], but not Germany's preferences. Power-based approaches explain the centrality of Germany in the negotiations, but asymmetrical interdependence by itself cannot account for Germany's concessions. Accounts classifying these concessions as a 'benign hegemony' strategy in order to get its way on the most important issues fail because it is exactly on these important issues that Germany made significant concessions.

An ideational frame fills the gaps left by liberal intergovernmentalist explanations. The currently most insightful account of the banking union negotiations by Howarth and Quaglia (2013; 2014) implicitly shares many of liberal intergovernmentalism's assumptions and its explanatory logic by emphasising the importance of material interests and interstate

[6] Ideas are defined as principled or causal beliefs (Goldstein and Keohane, 1993, pp. 9–10).
[7] As stated by the most important umbrella organisations of the banking sector in key member states, see e.g. BBVA, 2013, pp. 12–13; AEB, 2014, p. 32; FBF, 2012; FBF, 2013, p. 2.

negotiations. Their highly valuable contribution clarifies the most relevant material interests and the preference configuration in the negotiations. Nonetheless, their account underestimates the impact of ideas on both the domestic preference formation and the intergovernmental negotiations. The impact of ideas on the EMU negotiations is widely acknowledged (McNamara, 1998; Dyson and Featherstone, 1999; Jabko, 2006; Bonatti and Fracasso, 2013). We can reasonably expect ideas to have an impact on the banking union negotiations as well. Indeed, Featherstone (2012, pp. 5–11) argues that ordoliberal EMU policies got 'locked in' at Maastricht and guided the policy responses to the euro zone crisis. Furthermore, important scope conditions for ideas to have an impact, such as a prior external shock and uncertainty, were present during the banking union negotiations (see e.g. Hall, 1993, p. 279). The historical record and the presence of key scope conditions make a strong case for analysing the role of ideas in the banking union negotiations.

This article narrows down its analytical focus by distinguishing two coalitions among the actors involved in the negotiations. The German coalition also includes Finland, the Netherlands, and some other mostly Northern European euro zone member states. These governments were reluctant towards joint liabilities and stressed self-reliance. The most relevant members of the Southern coalition are France, Spain and Italy, with many followers among the economically weaker euro zone member states. They were frequently supported by the Commission, the European Parliament and occasionally the European Central Bank. This coalition sought a fully-fledged banking union with centralised decision-making powers and large financial means. These coalitions are by and large consistent with earlier patterns, with the 'monetarists' led by France and 'economists' led by Germany (Chang, 2009, p. 23). The euro outs are a potential third coalition, but this article does not analyse them in depth because their impact on the outcome was rather negligible. The analysis is confined to the most contentious issues, namely: (a) the scope of application, (b) the 'bail-in' provisions, (c) the establishment of the Single Resolution Fund, and (d) the decision-making procedure in the SRM.

Liberal Intergovernmentalism: explaining the banking union with economic interests and material bargaining power

Applying liberal intergovernmentalist insights to the banking union negotiations, we can derive two main hypotheses, relating to its two core components: preference formation and interstate bargaining. With regard to the former, liberal intergovernmentalism argues that a state's '[p]references reflect the objectives of those domestic groups which influence the state apparatus' in a specific issue-area (Moravcsik, 1999, p. 24). If liberal intergovernmentalism is right in the banking union case, we would expect banking associations to wield the decisive influence on the governments, leading to the following hypothesis about Germany's preference formation.

> H1: *Germany's preferences reflect the interests of the domestic banking lobby as most powerful issue-specific interest group.*

Evidence supporting the hypothesis would be that the German government's preferences are similar or even equal to those of associations speaking on behalf of the banks. We would also expect that the discourse of the government reflects predominantly a cost-benefit analysis of domestic banks.

In intergovernmental negotiations the outcome 'reflect[s] the relative power of states – more precisely, patterns of asymmetrical interdependence' (Moravcsik, 1999, p. 3). If liberal intergovernmentalism is correct, we would assume that the agreement on the banking union largely follows Germany's preferences, as discussed above.

> H2: *The outcome of the banking union negotiations corresponds to the preferences of Germany because of its high issue-specific resources and low preference intensity.*

Evidence for the importance of Germany's material bargaining power for the banking union agreement would be a high similarity between Germany's preferences and the outcome of the negotiations. We would also expect a discourse based on threats and promises as typical for material bargaining in interstate negotiations.

