German Policy on EU financial support mechanisms:
between the New Hanseatic League and Franco-German Bilateralism

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Please see the full version of their article for more details:

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On 5 March 2018, eight 'New Hanseatic League' (HL) governments — the Netherlands, Denmark, Finland, Sweden, the three Baltic states and Ireland — came out with a common statement against the idea of a European-level fiscal instrument championed by France. Instead, they emphasized the need for national fiscal buffers (Government Offices from Sweden 2018). Since then, this strategy of New Hanseatic League counter coalition-building and public announcements — 'going public' — became a recurrent feature in the EMU governance reform debates and decision making. In a June 2018 letter, twelve EU member state governments, the HL governments joined by Austria, Belgium, Luxembourg and Malta, announced publicly their opposition to Franco-German proposals for the creation of a Eurozone budget (*Financial Times* 20 June, 2018; 22 June, 2018). This letter was joined with a number of unilateral statements of opposition by HL member state finance ministers. In November 2018, additional French and German government proposals on the Eurozone budget were followed by renewed HL opposition (*EUObserver* 21 November, 2018). In May 2020, France and Germany made a common proposal on a large-scale post-COVID-19 recovery fund to disburse grants of €500 bn., financed by joint debt instruments (French and German Government 2020). Some of the HL countries — Netherlands, Denmark, and Sweden — joined ranks with Austria to submit a counter proposal (*Financial Times*, May 24, 2020). In the past, the Netherlands, the leading member of this informal group, made its voice heard by privileging informal bilateral consultation and coordination with its powerful German neighbour. The New Hanseatic League's attempt to gain bargaining leverage and veto power by way of coalition-building and public announcements presented Germany with more difficult policy choices than the previous management of informal bilateral contacts.

The German finance minister, Olaf Scholz, welcomed groups of member states — referring to HL governments — reaching common positions. However, on 22 November 2018, the French finance minister, Bruno Le Maire, made clear his opposition to HL policy positions, arguing that he was opposed to 'closed clubs' (*Financial Times*, November 23, 2018). The distinctively positive German positioning on HL cooperation — despite the League's explicit opposition to Franco-German policy proposals — reflects the similarity of economic preferences.

Explicit German preferences on EU / Eurozone financial support mechanisms align closely with HL preferences with marginal — albeit significant — divergence on policy design and implementation. A focus upon economic ideology and repeatedly stated preferences on EU fiscal integration (and a range of EMU-related issues) since the 1980s suggests that the HL and German governments should be close allies, notably on financial support mechanisms and the creation of a Eurozone budget. The similarity of their preferences made them both advocates of a 'stability union' as opposed to a 'fiscal union' that comes with substantial EU level fiscal instruments and fiscal capacity building including redistributive transfers. As the distance between their preferences on financial support mechanisms and the status quo is small, the choice of a 'foot-dragging' strategy and coalition-building among like-minded states would seem likely. At the same time, German governments have avoided joining the HL in these policy announcements, were never officially part of a coalition with the HL and have maintained a certain diplomatic distance from the loose alliance. We observe that German governments have repeatedly accepted compromises with France and resisted joining with the HL coalition on EU fiscal support mechanisms. German governments have performed a balancing act between, on the one hand, closely coordinating with France and, on the other hand, bringing small northern creditor states on board with Franco-German compromises. How can this apparent contradiction best be explained?

In our published article, we explain how a particular and tension-ridden mix of economic preferences, on the one hand, and broader norms of cooperation as well as geostrategic interests, on the other, pulls German policy makers in different directions. Economic preferences pull them towards like-minded smaller HL states, while norms of cooperation and geostrategic interests pull them towards France. What results is a 'skewed balancing act' and a 'paper-thin harmony' ensuring compromises with French governments. The normative foundations of Franco-German bilateralism and geopolitical concerns linked to this strategic partnership have — up to now — had a heavier weight than Germany's short term material interests and ordoliberal predisposition on EU fiscal integration. This 'skewed balancing act' shows up in the political strategy chosen by Germany to pursue its interests, notably in the observable consultation and coordination patterns with other governments. We observe, over the past decade, a much higher density of consultations and a larger number of common statements and proposals with France compared to those with HL countries.

The most significant German concession to France in debates on European financial support mechanisms came during debates over how to finance the economic recovery from the COVID-19 pandemic. In the early stages of the crisis, France produced a deep split when openly siding with Italy, Spain and six other Eurozone members in a letter advocating a common debt instrument for the Eurozone with joint liability ('coronabonds') — a discussion immediately dismissed as a 'phantom debate' by the German minister for economic affairs, Peter Altmaier (*Financial Times*, 26 March, 2020). On 18 May, however, the French and German governments produced a common initiative on a temporary recovery fund of €500 bn. (Bundesregierung 2020). To the surprise of many observers, the German government made two important concessions. Making a U-turn from its long-standing position, it advocated grants instead of loans for the member states most affected by the pandemic. Having refused fiscal transfers for years, it now suddenly called for very substantial, albeit temporary transfers. The German government broke another taboo by supporting the issue of common EU debt to finance the recovery fund. This does not imply joint liability. However, Germany would be liable up to its share of the ECB's capital (27 per cent) and thus €135 bn. German concessions to France when elaborating this initiative were far more important than the French concessions to Germany — France accepted to link the recovery fund to the EU's budget and the MFF instead of setting it up outside the Union's budget (cf. *The Economist*, 23 May, 2020). This contrasts with the previous Franco-German compromise building on a Eurozone budget regarding which Germany's concessions to France can be best described as symbolic.

