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Eurozone Crises. Leopard Politics in Action

Introduction

The Eurozone crisis is more than the sum of the economic crises of some of its member economies. It is simultaneously a crisis of the institutional setting of the Eurozone, as well as of its underlying economic-political architecture and mode of regulation. The Eurozone crisis revealed the inadequacy of the established form of economic governance, and consequently forced political responses in order to avoid the common currency project collapsing. These responses were cautious, and on many levels inadequate. Rather than solving the crisis they carried the crisis on. What initially was meant to be a post-hegemonic project, where all members have equal rights and obligations, suddenly devolved into a project that required political and economic *leadership* from the few chosen ones – a necessity that was not foreseen in the original governance structure. It seemed that though the most recent incarnation of the French-German axis, popularly labeled as *Merkozy*, would successfully co-run the crisis management, and eventually be able to mobilize critically needed support from all members for swift policy actions. However, rather than designing a coherent crisis strategy, *the Merkozy* axis was only able to come up with weak bilateral policy compromises that did not aide in recovering from the crisis at all. The more the crisis prolonged, the more it became clear that the Eurozone was politically divided on what the required economic policy course was. When the French-German motor began stuttering, it was Germany that began to emerge as the key actor in the ongoing crisis management. A new *creditor axis* began to form, with Germany at the center. Paradoxically, the long-term name bearer of 'Eurosclerosis' was in strong demand to act as crisis manager of last resort.

In contrast to the chorus of critics who sing, or shout, the tune of a new German dominance in Europe, I will argue that the German government has not changed its overall policy approach towards Europe, but instead moves along a deeply entrenched policy path. This leads to a paradoxical outcome, though. Rather than successfully managing the crisis, this path drives the Eurozone ever deeper into a political and economic constellation that eventually risks the sustainability of the Eurozone in its current form[1]. Germany has not emerged as a regional hegemon in Europe,

[1] Sustainability in the simple sense of a high value added-growth area that combines social security (including high employment) and qualitative growth, as it is outlined in the Lisbon Strategy of the EU.

but as a political economy that is guided by narrowly defined national preferences.

The crisis management of the Eurozone is a narrative of struggles about the directions and principles of required changes and adjustments, and this conflict mainly plays out in the Council[2]. Rather than operating with a master plan, the German government has so far followed a form of social engineering where national preferences in regards to (i) fiscal sober-mindedness, (ii) containing moral hazard and (iii) avoiding an immediate breakdown of the Eurozone have been the key objectives of the chosen strategy. Rather than pushing ambitious policy initiatives the German

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[2] The emphasis is on 'mainly'. There are numerous examples of struggles over influence and decision-making between Council and Commission, as well as between the Commission and individual member states. The most recent example is the controversy between the Commission and the French government. In the context of the Excessive Deficit Procedure, France was granted a two- year extension until it needs to obey the criteria; the Council followed the suggestion of the Commission. The French government, however, was frustrated that the Commission made concrete reform proposals in its official report, and even more upset that the Commission urged France to speed up the reform processes. The French Prime Minister, Jean-Marc Ayrault commented on the suggestions with the argument that France is willing to reform, but will do so on its own political pace. The Treaty of Lisbon may have introduced principles like double majority and overall led to an increase of power in the European Parliament, and to some extent also upgraded the role of the European Commission. However, in this emergency situation it turned out that the European Council took the lead and often bypassed the Commission and the EP. It is this institution where the Merkel government exercises leadership. This paper operates with the assumption that intergovernmentalism is back in force. This may be seen as a strong assumption, and this requires justification. The fact that the actual composition of the Commission is a beast of selection by national governments is not the best justification, even though one should not underestimate the policy effects of this selection procedure. More important is that the Commission can mainly make proposals, and that it is the Council that eventually decides. It would be an analytical overstretching to label the Commission as the agent and the Council as the principal in the game; also, such an analytical perspective would miss the fact that not all members of the Council are born equal. Still, it is the Council who calls the shots, and it is the Commission that, while having some political leeway to express deviating views, eventually has to stick to the policy route commanded by the Council. The Commission is not without authority to act, but this authority is strongly constrained and in the course of the crisis dynamics increasingly contested.

government essentially sticks to deeply rooted principles of German 'Ordnungspolitik'. The basic policy principles, as will be shown, are not detested at all in the German political arena.