The Impact of Ideas on the Banking Union

The literature allows us to distinguish two major causal mechanisms for the impact of ideas: ideas as source of preferences or ideas as strategic resource in negotiations. Starting with the former, Hall argues that policy-makers semi-automatically follow ideas for both understanding problems and finding solutions of how to address them (Hall, 1993, p. 279). Actors may even internalise ideas, i.e. take their claims as granted and adjust the policy accordingly (Checkel, 2005, pp. 812–813). Following internalised ideas is based on a logic of appropriateness (March and Olsen, 1998, pp. 951–952); ideas constitute actors' preferences and their underlying interests. These considerations allow us to derive the following hypothesis about domestic preference formation.

> <u>H3:</u> *Germany's preferences follow the ordoliberal stability culture as most relevant set of ideas.*

What evidence will support or falsify the hypothesis? It is easiest to confirm if a government favours policy options that are in line with prevailing and professed ideas, and if these differ from policy options reflecting the material interests of powerful domestic actors. If the German government defends its preferences rhetorically with assumed benefits of self-reliance, strong market forces or concerns about moral hazard, we have further evidence that it follows ordoliberal beliefs about the stability culture.

Another group of authors focuses on the strategic use of ideas in negotiations. According to the concept of 'rhetorical action' (Schimmelfennig, 2001, pp. 62–66), an actor's objectives have to meet the standard of legitimacy in a political community. Ideas can either constrain the negotiating position of an actor by defining 'no go' areas of illegitimate behaviour or enhance the bargaining power of materially weak actors by adding (cheap) legitimacy to their position if it matches the common standard of legitimacy (Schimmelfennig, 2001, p. 63; see also Jabko, 2006, pp. 5–8). Against this background, we hypothesise the outcome of interstate bargaining as follows:

> <u>H4:</u> *German concessions on significant aspects of the banking union exceed the side payments that the material bargaining power of the Southern coalition can*

extract if it can justify its demands with reference to ideas that the German government professes to share.

Evidence for this hypothesis would be that Germany's concessions are made in response to demands of the Southern coalition referring to a commonly and publicly accepted standard of legitimacy. The most salient standard of legitimacy that all actors were committed to was the objective to break the 'vicious circle' between banks and sovereigns.

Beliefs that Matter: salient ideas in the banking union negotiations

The Ordoliberal Paradigm: the stability culture

Ideas mattered for EMU since the very first attempts to create a currency union (Dyson and Featherstone, 1999; Jabko, 2006; McNamara, 1998). The most relevant set of ideas for Germany's preferences in EMU negotiations was the so-called 'stability culture' (Howarth and Rommerskirchen, 2013). It is a long-standing feature in Germany's economic policy-making that already shaped Germany's preferences in the Maastricht negotiations (Dyson and Featherstone, 1999, pp. 276–277; Heipertz and Verdun, 2010, pp. 92–93; Jabko, 2006, pp. 166–169; McNamara, 1998, p. 62; Risse *et al.*, 1999, pp. 168–169). Germany's government 'adhered tightly to many features of the economy that characterized its post-war economic miracle [i.e.] the economic theory of ordoliberalism' (Bonatti and Fracasso, 2013, p. 1028; see also Bulmer, 2014, pp. 1246–1248).

Four elements of ordoliberalism are particularly relevant when analysing Germany's policies in the euro zone crisis and in the banking union negotiations specifically. First, ordoliberals emphasise the need for a 'strong state' that pursues market-conforming policies. The state creates and maintains markets by providing the framework for efficient markets, but does not assume economic activity itself (Siems and Schnyder, 2014, pp. 379–382). Second, market pressure is an indispensable incentive to force governments to carry out sustainable budgetary policies. Hence the crisis management in the euro zone should not primarily neutralise market pressure on member states, but eliminate the causes for market pressure (Bulmer, 2014, p. 1246; Siems and Schnyder, 2014, pp. 381–382). Third, 'put-your-own-house-in-order' is the remedy to market pressure in the euro zone's periphery. A stable currency 'begins at home' (Dyson and Featherstone, 1999, p. 275) by carrying out structural reforms that increase a country's competitiveness (Bonatti and Fracasso, 2013, p. 1032). As the ordoliberal hawk and former ECB chief economist Otmar Issing put it: 'Get your finances in order and stop blaming Germany' (Financial Times, 2014). Fourth, there is no financial assistance without constraints on national sovereignty. A lack of liability is believed to cause moral hazard. Hence a mutualisation of funds must go along with conditionality or a transfer of sovereignty from national governments to the EU level (Bonatti and Fracasso, 2013, pp. 1024–1025; Siems and Schnyder, 2014, pp. 381–382). This article considers the four core aspects of ordoliberalism as causal beliefs that have acquired a high degree of taken-for-grantedness and have been internalised by German policy-makers as the 'right' policy. In this sense, they have obtained paradigmatic status and ordoliberal ideas constitute German preferences for the banking union negotiations.

