Universität Trier

Joachim Schild

Leading together or opposing each other?

Germany, France and the European banking union

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Correspondence:
Prof. Dr. Joachim Schild
University of Trier
FB-III/Political Science
Universitätsring 15
D-54296 Trier
e-mail: schild@uni-trier.de

I. *Introduction*

Many observers consider the steps taken towards a European banking union since 2012 as the most important instance of deepening European economic integration since the Maastricht Treaty and the start of the European Monetary Union (EMU). In the past, France and Germany played a leading role in setting the agenda for and paving the way towards EMU (Schönfelder/Thiel 1996; Mazzucelli 1997; Dyson/Featherstone 1999). The dominant scholarly explanation of the move towards EMU is an intergovernmental one, albeit with diverging interpretations as to the underlying rationale based on either geopolitical (Baun 1996) or mainly economic motives (Moravcsik 1998). In the case of EMU, Franco-German bilateralism "operated as the inner link within the wider EMU negotiations. (…) Political leadership from Kohl and Mitterrand acted as the vital animating and organizing force behind the EMU negotiations, assisted by Delors in oiling the wheels of the process" (Dyson/Featherstone 1999: 757-58).

A similar pattern of Franco-German leadership gradually emerged in critical phases of the Eurozone's crisis. After a hesitant start in 2010, France and Germany took center stage in the EU's dealings with the existential crisis of the euro area and its common currency thanks to high frequency bilateral contacts, common proposals and a systematic and high level bilateral preparation of important European summits (Schild 2011; 2013; Jamet et al. 2013). This "Merkozy" phase of very intensive bilateral consultations and cooperation between chancellor Merkel and president Sarkozy ended – at least temporarily – with the election of the new French president François Hollande in May 2012. This was exactly the time when the European Council meeting of 29 June 2012 started the EU's decision-making process leading to a banking union.

In how far, then, can an intergovernmental explanation based on the role of Germany and France as key actors in this play account for the establishment of a banking union's basic pillars between 2012 and 2014? And to what extent, if any, did the two core members of the EMU exert a common political leadership in bringing about a European banking union?

In order to provide some answers to these questions, this paper proceeds as follows. First, we lay out our understanding of a (Franco-German) leadership role inside the European Union. Then we sketch the basic preferences of Germany and France with regard to a number of core issues that sparked controversies in the negotiations on a European banking union. Finally, we trace the process of negotiations, concentrating on how France and Germany dealt with their divergences and distributive conflicts and asking in how far Franco-German bilateralism played a helpful role in setting the agenda, in moving the process down the road, and in bringing about the crucial final compromises.

II. *Franco-German Leadership in Regional Politics*

According to a definition advanced by Eckhard Lübkemeier, "leadership in the EU is provided by actors who are willing and capable, acting as co-leaders, to prompt other actors to contribute to the achievement of collective goals" (Lübkemeier 2007: 7). In the past, Franco-German "embedded bilateralism" (Krotz/Schild 2013) in Europe provided such leadership in critical phases of the European integration history and in core policy fields, especially in monetary cooperation and integration. We may distinguish three basic types of bilateral leadership in regional politics: (1) promoting European integration, (2) crisis management, and (3) encouraging closer cooperation in subgroups of Member States. These may be exercised in three ways: (1) agenda setting; (2) consensus building; and (3) coalition building.

European *agenda setting* includes the interpretation of a given political situation and the definition of a problem to be addressed by the EU as a whole or by a subgroup of Member States. In a number of instances, Franco-German European agenda setting has taken the form of submitting common Franco-German proposals. These have importantly involved proposals for institutional innovations, especially relating to the basic framework of the European Union as part of negotiations for treaty change. *Consensus building* in EU-level negotiations refers to an entrepreneurial function of leadership (Young 1991: 293-98). Entrepreneurial leaders help to reap all the potential benefits on the negotiating table and work to overcome collective action problems. They provide focal points for negotiations or broker compromises, and they may help to overcome situations of decision-making deadlock. Franco-German contributions to European consensus building often followed a logic of "compromises by proxy" (Koopmann 2004: 13): France and Germany were able to strike bilateral deals acceptable to other Member States that felt their own interests properly represented by either France or Germany. Hence, Franco-German bilateralism reduced transaction costs of complex bargaining processes and enhanced their efficiency. In a different kind of entrepreneurial leadership, France and Germany may succeed in the art of *coalition building*, gathering support for their own common preference. In such cases, both are part of a powerful winning coalition able to sideline opponents or, alternatively, establish subgroups of Member States excluding reluctant states.

Table 1: Types and ways of providing European leadership

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

consensus building

coalition building</td></tr>
<tr><td>crisis management
– overcoming political decision-making deadlock
– management of economic crises</td></tr>
<tr><td>acting in smaller subgroups of Member States
– permanent differentiated integration
– ad hoc minilateral coalitions
– leadership by example</td></tr>
</table>

Source: Own compilation based on Krotz/Schild 2013: 20.

Before turning to the question of which type of leadership – if any – Germany and France were able to exercise in bringing about a European banking union and which ways of providing leadership they employed, we first try to briefly sketch the basic preferences of France and Germany that underlay the negotiations on the banking union project.

III. French and German Preferences on a European Banking Union

Plans to move towards a European banking union comprised five core elements (Howarth/Quaglia 2013: 103):

1. A single rule book for banks providing the EU's financial sector with a unified regulatory framework and a single set of harmonized prudential rules.

2. A shift of banking supervision from the national to the European level, discussed under the heading of a “Single Supervisory Mechanism” (SSM).
3. European (Eurozone) level decision-making on bank restructuring and bank resolution (“Single Resolution Mechanism”, SRM) underpinned by a “Single Resolution Fund” (SRF) financed by bank levies.
4. A common public backstop to fund bank restructuring and resolution in case private and national funds turn out to be insufficient.
5. A common bank deposit guarantee scheme.

These plans and the related legislative proposals of the Commission (European Commission 2012; 2013) sparked a number of controversies, the most important being the following:

- The scope of centralized banking supervision under the Single Supervisory Mechanism (SSM) and the scope of the Single Resolution Mechanism (SRM). Should both apply to all roughly 6000 banks in the Eurozone or only to the most important, systemically relevant banks and those with cross-border activities?
- Who is in control of decision-making on bank resolution in the SRM, the European Commission or the Member States?
- The time frame for the entry into force of the core elements of the banking union.
- The legal basis upon which the Union’s legislation should be based. Do some elements require a previous treaty change?
- The availability of a public backstop for direct bank recapitalization and the conditions under which to make use of it.

Basically, these core issues boil down to conflicts on two dimensions: how much mutualization of risks and liabilities and how much centralization of decision-making. Another contentious issue, which is beyond the scope of this paper, was how to define the relationship between the “ins” and “outs” of the Eurozone and the link – or disconnection – between the euro area and the single market (Moloney 2014: 1661-63).