To avoid a misinterpretation of this stance: The EU has shown a surprisingly strong capacity to make changes of its institutional architecture. Even the German government has pushed, sometimes hard, to renovate the mode of regulation of the Eurozone. I will argue that this renovation has its inherent limits, though. 'Leopard politics' is the best way to describe the German policy approach:' *If we want things to stay as they are, things will have to change'.* The Merkel government is willing to change everything in order to safeguard the underlying principles of the Eurozone that were put in place during the design and launch period of the Euro. These principles reflect long-standing attitudes and political values of Model Germany that are shared by nearly all political parties and actors (Hübner 2014) this date is impossible. I will show that the German government has so far shown that it could succeed with a strategy of asymmetrical cooperation, not least due to the economic and political weakness of its former main ally, France. This paper argues that the German policy preferences have strong self-defeating economic effects and generate political liabilities that contribute to further political blockades in crisis management efforts, and eventually generate institutional conflicts. Rather than demonstrating political leadership, the Merkel government is guided by narrowly defined national preferences that contribute to high social and economic costs; moreover, it has created an 'institutional civil war' about the current and future role of the European Central Bank (ECB). European crisis management has moved into a state of 'bad equilibrium', and it will need even stronger external shocks to make actors think more deeply about how this blockade can be overcome.

Looking back

It is tempting to position the current Eurozone crisis within the history of currency crises of EU member states. Currency cooperation in Europe after WWII is a history of crises, resolutions, and crises again. Its start can be dated in earnest with the breakdown of the fixed exchange rate of Bretton Woods in 1971/73. This is when the US unilaterally relinquished the system of fixed gold parity to the US-Dollar (USD), and eventually dissolved the regime of fixed exchange rates. Rather than following the practice of other OECD-economies and going along with this new system,

France and Germany jointly decided to create a zone of currency stability in Europe. They did this by making themselves free of the currency policy of the US, which was seen at the time as being guided by narrow national interests. Instead of going it alone the ‘Snake in the Tunnel’ pegged national monies to each other in order to avoid strong exchange rate swings that could endanger their densely knitted trade relations. The ‘snake’ can be seen as a classic example of joint French-German leadership in the EU where both actors agreed in producing a collective good and sharing in its production costs. In the language of hegemonic theory France and Germany showed (i) the willingness to act as regional leaders and (ii) the economic and political capacity to lead; both were also, (iii) accepted by others and thus found sufficient followership.

In response to internal weaknesses of this improvised device, Germany and France urged other member states to the creation of a more formal institutional framework. The European Monetary System (EMS), put in place in 1979, was a fixed exchange rate regime with overall narrow bands. In many respects the EMS resembled the fixed exchange rate regime of Bretton Woods, in particular the provision for joint realignments of exchange rates in case of external disturbances or asymmetric shocks. Unlike Bretton Woods however, the EMS was not centered on a key national currency, nor did gold play any role in creating trust in the new regime. As a truly fiat currency regime its proper functioning depended on the smooth reproduction of national economies and the cooperation of national central banks. Moreover, France and Germany at the time were able and willing to push a project that was attractive for others, and thus all member states besides the UK joined the exchange rate mechanism[3].

McNamara (1998) made the point that the EMS reflected the neoliberal *Zeitgeist*, and that the EMS finalized the move from ‘embedded liberalism’ to ‘competitive liberalism’[4]. The launch of a fixed but adjustable exchange rate regime in Europe was meant to isolate the newly created currency space from the effects of economic policies from ‘outside’, particularly the US. Swings in the exchange rate of the USD were expected to no longer disturb trade relations inside Europe. In this regard, the EMS was

[3] A condensed overview is given by: http://europa.eu/legislation_summaries/economic_and_monetary_affairs/introducing_euro_practical_aspects/l25007_en.htm

[4] Latter is a pleonasm as liberalism is another label for unrestricted competition.

meant to be seen as a zone of stability that was supposed to manage exchange rate via rule-based central bank interventions. The simultaneous push for the further liberalization of financial markets, however, was a political signal that hinted to the overarching political project to establish a market-driven growth regime in Europe. This liberalization project gave voice to financial market actors, and was meant to introduce market-driven supervision in order to ensure sound fiscal policies, and to increase the level of competition between European nation-states. The founders of the EMS soon had to learn the lesson that a regime of fixed exchange rates and open financial markets cannot simultaneously enjoy both fiscal policy autonomy and monetary independence.