The Post-Keynesian Paradigm: the 'vicious circle'

Despite some heterogeneity, a post-keynesian set of ideas is widely shared in the counter-coalition. It builds on long-held beliefs that underlined particularly French proposals for EMU during the Maastricht negotiations (see e.g. Dyson and Featherstone, 1999, pp. 229–236; Chang, 2009, pp. 47–50; Risse *et al.*, 1999, p. 172). The first belief of the counter-coalition is that politics should shape markets and not vice versa (Lequesne, 2013, p. 43; Dyson and Featherstone, 1999, p. 63). Markets are perceived more as a threat to democratic decision-making than a positive driver towards effective policies. Second, market pressure has to be resolved with *intégration solidaire* (Lequesne, 2013, p. 47). French Finance Minister Moscovici defines this term as 'the promotion of mechanisms for risk sharing among Member States, and greater integration of European economies' (Moscovici, 2012). This refers to a Keynesian growth programme, a partial debt mutualisation or a joint euro zone budget, structural reforms and the ECB as 'lender of last resort' (De Grauwe, 2013; Lequesne, 2013, p. 47).

A third idea shared by the counter-coalition is the identification of a 'vicious circle' as the biggest obstacle to economic recovery in the euro zone. The concept describes the 'deadly embrace' (De Grauwe, 2013, p. 3) between sovereigns and banks. Many banks were at the verge of failing during the financial crisis. When states provided financial support, they increased their own indebtedness. This in turn devaluated sovereign bonds mainly held by banks. When banks requested another publicly financed bail-out, they triggered the vicious circle again. 'If one of the two falls off the cliff the other one is pulled down also' (De Grauwe, 2013, p. 3). After bail-outs 'failed (…) [s]pectacularly' (Moscovici, 2012) and single states lack effective instruments to deal with a banking crisis the vicious circle idea suggests a joint liability for bank failures. 'The aim is to break the vicious circle between banks and governments' (Moscovici, cit. in Bloomberg, 2013a). Overcoming the vicious circle was a goal that was recognised by the German coalition as well. Germany's Finance Minister Schäuble publicly acknowledged the 'destructive synergies between strained banks and indebted states in the eurozone' (Schäuble, 2013). The Euro Summit in June 2012 stated that it was 'imperative to break the vicious circle between banks and sovereigns' (Euro Summit, 2012, p. 1). The EU heads of state or government reiterated the statement in December 2012 (European Council, 2012, p. 3). The Southern coalition frequently referred to this European Council agreement in the negotiation and emphasised its character as a joint objective. The French foreign minister Moscovici described the results of this euro summit months later as follows: 'We agreed that stabilizing the eurozone, breaking the vicious circle between banks and sovereigns and preventing contagion among other European economies was the number-one priority' (Moscovici, 2012). The 'vicious circle' idea became the most relevant idea negotiators had to engage with on almost all issues of the banking union negotiations when arguing about the right course of action.

Negotiating the Banking Union: analysing the most contentious issues

The Scope of Application: a joint scheme?

The first of the four most contested issues in the negotiations concerned which banks the rules of the banking union should apply to. According to the European Commission's initial legislative proposals the Single Supervisory Mechanism and the Single Resolution Mechanism would cover all banks in the euro zone. Germany was strongly opposed and aimed to restrict the scope to banks with a systemic relevance, even though it was almost completely isolated (Agence Europe, 2013a; Financial Times, 2012a; Howarth and Quaglia, 2013, p. 112; 2014, p. 133; Schäuble, 2014). A broad counter-coalition of member states around France as well as the European Parliament, the Commission and the ECB advocated the SSM and SRM covering all banks in (at least) the euro zone (Agence Europe, 2013a; 2013b; Howarth and Quaglia, 2013, pp. 112–113).