France and Germany were to be found almost systematically on opposing ends of the spectrum of positions around the negotiating table. The basic motive underlying French preference formation consisted in severing the feedback loop (“doom loop”) between the crises of banks and sovereigns by mutualizing funds, particularly public funds serving as an ultimate backstop and lender of last resort in case of severe banking failures and crises. France, together with Italy and Spain, pushed for a swift movement towards banking union and, as Germany dragged its feet, wanted to make sure that intermediary solutions also provided a public backstop in case the current banking crisis in the euro area’s periphery deteriorated. This stance was fully in line with former French positions in favor of more “European solidarity” by means of stronger emergency measures and instruments such as well-equipped public rescue funds, the introduction of Eurobonds, the monetization of debt by the European Central Bank, a banking license for the European Financial Stabilization Facility (EFSF) and the permission for the European Stability Mechanism (ESM) to directly finance troubled banks.[1] All this boiled down to mutualizing risks and liabilities in the euro

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

area in order to calm the financial markets and to bring down spreads on bonds reflecting the extent of default risks. "French efforts (to promote banking union, J.S.) stemmed from their limited success in convincing the Germans to agree to other measures to tackle the crisis" (Howarth/Quaglia 2013: 111).

Table 2: Exposure of the French and German national banking sector to the GIIPS-states

Consolidated foreign claims and other potential exposures (ultimate risk basis) on individual countries by nationality of reporting banks / Amounts outstanding at the end of 2011 (in million US-Dollars)

	France	Germany
Claims vis-à-vis		
Greece		
public sector	$6.502	$6.749
banks	$223	$759
non-bank private sector	$37.628	$5.847
total	**$44.353**	**$13.355**
Ireland		
public sector	$2.151	$2.638
banks	$7.971	$17.883
non-bank private sector	$17.340	$74.808
total	**$27.462**	**$95.329**
Italy		
public sector	$66.167	$41.861
banks	$31.377	$31.770
non-bank private sector	$234.801	$60.323
total	**$332.345**	**$133.954**
Portugal		
public sector	$4.208	$7.139
banks	$4.461	$10.539
non-bank private sector	$13.091	$12.530
total	**$21.760**	**$30.208**
Spain		
public sector	$18.621	$24.749
banks	$23.381	$53.129
non-bank private sector	$72.700	$68.218
total	**$114.702**	**$146.096**
Total bank exposure to GIIPS	**$540.622**	**$418.942**
in % of GDP	**19%**	**11%**

Source: Bank of International Settlements, BIS Quarterly Review, June 2012, Statistical Annex (URL: http://www.bis.org/publ/qtrpdf/r_qa1206.pdf) and own calculations.[2]

This French preference must be seen against the background of the worsening banking crisis in Spain and the high exposure of French banks in the Eurozone's "GIIPS" countries (Greece, Ireland, Italy, Portugal, and Spain). By the end of 2011, French banks were much more

[2] We chose to present BIS data from the end of 2011 as available for decision-makers in mid-2012.

exposed than German ones in absolute terms, but especially as a ratio of the respective national GDP (see table 2).

For Germany, on the other hand, "(b)anking union was to avoid the next crisis, not to pay for this one."[3] The basic German preferences can be summed up as follows: to protect the German taxpayer from the costs of bank bailouts in other euro area Member States; to deny the European Union the powers to supervise German local savings and cooperative banks (the main lenders to the SME backbone of the German economy) or to decide on their restructuring or resolution; to preclude a mutualization of national deposit guarantee funds, thereby avoiding that small and stable German banks might have to pay for banking and supervising failures in other Member States; to prevent moral hazard caused by wrong incentives – the mutualization of risks and the provision of a public backstop – encouraging risky business models and bank strategies.[4] Besides these substantive concerns, the German government wanted to minimize the risk of successful legal complaints lodged against core elements of the European banking union before the German Federal Constitution Court as European-level decisions might deprive the national parliament of its budgetary powers. The German government acted – much more than the French one – under conditions of high domestic constraints, both legal-constitutional and political constraints as it faced a public opinion highly skeptical towards costly intra-European solidarity.[5]

There was some common ground, however. Both France and Germany advocated a centralization of banking supervision. But France, with its highly concentrated banking system with four dominant, transnationally active bank groups (Groupe Crédit agricole, BNP Paribas, Groupe BPCE and Société Générale), preferred all euro area banks to be covered by the European supervisor. It also supported a key role of the European Commission in decision-making on bank restructuring and resolution and a wide scope of the SRM, covering all euro area banks – fully in line with the Commission's proposals.

Germany, on the other hand, wanted to restrict this European-level supervision to big, systemically important banks, leaving the German savings and cooperative banks under national supervision. In terms of bank restructuring and resolution, Germany favored a network solution, bringing together national resolution authorities at the European level and

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[3] Financial Times, 17 December 2013: EU ministers set to define banking union (URL: http://www.ft.com/intl/cms/s/0/c552f182-6736-11e3-a5f9-00144feabdc0.html#axzz3S5mrhRQS).

[4] See the CDU/CSU-SPD governments' coalition treaty (2013), which dedicated en entire page to core German demands with regard to a European banking union. On German moral hazard concerns, see Howarth / Quaglia 2014: 128-29.

[5] On the limits of German "solidarity" during the Eurozone crisis, see Schieder 2014; on the domestic constraints the German government faced during the Eurozone crisis, see Bulmer/Paterson 2013. Numerous German economists also voiced their strong concerns about the plans for a banking union, see the protest letter of 172 economists dating from 5 July 2012 (URL: www.faz.net/aktuell/wirtschaft/protestaufruf-der-offene-brief-der-oekonomen-im-wortlaut-11810652-p2.html).

leaving all small banks without transnational activities outside the SRM, a scheme strongly advocated by its savings banks (Fahrenschon 2013: 14-16).[6]

Overall, Germany found itself in a defensive position. In the negotiations on the European banking union, it faced France, Italy and Spain taking the role of *demandeurs*, asking for German concessions. If it is true that "access to centralized fiscal support was the political *raison d'être* for BU (banking union, J.S.)" (Moloney 2014: 1624, emphasis in the original), then Germany and France clearly did not share a common objective.

As France and its southern allies needed German support – especially German financial support/guarantees in terms of a private resolution fund and a public backstop –, Germany found itself in a strong bargaining position – a classical instance of asymmetric interdependence conferring negotiating power to the state less interested in and less dependent on a successful outcome of the negotiations than the *demandeurs*.