Differing trajectories of national growth as well as differing national political projects created problems for the EMS from the start. Most prominent was the episode of the French Socialist-Communist government of President Mitterrand that came with an economic policy program that frightened national as well as international investors with its emphasis on nationalization, Keynesian demand policies and the shortening of working hours (Altvater/Huebner/Stanger 1982). Moreover, due to a politically motivated entrance exchange rate of the Franc to the Deutschmark that resulted in a strong overvaluation, the trade balance of France deteriorated, and so did the trust in France's economic capability. Capital flight out of France was the consequence, and the newly launched exchange rate mechanism came under pressure. When President Mitterrand accepted three depreciations in short succession, it was obvious that his economic policy program was not viable, and a turn towards a German-inspired *Franc fort* was chosen as new policy route (Lee 2004). From there on the currency zone mutated quickly into a Deutschmark zone. In a constellation of open financial markets and differences in national inflation rates, it was the interest rate policy of the economy with the lowest inflation rate that acted as stability anchor[5]. The inflation 'hawks' of the Deutsche Bundesbank guaranteed sub-average inflation rates by strict use of its key lending rate. In order to avoid

[5] The mechanism is well known. The central bank of the anchor currency will make strict use of its interest rate tool in order to keep inflation to a low level. If other economies of a fixed exchange rate regime run relatively higher inflation rates capital flows are being triggered. The low inflation economy will receive capital inflows and thus experience appreciation pressure. In order to avoid capital outflows, central banks of high inflation economies will increase their key lending rate and risk a decrease in economic growth.

politically detrimental costs that come with depreciation effects, other national central banks, in particular the Banque de France, had to follow the leader.

The strict orientation on national preferences on the side of the German central bank became even more obvious in the early 1990s. Concerned about the inflationary effects of the debt-financed process of German unification, and the price-effects of the so-called 'unification boom', the Deutsche Bundesbank used its autonomy in setting the key lending rate to signal to the German government that it would not be willing to accept an increase in the inflation rate. In July 1992 the Bundesbank raised its discount rate to a new post WWII record of 8.75%; at the same time as the US-Federal Reserve, as well as the Bank of Japan decreased their key lending rates in order to fight emerging recessions. The result of these opposing interest rate policies was a massive regrouping of global portfolio investments that brought the exchange rate mechanism of the EMS under serious pressure. The unilateral interest rate decision by the Bundesbank also fed the fantasies of global financial actors, who quickly started systematic speculative attacks on the weak members of the EMS, mainly Italy and the UK. Rather than dealing with these attacks by reversing its high interest rate approach, the Bundesbank focused solely on its domestic price stability target. This lack of 'Europeanness' came with high costs, as the EMS was more or less dismantled in the aftermath (Herr/Hübner 2005: 208ff.).

The project of a common currency, even though it had already been foreshadowed in the early 1960s with the Werner-Report, can be interpreted in light of these experiences as a deliberate attempt of some European governments to domesticate the Bundesbank, by creating a level playing field for all central banks. This attempt was very much led by the French government which acted on the political vision that a newly united Germany would quickly over-power Europe and thus undermine the hard achieved economic-political power balance. The Euro indeed came with a governance structure that formally made each participating central bank an equal member. However, the Bundesbank, as well as the German government, made ample use of their agenda setting capability that eventually transformed the new organization into an 'über-Bundesbank'. Like the Bundesbank, and unlike other central banks, the ECB got a policy mandate that focused solely on price stability. In order to be able to become a member of the Eurozone national economies had to pass the

Maastricht criteria test. This criteria reflected a Bundesbank influenced mentality, and focused on a range of indicators that were more oriented towards price stability than on indicators that reflect dynamics of national growth regimes. For quite a while the interest rate set by the ECB turned out to be too high for Germany and too low for economies like Ireland and some southern members of the Eurozone. The result was a divergence in national inflation rates that had severe repercussions for the real effective exchange rate, and thus for international competitiveness. Economies with higher than average inflation rates experienced appreciations in their real effective exchange rates, and therefore a deterioration of their price competitiveness position. The narrow policy mandate of the ECB, along with the unavoidable one-size-fits-all problem of a unified monetary space that still contains national fiscal policy autonomy, created conditions over time that added fuel to the economic divergence tendencies of the Eurozone (Hübner 2013).