=> Table 1

The outcome of the negotiations is a restriction of the SSM's and SRM's scope to 'significant' banks, i.e. most importantly those with assets exceeding 30 billion euro or 20% of the host member states' GDP. 120 banks equalling 85% the bank assets in the euro zone will be covered by the SSM or SRM (Gros and Schoenmaker, 2014, pp. 2–3; European Central Bank, 2014).

The outcome presents two puzzles for a liberal intergovernmentalist explanation. First, economic interests of powerful domestic interest groups cannot account for Germany's preferences because of the sharp division of its banking sector on the banking union's scope (Financial Times, 2012b). The public banks lobbied to be excluded (BVR/VÖB/DSGV, 2012, p. 1; BVR/VÖB/DSGV, 2013, p. 5), while the private banks wanted them included to put an end to more favourable conditions for public banks on the German market (BDB, 2013a, pp. 3–4). The government's position matches that of the public banks in this case, however, it remains unclear why. A potential counter-argument suggests that the private banks simply lobbied ineffectively and were not heard by the government. Yet we would then expect that the government consistently follows the public banks' preferences across all four cases. This is not the case as we will see below. The government followed the private banks on two issues and disregarded the interests of both public and private banks in another case. Therefore differences in the lobbying power are no convincing explanation for the government's preference formation.

Considering the role of ideas helps to fill this gap. The public banks successfully cultivated the idea that the 'patient lending' of a high number of region-based small credit institutions to export-oriented small- and middle-sized enterprises (*Mittelstand*) in their respective region is indispensable for maintaining Germany's economic model (Bonatti and Fracasso, 2013, p. 1028; Hardie and Howarth, 2013, pp. 103, 108). Even though there is no clear-cut economic rationale to favouring public over private banks (IMF, 2013), the particular banking system with savings, private and cooperative banks 'is widely seen as having been a key ingredient of the post-war German economic success story’ (Hardie and Howarth, 2013, p. 118). The concern that the economic structure of the country with a strong basis of small- and middle-sized enterprises could be negatively affected by the banking union plans was a key factor influencing the government’s preferences (Schäuble, 2012; Financial Times, 2012c).

The second puzzle for liberal intergovernmentalism is that Germany was forced to make significant concessions on the scope of the banking union. The ECB can at any time assume supervision powers for non-significant banks as well in order to ensure the consistent application of supervisory standards. This was a key demand from France and the Southern coalition (Verhelst, 2013, p. 19; Gros and Schoenmaker, 2014, p. 3). Against the background of Germany’s powerful negotiation position, intergovernmental bargaining theory cannot account for this concession.

The strategic use of the vicious circle idea is a more convincing solution to the puzzle. Germany’s counter-coalition repeatedly argued that a limitation of the scope of the banking union would question the entire rationale of the banking union (Moscovici, cit. in Bloomberg, 2013a; Agence Europe, 2013a; 2013b; 2013c; Howarth and Quaglia, 2013, pp. 112–113). It is a ‘pivotal element’ in the credibility of the new mechanisms (Verhelst, 2013, p. 19; see also Gros and Schoenmaker, 2014, p. 3). Since also Germany acknowledged the difficulties going along with the interdependence between states and banks (Schäuble, 2013), drawing on the joint objective of breaking the ‘vicious circle’ as a standard of legitimacy that all parties committed to was a powerful tool to extract concessions from Germany. The Irish Finance Minister Noonan recalled that ‘[t]he single supervisor is the core element of banking union and a vital step in breaking the vicious link between the banks and the sovereigns’ (Financial Times, 2013a). Consequently, the counter-coalition insisted on extending the scope and reminded Germany on the European Council decision dating back to June 2012: ‘We have no mandate for a dual system of supervision, which would call into question the existence of a single system for some banks’ (Moscovici, cit. in Reuters, 2012). Acknowledging the goal to break the vicious circle manoeuvred Germany into a rhetorical trap and pressured it to make a concession on the emergency clause. Even though the scope remains restricted, this clause makes the ECB the 'indirect supervisor' (Gros, 2014, p. 2) of all banks.