In the past, France and Germany rarely agreed spontaneously on important European issues. However, diverging underlying preferences and initial positions in European negotiations provided them with opportunities to exchange concessions, as long as their preferences were complementary and as long as they shared a broader overarching goal in concrete negotiations (Krotz/Schild 2013: 37-43). The logic of "compromise by proxy" (Koopmann 2004: 7) explains why Franco-German compromises often proved acceptable to other EU Member States. France and Germany's capacity to lead in the European Union rests on the combination of bilateral differences at the beginning of a political bargaining process, reflecting divisions between other Member States as well, and their ability to build bridges between these opposing groups by means of a bilateral exchange of concessions.

The role and importance of France and Germany in crucial European negotiations can however not simply be derived from their – converging or diverging – preferences and the policy interdependence, the pattern of interdependent state preferences they create.[7] It is the French and German actors' deliberate choice to assume a shared and leading role in European decision-making and to make full use of the institutions and routines of their "embedded bilateralism" in order to set European agendas, to table common proposals and to promote compromise building.

In how far can we empirically observe such a deliberate choice to provide common leadership in the negotiations on the European Banking Union? In order to answer this question, we will take a look at crucial stages of the decision making process on key elements of the European banking union.

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[6] Georg Fahrenschon is the president of the *Deutscher Sparkassen- und Giroverband – DSGV*, the peak interest organization of German public regional banks (*Landesbanken*) and savings banks (*Sparkassen*).

[7] For a structural view on "policy interdependence", see Moravcsik 1997: 520.

IV. Negotiating Banking Union

1. Agenda setting

A European banking union was absent from the EU's policy agenda and "rarely discussed in European policy-making circles prior to 2012" (Howarth/Quaglia 2013: 103). A high level expert group working on financial supervision in the EU and drawing lessons from the international financial market crisis, chaired by Jacques de Larosière, explicitly denied the need for a shift towards a centralized model of European financial supervision and micro-prudential oversight.[8] Based on this report, the EU proceeded only to a quite limited change in its financial supervisory architecture after the financial market crisis (Kudrna 2012; Hennessy 2013). The new and basically decentralized European System of Financial Supervision (ESFS) made its start only on 1 January 2011.

Soon afterwards, the deepening of the Eurozone crisis in 2011 and 2012 provided a window of opportunity for actors pushing towards a European banking union. Rising risk spreads on Italian and Spanish bonds changed the situation in the first half of 2012. In early 2012, the ECB started to promote the idea of a centralized supervision and resolution of banks (De Rynck 2014: 18-19), the Commission followed in May 2012 and the president of the European Council, Herman Van Rompuy, integrated this project into his report "Towards a genuine Economic and Monetary Union", which was prepared together with the presidents of the Commission and the European Central Bank and presented in its first version on 26 June 2012, immediately ahead of the decisive euro area summit and European Council of 28-29 June 2012. Van Rompuy's report favored an "integrated financial framework to ensure financial stability in particular in the euro area and (to) minimize the cost of bank failures to European citizens. Such a framework elevates responsibility for supervision to the European level, and provides for common mechanisms to resolve banks and guarantee customer deposits" (Van Rompuy 2012: 3).

The historical decision to move towards a European-level bank supervision cannot be explained without the link of this issue to another one: the direct recapitalization of banks. It was the Spanish banking crisis that served as a focusing event, opening a policy window by drawing the attention on the link between banks and sovereigns (De Rynck 2014: 18). In the first half of 2012, it became clear that Spain would request external financial assistance, which it officially did after long hesitations on 25 June 2012, immediately before the European Council meeting on 28-29 June 2012 launching the work on a European banking union. Spain, Italy and France strongly advocated the use of ESM funds to directly recapitalize Spanish banks, without channeling the money via the state treasury, hence without adding to the debt burden and debt ratios of Spain (or other Member States). Thus, Germany faced a large coalition of like-minded Member States and European institutions advocating the direct recapitalization of banks via the ESM. In her government declaration

[8] "While the Group supports an extended role for the ECB in macro-prudential oversight (…), it does not support any role for the ECB for micro-prudential supervision" (Larosière report 2009: 43).

immediately ahead of the euro area summit, chancellor Merkel expressed her fear that “this Council will talk all in all too much about all kinds of ideas for a common liability and too little about improved controls (…) Control and liability must go hand in hand”. And she warned her European partners that “the German strength should not be overestimated” (Merkel 2012: 22224 and 22225, my translation).

At this historical summit meeting “in deep crisis mode” (Emmanoulidis 2012) on 28-29 June 2012, French president François Hollande sided with the Italian and Spanish prime ministers, Mario Monti and Mariano Rajoy, to put pressure on Angela Merkel in order to make her accept a direct recapitalization of banks through the ESM.[9] Monti and Rajoy threatened to block the “Growth and Jobs Pact” – which Hollande desperately needed for domestic political reasons –, unless the direct recapitalization of banks would be decided (Emmanoulidis 2012: 3). In exchange for that concession, Germany successfully pushed for a centralized European banking supervision, the “Single Supervisory Mechanism” under the responsibility of the ECB, a step the German chancellor Merkel had already advocated before the summit meeting at least for systemically important banks (Merkel 2012: 22223).[10] As soon as a single supervisory mechanism would be in place, Spanish (and other) banks might be directly recapitalized through the ESM. In the words of the euro area summit declaration: “We ask the Council to consider these Proposals (of the Commission on the SSM. J.S.) as a matter of urgency by the end of 2012. (…) When an effective single supervisory mechanism is established, involving the ECB, for banks in the euro area the ESM could, following a regular decision, have the possibility to recapitalize banks directly (…)” (Euro area summit 2012). As regards the recapitalization of Spanish banks, the capital will be “provided by the EFSF until the ESM becomes available, and (…) it will then be transferred to the ESM, without gaining seniority status” (ibid.).

This compromise meant that Germany was not willing to inject capital into Spanish banks without any control through external supervision over those banks. “Germany’s refusal to grant Spanish banks direct capital injections is rooted in the desire to break the cycle of financial assistance today in exchange for legal changes and clarity later” (Henessy 2013: 12).

Later, French minister of finance, Pierre Moscovici, attributed the initiative for a banking union to France.[11] French Commissioner for the single market, Michel Barnier, however, attributed a key role to Angela Merkel: “it was she (Angela Merkel, J.S.) who, on 29 June 2012, asked the European Council to put banking union in place”.[12] Still others see the ECB in

[9] See International Herald Tribune, 30 June 2012: European steps toward centralized banking control. New coalition pushes Germany to bend on funding of bailouts.
[10] Minister of finance, Wolfgang Schäuble (2013), asserted that the „German government was among the first to float the notion of a European supervisor as a way to combat the destructive synergies between strained banks and indebted states in the eurozone“.
[11] “Elle (la France, J.S.) a pris, grâce à François Hollande, l'initiative de cette union bancaire” (Moscovici 2013).
[12] Agence Europe, Europe Daily Bulletin No. 10927, 24 September 2013: General consensus across Europe on clear Merkel vicory.

the key role of policy entrepreneur in favor of a centralized European banking supervision and resolution framework (De Rynck 2014). Yet nobody, to our knowledge, makes the claim that France and Germany acted together as agenda setters for a European banking union. Neither did they share a common understanding of the crisis and a common definition of the situation they faced, nor did they promote a common social purpose. France pushed for rapid decisions to add just another crisis management instrument, the direct recapitalization of banks via the ESM, while Germany tried to get more supranational control over foreign banks in exchange for its concession on this point.