What started as a French-German project that simultaneously offered benefits for other member economies, turned during the turbulent 1980s into a currency project that largely reflected German policy preferences, dominated by price stability considerations. These episodes also indicated early on the strong position of the independent Bundesbank within the institutional setting of Model Germany. The rigorous policy target of a relatively stable domestic price level was operated via the autonomy to set the interest rate independent of its implications for the other members of the fixed exchange rate regime. The move towards a common currency was supposed to have the side effect of 'downsizing' the Bundesbank to one of many players with the same rights and obligations. This exercise was to some degree successful. As has been argued, however, the Bundesbank as well as the German government formally accepted this downsizing, but were successfully using their relative power position to shape the design of the new institutional setting. Given these episodes, it seems to me that the current political debate about a *new* 'German Empire' is misleading. Rather than using the Eurozone crisis to ultimately push for a fundamental restructuring along German national interests, and thus to introduce German policies within the EU, the German government is simply maintaining course and continues with a policy approach that was already put in place in the early 1980s: 'Leopard' politics at its best. This policy continuity of the Merkel government plays out in the current crisis management debate. On the European level, the German government follows its 'path-dependent'

instincts and stays course with its overall approach towards Europeanization: Germany provides financial support in exchange for far-reaching policy changes which move political autonomy from the nation-state to the level of the European Council. On the domestic side, this strategy is politically safe as most of the opposition parties are long-time subscribers to this version of German interpretation of stability and power sharing.

The Logic of National Preferences

The events of the Eurozone crisis as well as the crises of member economies of the Eurozone triggered some heated debates in the field of European Studies. The most recent of the many attempts to understand policy actions is labeled as ‘discursive institutionalism’ (Schmidt 2013) and offers an enormous number and range of relevant political discourses that are supposed to explain the concrete crisis management trajectory. ‘Punctuated equilibrium theory’ (Princen 2013) combines ideational and institutional concepts in order to explain policy change. The interplay of ‘narratives’ and political-economic factors touches a critical point. However, rather than following such analytical exercises, I am in favor of simply analyzing programs of relevant German political parties and their public statements. It is clear that programmatic statements are not synonymous with actual policies. Therefore, I did a preliminary content analysis of German newspapers and weekly papers[6]. The political parties were analyzed in regards to six generally sticky policy elements: (i) attitude towards strengthening the criteria and supervision of the Stability and Growth Pact; (ii) position on the Fiscal Pact; (iii) stance regarding the specific Debt Brake policy; (iv) attitude towards the austerity approach; (v) opinion on the Outright Monetary Transaction policy of ECB; (vi) attitude towards all versions of Eurobonds.

[6] Frankfurter Allgemeine Zeitung; Sueddeutsche Zeitung; Spiegelonline; Zeitonline.

Table1: Attitudes of German Political Parties Towards Eurozone Crisis

	Strengthening SGP	**Fiscal Pact**	**Debt Brake**	**Austerity**	**OMT**	**'Eurobonds'**
CDU/CSU	+3	+3	+3	+3	-3	-3
SPD	+3	+3	+3	-2	+2	+3
FDP	+3	+3	+3	+3	-3	-3
Green Party	+3	+3	0	0	-1	1
Linke	-3	-3	-3	-3	-1	+3

From '+3 in strong favor to -3: strong rejection'

This admittedly very unsophisticated exercise, still contains some powerful results. First, the party preferences along critical policy issues show that the governing CDU/CSU has the most coherent policy preferences. The two sister parties agree strongly in a policy that strengthens the SGP, favors the Fiscal Pact and the debt brake, and supports strongly the unifying austerity approach. Consequently, both parties vehemently reject the bond purchase policy of the ECB and radically oppose any form of Eurobonds. Their coalition partner, the Free Democrats (FDP), express exactly the same preferences. This makes the governing party camp a very homogenous grouping that seems to be able to weather minor differences.