The Bail-In Rules: policy learning after the crisis

The bail-in rules were the second contentious issue at the banking union negotiations. A 'bail-in' refers to the obligation of private investors to bear part of the costs of bank resolution or restructuring. It applies to all EU member states.

Germany was the main advocate of bail-in rules. It was supported by Finland and the Netherlands (Finance Ministries, 2012), some other member states, the European Parliament and the ECB. This coalition called for an application of bail-in rules already in 2015 and limited exemptions in order to ensure the credibility of the bail-in provisions (Agence Europe, 2014a; 2013a; 2013d; 2013e; 2013f; European Central Bank, 2013; Financial Times, 2013b).

The member states of the counter-coalition shared the goal of reducing the use of public funds for bank rescues. They were, however, reluctant to increase the burden on banks as this was expected to delay the economic recovery. They therefore aimed to postpone the entry into force of the bail-in rules to 2018, to lift restrictions on the preventive capitalisation of banks, and to create other avenues for state interventions (Agence Europe, 2014a; 2013d; 2013e; 2013f; Financial Times, 2013b; Howarth and Quaglia, 2014, p. 134).

=> Table 2

According to the negotiation outcome the bail-in rules apply as of January 2016. Preventive recapitalisations require authorisation by the Commission on a case-by-case basis. After 8% of a bank's total assets were bailed in public authorities have some flexibility to decide upon mobilising further funds from their own national budget (European Parliament, 2014, p. 1).

This case also presents liberal intergovernmentalism with the two main puzzles. With regard to domestic preference formation, the German banking sector was again divided. Whereas the public banks were strictly opposed to the bail-in rules (BVR/VÖB/DSGV, 2013, p. 6), the private banks were more favourably inclined, provided the bail-in would apply to all banks (BDB, 2013b). Against this background, material interests do not convincingly explain

Germany's preferences. By contrast, there is a match between Germany's preferences and the relevant ideas. Bail-ins fit the ordoliberal paradigm by increasing the liability of investors for their investments and prevent moral hazard (Siems and Schnyder, 2014, pp. 365–368; European Central Bank, 2013). Putting an end to bail-outs ensures that states do not distort market forces by saving failing banks. Furthermore, '[t]he best way to break the link between banks and states is to ensure that enrolling taxpayers to rescue banks becomes the exception rather than the rule' (Schäuble, 2013; see also Moscovici, 2012).

The puzzle of German concessions in interstate bargaining also holds in this case. Several exemptions, such as loop-holes for preventive recapitalisations undermine the credibility of the bail-ins. This article argues that Germany was rhetorically entrapped and this was exploited by the Southern coalition to extract concessions. Strict bail-in provisions were expected to trigger further capital flows from the Southern to the more stable Northern member states. Especially the French and Spanish governments feared a two-class banking system prolonging the credit crunch in Southern Europe (Financial Times, 2013b; see also European Central Bank, 2013). The Southern European coalition strategically argued with the idea of overburdened banks that would delay the return to growth (Financial Times, 2013c). The German coalition had already committed to this idea when warning against a too short contribution period to the Single Resolution Fund (SRF; see next section). Schäuble argued that any shortening would reduce the banks' lending capacity (Bloomberg, 2014a). The Austrian Finance Minister Spindelegger seconded him saying that '[t]he more you have to pay into a fund the less is available to lend to the economy' (Bloomberg, 2014a). While this argument served in the SRF case to strengthen Germany's objections against a joint fund, it in turn weakened Germany's ability to insist on strict bail-in rules without appearing inconsistent.

The Single Resolution Fund: pooling of resources against the vicious circle

A joint resolution scheme without financial means at its disposal lacks credibility. Whether there should be a joint fund or a harmonisation of national funds was the main subject of controversies. It was a high priority of the German government to prevent further payments to other member states. Therefore it repeatedly blocked the creation of a joint fund of the euro zone member states. It advocated a network of harmonised national funds to ensure control over the resources (Agence Europe, 2013a; Howarth and Quaglia, 2014, p. 129; Schäuble, 2013).