After this initial decision on 29 June 2012 to embark on the journey towards a banking union, a political dynamic set in, first to lay the foundations of the "Single Supervisory Mechanism" (SSM) until the end of 2012, then to complement this European centralized supervision with European-level decision-making on and funding of bank restructuring and resolution.

In the debates and intergovernmental negotiations following this initial political agreement on the principle of a Single Supervisory Mechanism (SSM), "the main players were France and Germany" (Howarth/Quaglia 2013: 111). But most of the time, they played against each other, trying to build coalitions with like-minded Member States. Only occasionally did they prove able to provide leadership, advancing the search for European-level compromises by means of intensive bilateral consultation and some bilateral deals ahead of important European-level meetings.

2. *Being part of opposing camps I: SSM and direct bank recapitalization*

France and Germany sharply diverged on the timetable for setting up the SSM. François Hollande called for a European banking union "the earlier the better" whereas Merkel warned that "haste might prove costly".[13] And whereas France wanted the option of direct recapitalization of banks as soon as the legal framework of the SSM would enter into force, Germany insisted that the centralized European supervision should be fully operational without setting a final date.

These divergent goals led to an open conflict at the October 2012 European Council. Against the background of the acute recapitalization needs of Spanish banks, French president François Hollande wanted it to pave the way for a conclusion of major work on the SSM by December 2012, whereas Angela Merkel made clear ahead of this summit that it was too early to come up with important decisions.[14] And she got her way: "After repeated and bad-tempered clashes with the French president at a Brussels summit in the early hours of

[13] See Agence France Presse, 22 September 2012: Merkel, Hollande rift on banking union deepens; see also: AFP, 18 October 2012: France, Germany move to compromise on banking union; and Le Monde, 19 October 2012: Europe: Hollande répète vouloir mettre en place l'union bancaire 'd'ici à la fin de l'année'.

[14] See Agence France Presse, 18 October 2012: Deutsch-französischer Zwist überschattet Gipfel: Zeitplan für Aufbau der Bankenaufsicht spaltet die Europäer.

Friday morning, Chancellor Merkel succeeded in postponing the creation of a new European Central Bank banking supervisor until the end of next year", that is 2013[15] – it eventually took until 4 November 2014 until the SSM became operational after the European Central Bank had completed its comprehensive assessment of 130 banks. François Hollande could not achieve a firm deadline for this work (European Council 2012a), commenting that "Merkel has her own deadline, in September 2013", the month of the upcoming German Bundestag election.[16] Angela Merkel in turn called allusions to electoral motives a "bad insinuation".[17]

Yet another important divergence of views occurred on this issue of direct capitalization of banks: Should it be available to deal with current bad assets of banks in crisis ("legacy assets") or should its use be restricted to deal with future banking crises? Germany, Finland and the Netherlands joined ranks to oppose a direct bank recapitalization by the EMS applying to banking crises that started before the SSM takes effect. In a common statement of their ministers of finance, the three governments underlined that "legacy assets should be under the responsibility of national authorities", that is not of the ESM (Finish Ministry of Finance 2012). France, on its part, wanted to include past debts as well. Germany, Finland and the Netherlands also made clear that "direct bank recapitalization by the ESM should take place based on an approach that adheres to the basic order of first using private capital, then national public capital and only as a last resort the ESM" (ibid.). "We do not want a shift of legacy assets of individual countries on other countries' national taxpayers", as the German minister of finance, Wolfgang Schäuble, had it (Schäuble 2014: 3).

Three contentious issues blocked the road towards a swift agreement on the SSM in late 2012: The scope of the SSM in terms of the number of banks to be directly supervised by the ECB; the institutional setup that should guarantee the independence of the ECB and minimize the conflict between its roles as a European banking supervisor and as the guardian of price stability; and finally the place of non-euro area countries in this new architecture of banking supervision (Howarth/Quaglia 2013; Moloney 2014).

On the first two points, France and Germany clearly were the main opponents. Germany's finance minister Wolfgang Schäuble told his colleagues that he could not imagine how the ECB could supervise thousands of banks, whereas his French colleague, Pierre Moscovici warned against a dual system of supervision and strongly made the case for a comprehensive supervisory role of the ECB, a position that was supported by the latter (De Rynck 2014). In order to guarantee the independence of the ECB, Schäuble asked for a "Chinese wall" between the supervisory and monetary policy powers of the ECB, which would only be guaranteed if the ultimate supervisory decisions were not in the hands of the ECB Governing Council.

[15] The Telegraph, 19 October 2012: Merkel wins victory over Hollande.
[16] The Guardian, 19 October 2012: France and Germany fight over euro cure.
[17] Associated Press, 19 October 2012: European bank supervisor step closer but deal hazy.

In order to guarantee a clear separation of supervisory and monetary policy function, Germany wanted the governance structure of the SSM to include a mediation panel and got its way: the ECB has to create such a mediation panel (Art. 25 of the Council's SSM regulation No. 1024/2013 of 15 October 2013). In case the ECB Governing Council (the de jure decision-maker) rejects a draft decision suggested by the supervisory board (the de facto decision-maker), this panel has to arbitrate between the two by a simple majority vote. It consists of representatives from each of the participating Member States who are members of either the ECB Governing Council or the supervisory board.

A Franco-German convergence of views occurred, however, on the issue of picking the ECB as the European supervisor on the legal basis of Article 127(6) TFEU, as the choice in favor of another independent body to supervise Eurozone banks would have required a treaty change.[18]

Both the French and the German positions were not free of internal tensions. On the French side, it was obviously contradictory to ask both for a maximum speed and maximum scope, namely swift start of the ECB's work as a banking supervisor and making it responsible for the oversight over 6000 banks.

On the German side, there was a contradiction between insisting on a clear separation between supervisory and monetary policy functions of the ECB and its insistence on a sound legal basis. The former would logically have implied to deny the ECB Governing Council a role as ultimate decision-maker. Yet European primary law and its longstanding interpretation by the European Court of Justice excluded any possibility for an EU Treaty institution, in this case the ECB, to delegate executive powers with wide discretion to another body such as an agency without a foundation in primary law (Moloney 2014: 1660-61). The newly created mediation panel between the supervisory board and the ECB Governing Council might trigger legal challenges as the "wording of the SSM Regulation does not explicitly rule out the interpretation that the Mediation Panel ultimately overrides the Governing Council; that would, however, not be compatible with higher-ranking EU law" (Deutsche Bundesbank 2013: 23).