The Franco-German proposal was in major parts taken up by the Commission in its 'Next Generation EU' recovery fund, presented on 28 May, which included €440 bn. in grants to be financed by debt issuance backed by future EU budgets. In the wake of this proposal, the introduction of a separate Eurozone budget line in the EU budget was dropped without public debate (*Financial Times*, 29 May, 2020). The Franco-German proposal set the agenda and provided a key building block for the July 2020 European Council negotiations on the MFF and the €750 bn. Next Generation EU programme with the Recovery and Resilience Facility at its core. The 'frugal four' plus Finland finally accepted the Franco-German idea of massive grants, but succeeded in limiting their amount to €390 bn. (plus €360 bn. in loans). In order to placate the 'frugal four', Angela Merkel insisted that the beneficiaries of new resources must use them to support reforms designed to make their economies 'future proof' (*Financial Times*, 29 June, 2020).

The extent of German concessions made to France on Eurozone financial support mechanisms is open to debate. We agree with the widespread view that Germany was more influential and that France had to make more concessions to Germany than the other way round in Eurozone governance reforms, reflecting the power asymmetries that characterize the bilateral relationship. Before the COVID-19 pandemic, German concessions to France on fiscal capacity building were mainly of a symbolic nature. The German concessions on the COVID-19 recovery fund were, however, asymmetrical in favour of France — although this fiscal instrument is not restricted to the Eurozone. The German U-turn on the use of grants in financial support mechanisms and on how to finance them provides us with strong evidence that (short term) material interests and ordoliberal convictions give way when the survival of the European integration framework is at stake. Geopolitical interest prevailed as the EU faced its 'toughest challenge in history' (Angela Merkel), the major concern being 'that the economic crisis will destroy the European single market and even threaten the future of the EU' (a senior adviser to Chancellor Merkel's CDU, quoted in *Financial Times*, 22 May, 2020). The ideational influence of a younger generation of economists in the German ministry of finance might have played a facilitating role in this U-turn. Both the deputy finance minister, secretary of state Jörg Kukies, and the ministry's chief economist, Jakob von Weizsäcker, were not imbued with the German ordoliberal tradition and both had economic training in France (*Financial Times*, 9 June, 2020). However, whether this reflects a broader ideational shift strong enough to make itself felt beyond extreme situations of crisis remains to be seen. Moreover, the German Federal Constitutional Court's judgment from 5 May 2020 on the ECB's Public Sector Purchase Programme provided an incentive for the government to act on the fiscal side as this ruling created the potential for more tightly set limits to future ECB purchases of government debt.

The 'skewed balancing act' leaning towards France reflects German geo-strategic interests in maintaining a close bilateral relationship in order to ensure ongoing German influence in European integration and broader European macro-economic and political stability. It also reflects the strong normative underpinnings of the 'embedded bilateralism' as German governments of all political orientations perceive the long-term quality of the bilateral relationship and a strong Franco-German core to guarantee EU cohesion as being an integral part of German 'state reason'.

In our published article, we argue that the stronger the weight of economic preferences — compared to norms of cooperation and geostrategic interests — the less substantial the German concessions to France on fiscal integration. We also link the strength of norms of the Franco-German embedded bilateralism and German geostrategic interest to substantial German concessions to France. We show that the empirical evidence is mixed. German economic preferences, based on material economic interests of a creditor and current account surplus country and on ordoliberal ideas, have been largely aligned with those of HL governments on EU/Eurozone fiscal capacity-building and explain the limited concessions to France on the Eurozone budget. However, faced with HL counter coalition-building, robust bargaining and foot-dragging on the Eurozone budget, German governments have prioritised the bilateral relationship with France. We see German geo-strategic interests, the density of the bilateral institutional fabric and the norms of cooperation underpinning it — Franco-German 'embedded bilateralism' — as providing the key explanations for this empirical record. The long-standing Franco-German pattern of privileged cooperation, predating the emergence of the New Hanse, continued and prevailed. Nonetheless, HL government coalition-building served German interests. The German government's preference of avoiding a Eurozone 'transfer union' was supported by the HL which could express more forcefully the policy preferences it largely shared with Germany. In a 'normal' (non-crisis) period, HL governments succeeded in reducing a contentious risk mutualizing idea — the Eurozone budget — to insignificance, without the German government having to take the blame. HL efforts allowed the German government to make limited or only symbolic concessions to the French government, preserving the 'paper thin harmony' with France which is at constant risk of collapse. These limited concessions satisfied HL governments by accommodating their preferences, thus gaining their acceptance for Franco-German compromises.

However, when the EU found itself once again in a crisis due to the COVID-19 pandemic — when both EU macro-economic and political stability and, potentially, the survival of the Eurozone were once again at stake — the German government demonstrated its willingness to launch joint proposals with France on substantive and not merely symbolic reforms rather than siding with like-minded HL countries. The strong norms of cooperation and the geopolitical interest of safeguarding the multilateral institutionalized framework of the EU — combined with German long-term economic interest in the survival of EMU and the Single Market — all worked in the same direction. The German government decided to adopt a forceful 'co-shaping' strategy with its 'indispensable partner' France.