Germany was largely isolated with its resistance against a joint fund (Agence Europe, 2013a; 2013c). The vast majority of euro zone member states and the European Parliament supported the Commission's proposal to create a joint resolution fund (Agence Europe, 2013a; 2013e; Bloomberg, 2014a).

=> Table 3

The negotiations finally settled on a joint fund of 55 billion euros, which is seen as one of Germany's biggest concessions during the negotiations (Gros, 2013a, p. 2). The banks of each member state pay into national compartments that will be mutualised over an eight-years-period. Mutualisation starts with 40% in the first year, 60% in the second year and the remaining 40% will progressively be mutualised in the remaining six years.

Neither do material interests explain Germany's preferences, nor can power account for Germany's concessions. The government was under heavy pressure from the public banks to reject a joint resolution fund. They considered their own institutionalised security system sufficiently resilient (BVR/VÖB/DSGV, 2013, p. 12). By contrast, Germany's private banks welcomed the idea of a joint fund. They aimed to create a level-playing field provided that all banks were obliged to contribute to the SRF (BDB, 2014; BDB, 2013a, pp. 2–4). The division of the banking sector reduces the explanatory power of interest-based accounts. The ideational frame suggests a more persuasive explanation. A fully mutualised SRF is prone to trigger moral hazard. Those member states with lenient banking supervision prior to the crisis would be rewarded for their policy failure with access to newly created joint funds (Siems and Schnyder, 2014, p. 385). Consequently, Schäuble warned that '[w]e should not set the wrong incentives' (Schäuble, 2014) as self-reliance, a key component of the ordoliberal paradigm, 'is the first pillar of our stability and fiscal union' (Merkel, 2011). Therefore the initial division of the fund in national compartments was particularly important and Germany rejected any form of joint public assistance (Schäuble, 2013; Agence Europe, 2013e). The stability culture explains persuasively why Germany opposed a joint fund with a quick mutualisation, while an interest-based account focused on domestic preferences remains at best inconclusive.

The German concession to agree to a joint fund is a striking puzzle for power-based accounts. Germany's issue-specific power is particularly high as the contributions from its financial sector are indispensable for a joint fund. By contrast, ideational factors provide useful insights when explaining the concessions. Breaking the 'vicious circle' between banks and sovereigns without joint funds was largely unrealistic (Gros, 2013a, p. 1; Elliott, 2012, pp. 38–39). As all member states had committed themselves to the objective of breaking the vicious circle, it became an accepted standard of legitimacy. Confronted with Germany's continued opposition to a joint fund, the Southern coalition started to question Germany's commitment to this shared objective. The French government reportedly insisted that 'a simple network of national bailout funds is unacceptable because it would amount to a de facto abandoning of the very idea of banking union' (Agence Europe, 2013c). This standard of legitimacy significantly constrained Germany's bargaining power on a key aspect of the banking union. Even though Germany successfully attached conditions to the use of the funds and delayed the mutualisation, the Southern coalition reached its priority objective by strategically appealing to a shared normative standard, which forced Germany to make a 'big concession' (Gros, 2013b, p. 1).

SRM Decision-Making: sovereignty vs decision-making effectiveness

Who decides on bank resolutions? Germany and some mostly Northern European member states strongly objected to allocating the final decision-making power on bank resolutions to the European Commission. They were concerned about a conflict of interests between the Commission's role as state-aid watchdog and bank resolution authority. Germany also aimed to keep the final say over its SRF contributions. Instead the Council should decide about bank resolutions (Agence Europe, 2013a; 2013b; 2013g; Financial Times, 2013d; Howarth and Quaglia, 2014, p. 134).

Germany's concern about the conflict of interest was shared within the counter-coalition, but the Commission secured a certain support by presenting itself as guarantor for an effective procedure and by pointing on limited options arising from the legal basis (Agence Europe, 2013h; Financial Times, 2013d). Ensuring an effective decision-making procedure was a high priority for a large majority of member states, the ECB and most importantly the European Parliament (Agence Europe, 2014b; Howarth and Quaglia, 2014, pp. 134–137).