3. *Being part of opposing camps II: Deposit guarantee, SRM and SRF*

France saw a common bank deposit guarantee scheme as being an integral part of a European banking union. The Commission considered submitting a legislative proposal to this end. But meeting with staunch German opposition, it refrained from it. France had to limit its ambitions to amending the Deposit Guarantee Scheme Directive of 1994 (94/19/EC), first amended in 2009 (Directive 2009/14/EC), and again in 2014 (Directive 2014/49/EU). This directive adopts a decentralized approach of harmonizing national legislation and

[18] See Berliner Zeitung, 16 June 2012, p. 17: EZB soll Bankaufsicht übernehmen. Frankreich und Deutschland wollen Notenbank stärken.

guarantee schemes. In view of the ongoing banking crises and the nontransparent and possibly huge volume of bad bank assets throughout Europe, Germany saw a common deposit guarantee as a non-calculable and unacceptable risk with which it did not want to burden the German banking sector.[19] It also refused mandatory borrowing between the Member States' deposit guarantee schemes (DGS) as foreseen in the Commission's proposal (Article 10), just allowing for "DGSs to lend to other DGSs within the Union on a voluntary basis" under specific conditions (Art. 12 of the adopted Directive 2014/49/EU on deposit guarantee schemes). Thus, Germany using its de facto veto power[20] successfully prevented a common deposit guarantee scheme from making its way onto the EU's policy agenda, much to the annoyance of France, who repeatedly called for a rapid establishment of such a supranational arrangement (e.g. Assemblée nationale 2014: 5).

The debates surrounding the Single Resolution Mechanism provide a number of examples of France and Germany being the main opponents on core issues. The most important controversies revolved around the choice of the legal base, the respective roles of the Commission and the Member States in decision-making on the resolution of ailing banks, and a number of distributive conflicts on the details of how the resolution fund should be filled over time by bank levies and according to which criteria banks would have to contribute.

As regards the legal base, Germany favored a two-step approach: "A two-step approach could start with a resolution mechanism based on a network of national authorities as soon as the new supervisor is operational, the resolution directive has been adopted and the Basel III capital requirements are in place." This would "buy time for the creation of a legal base for our long-term goal: a truly European and supranational banking union, with strong, central authorities, and potentially covering the entire single market" (Schäuble 2013). Such a sound legal base would require a limited treaty change. Without treaty change, the assignment of a central role to the Commission in bank resolution would entail major risks of a legal challenge before the Federal Constitutional Court because of the intrusiveness of bank resolution decisions and their potential fiscal impact on Member States. German calls for a treaty change in order to provide a solid legal base for these transformational steps of deepening integration do not merely reflect the long shadow of the Federal Constitutional Court. There are indeed good normative reasons to think that these profound changes in the EU's economic constitution require a proper democratic legitimation through national ratification procedures.

The French government, on its part, supported a central role of the Commission in the decision-making process – instead of the German network approach – in order to guarantee

[19] The German government's 2013 coalition treaty simply states: "We reject communitisation of deposit protection at EU level" (Coalition treaty 2013).
[20] In a formal sense, Germany (as others) had a veto only in the case of the SSM regulation, based on article 127(6) TFEU which requires unanimous adoption, whereas the other proposals were negotiated under the Lisbon Treaty's ordinary legislative procedure – except the Intergovernmental Agreement signed in May 2014 on the build-up of the Single Resolution Fund.

rapid responses in situations of emergency. "(W)e need an effective decision-making process, as simple as possible", as French minister of finance, Pierre Moscovici, had it.[21]

Shortly before the Commission tabled its proposal on the SRM, France and Germany published a common declaration on 30 May 2013 in which France supported the German call for a "single resolution board involving national resolution authorities" as the central decision-making body on bank resolution (see below IV.4). The Commission ignored this part of the Franco-German declaration and tried to put itself at the heart of decision-making on restructuring or winding down ailing banks. By this means, it set itself on a collision course with Germany.[22] After the publication of the Commission's proposal on 10 July 2013, German minister of finance Schäuble wrote a letter to the Internal Market Commissioner Michel Barnier who was in charge of the Commission proposal, warning him that a decision of winding down a bank with far reaching consequences cannot be made by Brussels alone and repeated that such a centralization of decision-making powers would necessitate a treaty change.[23] At a Brussels meeting of European finance ministers on 9 July 2013 he added that he "would strongly ask the Commission in its proposal for an SRM to be very careful and stick to the limited interpretation of the treaty", otherwise Europe would risk "major trouble".[24] On legal grounds and from the point of view of normative democratic theory, it is indeed highly questionable that such an important shift of powers to a supranational institution could really be based on the treaty's single market article (Art. 114 TFEU). Germany saw the treaty's flexibility clause (Art. 352) as a more appropriate legal base. An assessment by the Council's legal service, however, backed the position of the Commission. This has probably contributed to the softening of the German position.[25]

The final outcome of the negotiations on the decision-making procedure substantially modified the Commission's proposal. Instead of conferring the ultimate decision on bank resolution to the Commission, the final compromise assigned a key role to the newly established Single Resolution Board (SRB), a Union agency composed of a Chair, four further full-time members, and a member appointed by each participating Member State and representing their respective national resolution authorities. The Commission and ECB were only given permanent observer status (Art. 43 SRM regulation). The Council and the Commission were granted power of objection against decisions of the SRB, making them veto players (Art. 18 SRM regulation). The Council can also object to the placing of an institution under European-level resolution in case it does not see the "public interest" criterion met (Art. 18 (1c) SRM regulation) and confer the task of winding it up to national authorities according to national law.

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[21] Agence France Press, 17 December 2013: Eurozone ministers thrash out final 'Banking Union' details; see also Agence France Press, 15 November 2013: EU ministers seek to lower differences over banking union.
[22] See Die Welt, 6 June 2013: EU sucht Machtkampf mit Berlin und Paris.
[23] See his interview with the German tabloid Bild, 12 July 2013: Für meine Steuererklärung brauche ich nur zwei Stunden (URL: http://www.bundesfinanzministerium.de/Content/DE/Interviews/2013/2013-07-12-bild.html); see also New York Times, 10 July 2013: Bank plan develops, but Germany has doubts.
[24] Irish Independent, 10 July 2013: Germany warns bank rules might be ‚trouble'.
[25] See EuropeanVoice, 20 September 2013: Germany ready to relent on single resolution mechanism.

This decision-making procedure, which also involves the ECB triggering the process by signaling that an entity is failing or likely to fail, has widely be criticized as very cumbersome and including too many veto players. According to Wolfgang Schäuble, however, "such a procedure might look complicated on paper. In practice, however, it is very unlikely that the Commission and the Council come to an agreement considering the severe time limits.[26] Therefore, in such a construction, it will normally be the Board taking de facto the final decision – and this would be the best solution" (Schäuble 2014, my translation).

A number of distributive conflicts underlay the debates on the Single Resolution Mechanism. Who should pay for banks in trouble, the private sector – banks, their shareholders, bondholders, owners of large bank deposits – or the taxpayer? And would the private sector and/or taxpayers have to clean up their national mess or also pay for bank restructuring and resolution in other euro area Member States?

The core element of the German political discourse on banking union was that (German) taxpayer should be protected against future public bailouts of banks, the keyword being "Haftungskaskade" (liability cascade). It strongly supported the Bank Recovery and Resolution Directive (BRRD), negotiated in parallel to the SSM and SRM and which applied to all EU-28 members. Its stipulations foresee a private "bail-in" of bank shareholders, bondholders and large depositors, a tool later integrated into the SRM regulation. In case this bail-in does not fix the problem, according to the German government, national resolution funds, financed via bank levies should come next. Additionally, the Member States would be responsible for injecting money. The Single Resolution Fund should only cover systemically important banks and banks with important transnational activities.

With regard to the bail-in, Germany, supported by Austria and the Netherlands, advocated a uniform application of rules, leaving little discretion to exclude classes of bank's creditors. France, supported by the UK and Sweden, however, wanted national governments to have some flexibility to exclude classes of creditors from bail-in obligations or define the extent to which they would have to contribute.[27] A first attempt of the EU ministers of finance on 19/20 June 2013 in Luxembourg ended without an agreement after 20 hours of negotiations, the main dividing line running between France and Germany.[28] A political agreement in the Council could only be achieved one week later on 27 June 2013 (Council 2013a: 1) It indeed left discretion for national authorities to exclude liabilities from a bail-in.[29]

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[26] The Council would have to approve the Commission's proposal for a modification of the Board's resolution scheme within 24 hours, the Commission having only 12 hours to put forward such a proposal to the Council.

[27] AFP 21 June 2013: EU finance ministers struggle on bank closure; The Irish Times, 26 June 2013: EU finance ministers edge toward bank plan.

[28] Welt online, 22 June 2013: EU-Finanzminister: Verhandlungen über Regeln für Krisenbanken geplatzt.

[29] National discretion is preserved in cases a speedy bail-in is not assured, if a bail-in would endanger the continuity of critical bank functions, to avoid contagion and to avoid raising losses borne by other creditors (Council 2013: 2-3).

Germany, Austria, Denmark, Finland, Latvia and the UK came out in favor of an early entry into force of the BRRD directive to be applied starting in 2016 instead of 2018. The earlier this date, the less likely it is that banks have to be bailed out with taxpayer's money.

On the two other important issues concerning the scope of the SRM, responsible for all EU banks or only those under direct supervision of the ECB, and the creation of a single resolution fund versus a network of national funds, Germany found little support among its partners.[30] Yet it succeeded in limiting the scope of the regulation in a way that the SRM's Single Resolution Board (SRB) is responsible for drawing up resolution plans and adopting decisions on resolution only for the banks under the direct supervision of the ECB and cross-border banks. National resolution authorities continue to be responsible for the resolution of other banks unless a resolution requires making use of the single resolution fund in which case the SRB adopts the decisions on the resolution scheme (Art. 7 SRM Regulation). This outcome almost ensures that decisions on the resolution of German local savings or cooperative banks are not taken at the European level.

In the dispute between adherents of a single fund (the vast majority of EU Member States) and those of a network of national funds, Germany could impose an intermediate solution, based on an international agreement outside Union law sidelining the European Parliament. It foresees a fund with national compartments that will only gradually be merged into a single fund over an eight year period until the end of 2023 and will by then be filled with an estimated €55 billion (1% of covered deposits of the banking union's banks). This approach, according to the French rapporteur on the SRM in the Senate, François Marc, "considerably reduces the principle of solidarity at the heart of the SRM" (Rapport Marc 2013: 33, my translation).

One more distributive conflict with regard to the contribution of small and large banks to the single resolution fund found France and Germany on opposite sides. The French government tried to make sure that the criteria for the contributions of individual banks to the fund, defined by a delegated legal act of the Commission, should not weigh heavier on the French banking sector than the national fund to be build up as a consequence of the BRRD, filled with roughly € 13 billion (Rapport Marc 2013: 31). It advocated an approach taking the risk structure of the bank's assets more into account than the bank's size. The French demand for a large scope of SRM covering all Eurozone banks should make sure that all the banks should contribute to the resolution fund, as they all might get money from it in case of resolution (Rapport Marc 2013: 23).

The German government, however, wanted to protect the small local savings and cooperative banks as much as possible from contributing to the Single Resolution Fund. On 21 October 2014, the Commission published its plans on the contributions of banks to the

[30] See Agence Europe, Europe Daily Bulletin, No. 10965, 19. November 2013: Single resolution – discussions at standstill.

single resolution fund. It made concessions to Germany, as small (German) banks have to contribute far less than the big (French) ones.

In terms of the timetable, Germany agreed to make a concession to the European Parliament which had asked for a shortening of the build-up period for Single Resolution Fund (SRF) from 10 to 8 years, but insisted that the period during which banks pay into the fund is likewise shortened, thus the fund being filled in 2024 instead of 2026 as originally agreed upon in the Council.

Germany also subscribed to the idea of providing a common fiscal backstop to be "developed during the transition period" until the SRF is fully equipped, but Berlin could make sure that "the banking sector will ultimately be liable for repayment by means of levies in all participating Member States" so that these new "arrangements will be (…) fiscally neutral over the medium term so that taxpayers will be protected" (Eurogroup 2013b).

France would have liked to have an instrument for direct recapitalization of banks in place in autumn 2014 when the outcome of the ECBs comprehensive assessment of banks going under its supervision was clear (Assemblée nationale 2014: 4; Rapport Marc 2013: 20). The Council agreed on 15 November 2013 on the order of backstops in case recapitalization needs were revealed. In a first instance, banks should raise capital or use retained profits. Should this prove to be insufficient, a national public backstop comes in. Only in the last instance, a European-level public backstop such as the ESM may be used (Council 2013b). Eventually, a direct capitalization through European-level funds turned out to be unnecessary as the capital shortfalls identified by the ECB in its comprehensive assessment amounted only to €24.6 billion across 25 banks (ECB 2014: 6).

4. *Intensifying consultations and striking bilateral compromises*

In the past, France and Germany often contributed to the achievement of collective goals by hammering out bilateral compromises ahead of important or history-making decisions at the European level. These compromises, reached after intensive bilateral consultations and negotiations, often proved acceptable to their partners provided they felt their interests represented by either France or Germany. Was there compromise building on core issues at central stages of the negotiations on banking union?