=> Table 4

The negotiation parties finally agreed that resolution decisions are made by the Resolution Board in its executive session composed of the chair, four other permanent and independent experts and the relevant national authorities. The ECB and the Commission are observers. The Council's involvement is restricted to the right to veto a decision within 24 hours after its approval by the Board, but only after prior authorisation from the European Commission and on behalf of the public interest or when the Board modified the requested SRF funds (Council of the European Union, 2014, p. 2).

The main two puzzles for liberal intergovernmentalism appear in this case yet again: neither do material interests explain Germany's preferences, nor does the outcome reflect the power asymmetries between Germany and the other member states. Both the private and public banks in Germany opposed the government's preferences towards involving the Council in the decision-making procedure. They pointed to the requirement of taking resolution decisions in a timely manner and preferred a supranational committee over a Council or Commission involvement (BDB, 2013a, p. 4; BVR/VÖB/DSGV, 2013, p. 10). This case is particularly puzzling for liberal intergovernmentalism because the two banking groups were not divided, but stood together opposing the government's preferences. However, there is a match between the government's preferences and ordoliberal ideas. Ordoliberals envision a strong state pursuing market-conforming policies to create and maintain efficient markets (Siems and Schnyder, 2014). Germany was concerned that the SRF funds could be used for market-correcting policies, such as retrospective recapitalisations, and aimed to ensure its say over the use of the funds (Howarth and Quaglia, 2013, p. 112). According to Schäuble, the German government's 'goal was a sensible decision-making mechanism with effective control of the resources and a minimization of risks to taxpayers' (Bloomberg, 2014b). Against this background the preference of the German authorities on an involvement of the Council matches very well the ordoliberal policy paradigm.

Germany finally made a significant concession by agreeing to delegate the decision-making power to the Resolution Board with only a weak involvement of the Council (Gros, 2013b; Gros, 2013a, p. 2). This outcome is puzzling against the background of strong power asymmetries in Germany's favour. The argument presented here is that concessions from

Germany result from a set of causal beliefs that was used strategically in the negotiations to constrain Germany. A fuller involvement of the Council would have rendered decision-making extremely cumbersome and the banking union dysfunctional. The Commissioner responsible, Michel Barnier, declared such a procedure would be 'too complex' (Financial Times, 2013e) and not credible at the markets. Germany's proposals seemed irreconcilable with the banking union's capability to break the vicious circle (Elliott, 2012, pp. 31–40) and therefore would have breached an agreed standard of legitimacy. The Italian Finance Minister Saccomanni retrospectively stated: 'I was willing to work in a spirit of compromise, but not on the existence of an efficient, effective mechanism' (Bloomberg, 2013b). Similar to the above-mentioned examples, the Southern coalition strategically used the need for the German government to maintain argumentative consistency and to adhere to commonly professed standards of legitimacy. Germany's commitment to a functional banking union finally caused the shift in the agreement with the joint board as a significant German concession despite strong power asymmetries.

Conclusion

This article's analysis of the banking union negotiations has identified key shortcomings in the ability of approaches based on material interests and bargaining power to explain the agreement on the banking union. It suggests that instead an ideational frame can fill these gaps both with regard to national preference formation and interstate bargaining. To be sure, liberal intergovernmentalism certainly offers a convincing explanation for crucial aspects of the banking union negotiations. The preferences of the member states in the Southern coalition are well explained with corresponding interests of their banking associations. The theory also accounts well for Germany's centrality in the negotiations based on its superior material bargaining power. The outcome of the negotiations also comes fairly close to several of Germany's policy positions, even though Germany did not achieve as much as the highly asymmetrical bargaining power would lead us to expect.

In contrast to H1, however, explaining Germany's preferences with the interests of the most powerful domestic interest group produces unsatisfactory results. The public and private banks were sharply divided regarding the scope of application, the bail-in rules and the

Single Resolution Fund. They jointly opposed the government's preferences on the resolution decision-making. Their interests cannot account for the government's preferences. Given the centrality of Germany in the negotiations, this case presents strong evidence against the hypothesis H1.

To confirm fully the liberal intergovernmentalist hypothesis H2, the outcome of the negotiations would almost completely mirror Germany's preferences because of its material power and its low preference intensity. In contrast the Southern coalition's preference intensity was high due to the ongoing banking crises and the bank sovereign nexus. Nevertheless Germany made significant concessions on each of the main contentious issues of the banking union negotiations, which go beyond what could be interpreted as strategic concessions and cheap side-payments. Power-based approaches cannot fully explain these concessions, which disconfirm hypothesis H2.