A compromise inside the Council on the Single Supervisory Mechanism (SSM) was brokered by the Cypriot council presidency on 12/13 December 2012 immediately ahead of the European Council meeting after 14 hours of bargaining between the ministers of finance.[31] Banks holding assets over € 30 billion or assets of more than 20 per cent of their home country's GDP and the three most significant credit institutions in each of the participating Member States would be directly supervised by the ECB whereas national supervisors continue to oversee smaller banks (Art. 6(4) SSM Regulation). The ECB can,

[31] See New York Times, 13 December 2012: Finance ministers agree to give central bank oversight of Europe's lenders.

however, “at any time, on its own initiative (…) or upon request by a national competent authority, decide to exercise directly itself all the relevant powers for one or more credit institutions (…)” (Art. 6(5) SSM Regulation). Thus, France could save its face as the ECB has the ultimate responsibility for banking supervision in the euro area and got the discretionary right to step in and supervise smaller banks as well, even though it leaves the day-to-day business of supervision to national competent authorities. And Germany got its way in de facto excluding its local savings and cooperative banks from the ECB supervisory remit and in delaying the SSMs full implementation well into 2014. When the SSM started on 4th November 2014, only 120 banks came under the direct supervision of the ECB.

France and Germany helped to bring about crucial final compromises on the SSM thanks to regular bilateral consultations: “Our teams have been in constant contact and we got in touch just before the meeting to bring our views into line”, according to the French minister of finance, Pierre Moscovici.[32] Thus, a Franco-German contribution to compromise building seems to have occurred only on the home stretch, just ahead of the finishing line. There is no evidence of common Franco-German contributions or proposals at earlier stages of the process. Nevertheless, shared Franco-German norms concerning the appropriate conduct of their bilateral cooperation in the framework of European Union politics seem to have worked. They at least helped to avoid an open clash between the euro area’s core countries at the final stage of decision-making on the SSM thanks to intense consultation in the run-up to a decisive meeting of the euro area’s ministers of finance.

It took a while before France and Germany could make an active common contribution to the work on the Single Resolution Mechanism. After the French presidential election of 2012, it took the German and French executives until May 2013 – that is a full year – before they were able to come up with a common proposal on the banking union and its most controversial part, the Single Resolution Mechanism under construction. Ahead of the Commissions publication of its proposal on the Single Resolution Mechanism (10 July 2013), the two most influential EMU members laid out their own idea of such a mechanism, thus influencing the Commission’s final work on the subject and framing the debates of the upcoming June European Council. They defined a number of principles upon which the Single Resolution Mechanism should be built and underlined that the SRM would be negotiated “on the basis of the current treaties” (Press and Information Office 2013).

Core points of this common proposal read as follows:

- “A single resolution board involving national resolution authorities and allowing quick, effective and coherent decision-making at the central level.
- The single resolution mechanism should be based on contributions by the financial sector itself, thus pre-financing over time an appropriate and effective private backstop arrangement building on national private backstop arrangements.

[32] AFP, 13 December 2012: France, Germany bury hatchet to nail EU bank deal.

- With private backstop elements growing in importance over time, the ESM should play the role of an additional public backstop both through lending facilities to Member States or direct recapitalization based on the operational criteria still to be decided" (ibid.).

Germany had insisted on national resolution authorities being part of the decision-making body – the single resolution board – instead of a more centralized structure build around the Commission and found French support on this core demand. French preference for a more important pooling of fiscal resources explains why the ESM is mentioned as "an additional public backstop" not only for sovereigns, but also for the recapitalization of banks.

However, this common proposal avoided to settle some contentious issues, such as the question how to deal with "legacy assets", that is whether direct bank recapitalization should include old bad debts. Apparently, France and Germany were not able to contribute in detail to the definition of an "operational framework, including the definition of legacy assets", which, according to the European Council of December 2012, "should be agreed as soon as possible in the first semester of 2013" (European Council 2012b), that is immediately after the publication of the Franco-German declaration. Shortly after, Germany conceded the possibility of using the ESM direct recapitalization instrument for dealing with "legacy assets". An important Eurogroup meeting agreed that the "potential retroactive application of the instrument should be decided on a case-by-case basis and by mutual agreement", i.e. giving Germany a veto right (Eurogroup 2013a).

Later, the Council had to negotiate on the SRM with the European Parliament in a co-decision procedure. When the Council had to fix its position before the start of negotiations on the SRM with the European Parliaments delegation, this was prepared by a core group of Member States comprising Germany, France, Italy, Spain and the Netherlands. They worked closely with the Lithuanian presidency, the Commission and the ECB ahead of the decisive meeting of ministers of finance on 17-18 December 2013.[33] According to the French minister of finance, Pierre Moscovici, the Franco-German cooperation was "surely decisive for the final agreement" in the Council that was reached after 12 hours of negotiations.[34] Later, in the crucial phase of trilogue negotiations of the Council with the European Parliament, the Eurogroup's president Dijsselbloem took center stage. He took care of informing Schäuble and Moscovici about the deal he could strike in the early morning hours of 20 March 2014.

Franco-German compromise building also helped to settle the contentious issue of how to calculate financial institutions' contributions to the Single Resolution Fund (SRF). A compromise could be struck by the end of 2014. Every bank in the euro area has to contribute to the SRF. The amount of their annual contribution is calculated on the basis of their aggregate liabilities (less own funds and covered deposits) and then risk-adjusted in

[33] See Agence Europe, Europe Daily Bulletins, No. 10982, 12 December 2012: SRM agreement starts to take shape, and Agence Europe, Europe Daily Bulletins, No. 10985, 17 December 2013: Politicians agree on bank resolution system in 2013.
[34] See Hamburger Abendblatt, 20 December 2013: Banken dürfen pleitegehen.

order to take into account the diversity of their risk profiles. Smaller banks – with total assets under €1 billion – will pay a lower lump-sum contribution. The French and German banking sector will have to contribute approximately €15.5 billion each until the end of 2023 (Spanish banks €5.4 billion, Italian banks €5.8 billion) which adds up to €31 billion or 55% of the SFR's overall volume (€55 billion) (Deutsche Bundesbank 2014). As French and German banks were to be the main contributors to the fund, their governments had a key role in fine-tuning the complex details of the calculation of bank levies in a way that would equitably distribute the financial burden between the two countries' banking sectors.[35]

5. Main negotiation outcomes

Table 3 summarizes the main outcomes of the negotiation process on core elements of the European banking union and compares them to the initial proposals of the Commission and the initial positions of France and Germany. The broad picture that emerges is one of Germany keeping the upper hand on a number of issues with strong distributive implications. It was successful in refusing any common deposit guarantee scheme, it conceded only a gradual build-up of the Single Resolution Fund, starting with national funds to be gradually merged into a single fund, and it could limit the contributions that its own small banks have to make to this fund. France successfully pushed for the option of using ESM funds for direct bank recapitalization. The maximum amount of € 60 billion available for that purpose (Eurogroup 2013a: 3) is, however, quite limited, compared to the huge sums injected in insolvent banks at the height of the financial market crisis. This outcome of the distributive conflicts, favorable to German interests, reflects Berlin's strong bargaining position of not being the key *demandeur* and driver of the process leading towards a banking union. It had credible unilateral alternatives to the common European solutions under discussion.

[35] See Le Monde.fr, 4 November 2014: Banques françaises et allemandes contribueront à même hauteur au niveau européen (URL: www.lemonde.fr/economie/article/2014/11/04/mru-les-banques-francaises-et-allemandes-contribueront-a-hauteur-de-15-milliards-d-euros_4517620_3234.html#HKbuxS3qhKsDb3bt.99).

Table 3: Negotiating positions and outcomes

	European Commission	France	Germany	Outcome
Start of SSM		1 January 2013	No firm deadline	4 November 2014
Scope of SSM	comprehensive	comprehensive	Only the big, systemically important banks	ECB supervises 120 big banks directly, delegating the day-to-day supervision for smaller banks to national supervisors
Common Deposit Guarantee Scheme	In favor, but no proposal tabled because of German opposition	Strongly in favor	Strictly opposed	No single deposit guarantee scheme, only harmonized national ones
Scope of SRM	Large, all 6000 banks	Large, all 6000 banks	Small, only banks under direct supervision of ECB	Small, only banks under direct supervision of ECB and cross-border groups
SRF	Single fund	Single fund	national funds ("compartments"), common fund later after necessary treaty change	National compartments gradually to be merged into a single fund until 2024
Calculation of banks' contributions to SRF	Contribution calculated according to bank's risk profile and lump-sum for small institutions	Contribution calculated according to bank's risk profile	Systemically important institutions should contribute more than others	Lump-sum for small institutions, higher contributions of bigger banks depending on their risk profile
Legal base for SRM	Art. 114 (Internal Market)	Art. 114 (Internal Market)	Art. 352 TFEU (flexibility clause); later treaty change	Art. 114 and intergovernmental agreement on single resolution fund
Commission empowered to resolve banks in SRM	Yes	Yes	No	No, decision by the Single Resolution Board with Commission and Council as veto players

Source: Own compilation.

V. Conclusion

Based on this empirical evidence, we may conclude that Franco-German leadership was by no means an essential driving force in this process. Its unexpected dynamic owes much to a combination of "favorable" context conditions, especially the deepening of the double sovereign debt and banking crisis which suddenly opened a policy window for deep reforms. This window of opportunity was used by active policy entrepreneurs inside the ECB, the Commission and by Member States such as France and Italy searching for European instruments of "solidarity" providing a safety net to fund bank restructuring and resolution. Germany, when put under pressure to massively contribute to such a financial safety net, asked for new European institutions of control and supervision as a quid pro quo for the sharing of risks and liabilities.

We could show that Germany and France were indeed the main players. But more often than not, they played in opposing teams. Only occasionally, they put the institutions and routines of their bilateralism to full use in order to make a common contribution to compromise searching and consensus building.

Table 4: Evidence for Franco-German leadership on banking union

Ways of providing leadership	Empirical observations
Agenda setting / common proposals	No common agenda setting at the start of the process; one common proposal (Franco-German declaration of 30 May 2013) ahead of the Commissions SRM proposal; Franco-German proposal avoided core distributional issues
Coalition building	No instance of coalition building with France and Germany siding together; many instances of France and Germany in opposing coalitions
Consensus building	Some examples of France and Germany relying on close bilateral consultations, being at the heart of consensus building in the final phase of negotiations

Source: Own compilation

How can we explain this limited *common* role of Germany and France? Which factors account for it? In order to answer this question, we have to distinguish between circumstantial factors and a deep divergence of views on overall goals.

The start of the debates and negotiations on banking union coincided with the start of the presidency of François Hollande. Unlike his predecessor Sarkozy, he did not see a political strategy of "staying close to number one" in the Eurozone as serving the pursuit of French interest in the context of the Eurozone's crisis. He defined the French role as one of a linchpin between Northern and Southern countries, assuming that the support of Southern Member States might give France more bargaining power than close coordination with the more powerful and resourceful German partner (Schild 2013b). A second factor limiting the wiggle room for a common approach was the strongly (re-)distributive character of core issues to be settled. France wanted Germany to pay for the banking crisis in the periphery which Germany simply did not want to do. France saw the building blocks of a banking union as instruments to manage and recover from the current crisis; Germany rather saw them as preventing and dealing with future ones. Against the background of a highly skeptical domestic public opinion, the German government found itself on the defensive most of the time, trying to postpone the sharing of risks and liabilities, to limit their extent, to protect the German taxpayer, and to avoid creating dangerous incentives for moral hazard behavior of banks. France, quite to the contrary, tried to use the window of opportunity to put into place instruments and institutions serving the mutualization of debts and risks. Basically, France and Germany did not share a common idea about the social purpose a European banking union should serve.

Franco-German leadership in Europe flourishes best if a collective purpose is pursued, a purpose shared not only by the two leaders, but also by their followers, feeling represented by them. This common purpose is of crucial importance, even though the French and German ideas on how exactly to achieve an overarching goal, which ways to follow and what instruments to use might sharply diverge at the beginning of the process. The lack of a loadstar provided by a common social purpose limited the Franco-German role to an intermittent, occasional leadership when the sharp edges of opposing positions had to be softened and final compromises had to be brokered. Hence, the role of France and Germany and their bilateralism in this important instance of creating a banking union is a far cry from their leadership role in bringing about monetary union 25 years ago.

"The half-hearted nature of reform to date owes to fundamental disagreements between France and Germany on how to tackle the crisis" (Howarth/Quaglia 2013: 120). Franco-German divergences precluded the construction of a consistent institutional architecture to stabilize the banking sector, either in terms of a centralized model with powerful and efficient European institutions and well-equipped funds for bank resolution and deposit guarantee schemes,[36] or in terms of a convincing decentralized model minimizing moral hazard and built around such elements as higher own capital requirements for banks, a strict limit on bank exposure to sovereigns, risk weights attached to bank credits to sovereigns, national supervision and regulatory competition diversifying risks and limiting the potential damage caused by flawed regulation.[37] Hence, the current European banking union entails the risk of neither really reassuring financial market actors, nor reliably limiting or preventing moral hazard potentially giving rise to future banking crises.

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[36] See for instance the plea of the IMF in favor of such a model of European banking union (Goyal et al. 2013).
[37] For a fundamental critique of the European banking union along these lines, see Vaubel 2013.

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