Ideas do explain what interest-based accounts cannot explain. Germany's preferences match the ideational paradigm of the stability culture on all four contentious issues. Key tenets of ordoliberalism, such as market-conforming policies, put-your-own-house-in-order and self-reliance influenced Germany's positions on the scope, bail-in, SRF and decision-making procedures of the banking union. How do we know that ideas are more than camouflage for interests? This common critique fails in the banking union case: using ideas as camouflage for interests would require the ideas to match interests. We see across all four cases that ideas were opposed to powerful domestic interests. The preferences of the German government therefore support hypothesis H3.

The strategic use of ideas persuasively explains how Germany was forced into concessions on key aspects of the banking union. The most salient idea was the notion of breaking the vicious circle between banks and sovereigns that became the key argument of the Southern coalition on the scope, the SRF and the SRM decision-making. Its power in the negotiations stems from the recognition by Germany (Schäuble, 2013) and its followers as a shared goal, e.g. in statements of the Euro Summit (Euro Summit, 2012, p. 1) or the European Council (European Council, 2012, p. 3). The Southern coalition successfully presented this idea as a shared standard of legitimacy that the negotiations needed to adhere to. Its rhetorical entrapment forced Germany to concessions. This supports the hypothesis H4 that expects German concessions in response to the strategic use of ideas.

In sum, this article supports the notion of ideas as long-standing features in EMU negotiations. Their role as both source of preferences and strategic resource in the banking union negotiations is only the most recent of a number of cases that demonstrated the impact of ideas. There is vast evidence for their impact from the negotiations on EMU in Maastricht (Jabko, 2006; McNamara, 1998) to the crisis management (Bonatti and Fracasso, 2013; Siems and Schnyder, 2014). This evidence suggests that ideas – and the battle of ideas – will remain crucial for the governance and further development of the Economic and Monetary Union.

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Tables

Table 1: Negotiations of the scope of the banking union

Germany's position	Parties aligning to Germany	Position of the counter-coalition	Parties forming the counter-coalition	Outcome of the negotiations
Restrict SSM's scope to large banks	-	All banks covered by SSM	All member states except Germany; Commission, ECB	Scope limited to 'significant' banks, emergency clause for ECB
Restrict SRM's scope to large banks	Slovakia	All banks covered by SRM	All member states except Germany + Slovakia; Commission, ECB, EP	Scope limited to 'significant' banks; SRM resolution authority if SRF involved

Table 2: Negotiations of bail-in rules

German position	Parties aligning to Germany	Position of the counter-coalition	Parties forming the counter-coalition	Outcome of the negotiations
Early bail-in (2015 or 2016)	Austria, Denmark, Finland, Latvia, Netherlands, UK; ECB, EP	Bail-in not before 2018;	Bulgaria, France (in the lead), Luxembourg, Poland, Portugal, Spain	Bail-in rules apply as of 2016
Strict application of bail-in	Belgium; Denmark, Finland, Netherlands; Commission	Exemptions to bail-ins to reduce additional burden on banks	France, Greece, Italy, Luxembourg, Portugal, Spain, Sweden, UK	Exemptions after bail-in applied

Table 3: Negotiations of the Single Resolution Fund

German position	Parties aligning to Germany	Position of the counter-coalition	Parties forming the counter-coalition	Outcome of the negotiations
Network of national funds; if joint fund slow mutualisation (10 years)	- (Austria)	Joint fund fully mutualised (5 years)	All MS except Germany, most visible: France, Ireland, Portugal, Spain; Commission, ECB, EP	Joint fund (SRF), 8 years mutualisation period

Table 4: Negotiations of SRM decision-making

German Position	Parties aligning to Germany	Position of the counter-coalition	Parties forming the counter-coalition	Outcome of the negotiations
Council decides about bank resolution	Finland, Romania; later Germany isolated	Commission or Resolution Board decides about bank resolution	Large majority of member states, later all except Germany; Commission, ECB, EP, Lithuanian Council Presidency	Resolution Board decides on resolution scheme; Commission assesses discretionary aspects of Board decision and Council may only object to Commission's decision for specific reasons