In regards to the main opposition party, the Social Democratic Party (SPD), the distribution of preferences indicates a serious policy trap. The party was instrumental in launching or actively supporting all projects of European currency cooperation, including the underlying political and economic forms of governance. Since the outbreak of the Eurozone crisis the SPD was in favor of strengthening the SGP, introducing the Fiscal Pact and even the debt brake. Despite supporting these elements, the party slowly but surely moved towards a critical stance on the austerity approach and became a relatively strong supporter of the OMT of the ECB. Additionally, it also favored forms of Eurobonds. These policy positions are not compatible with each other, and indicate deep rifts within the party. The actual support of the policies of the German government as shown in parliamentary votes is contradicted by alternative policy

discourses addressing the public at large. The Green Party is in an only slightly better position. In order to demonstrate political respectability, but also to reflect the party's fiscal conservatism – indicating a lack of macroeconomic principles - the Greens willingly gave parliamentary support for the government's crisis management decisions. Rather than presenting a policy project that would reflect coherent alternative policy proposals, the party opted for a dual approach, which supports the government while paying ideological tribute to alternative discourses. Die Linke presents the overall most coherent distribution of preferences in the opposition camp. This party strongly opposes all elements that constitute the austerity approach, and consequently favors forms of Eurobonds. Simultaneously, it sees the ECB as a neoliberal institution and thus rejects the active role of the ECB in managing the crisis[7], with the paradoxical outcome that the party is in line with the Euroskeptical political forces. Both policy preferences are not be compatible from analytical point of view; it only demonstrates that Die Linke tries hard to stick with at least some stability principles that define the German consent after WWII in order to earn respectability.

German political parties in general are well entrenched with the stability preferences that have become part of the social contract in Post-War Germany. In addition, the inter-party distribution of political preferences indicates that the current Merkel government has strong direct, as well as indirect, support for its specific approach to crisis management. Such a united domestic front is an additional power resource in European crisis management, and helps the Merkel government in its attempts to enshrine those principles into the framework of the Eurozone. This unified domestic policy arena contrasts starkly with the deep political and ideological divisions that characterize many other Eurozone societies.

From the French-German Axis to a Multitude of Temporary Alliances

The literature usually treats France and Germany as the political axis of European integration. Their agenda setting power and the ability to create consensus by offering acceptable compromises for other partners, as well as their well-demonstrated ability to jointly design policies that help overcome crises historically, was critical for the ongoing processes of

[7] Die Linke joined a rather heterogeneous group of individuals and organizations in a lawsuit over the legality of ECB actions (see below).

European integration (Krotz/Schild 2013). France and Germany came to this form of cooperation from different angles, and what's more with rather different political and economic resource bases. The theory of cooperative hegemony suggests that Germany was following a defensive version of cooperative hegemony in the early 1950s by seeking overall stability and political-moral rehabilitation, and at the same time securing the long-term benefits of European integration. This attitude reflects a consensus in German politics across ideological camps. The further argument that Germany moved in the late 1970s from a strategy of defensive cooperative hegemony, to one of offensive cooperative hegemony where Germany started to push for its own interest (Pedersen 2002: 686), seems to me to be missing the point. I have tried to show that Germany as well as France moved jointly in an economic, as well as political balance, cooperating on various projects of currency collaboration since the end of the BW system. External crisis pressure forced both entities to the closer cooperation of equals. This seems to have changed recently.

Mainly as a consequence of the Eurozone crisis, and thus due to internal pressure, it seems that Germany has started opting for an offensive cooperative hegemony. This offensive cooperative hegemony intends to shape the institutional design in favor of German desires. Both entities have different policy responses to the crisis, and are increasingly having difficulties finding mutual compromises, not to speak about broader compromises that allow for wide support in the European Council. There is no doubt that Germany as well as France want to keep the Euro intact, and both parties have made it clear that they also want the Eurozone to remain intact. Strategies and proposed economic policies to achieve these goals differed in substantial ways however (see below). Still, between October 2010 and summer 2012 the German and French governments used their unified agenda setting power in the Council, and pushed particularly hard for the German project of a 'Fiscal Pact' response to the core of the crisis management plan of the Eurozone. The quid pro quo for supporting German political 'pet projects', however, showed diminishing economic as well as political returns. France and Germany have continued cooperating, but the terms of cooperation have undergone changes. This was obvious when German Chancellor Merkel and French President Hollande eventually presented a joint paper on May 30, 2013. It addressed the planned banking union that is supposed to cut the ties between banking crises and sovereign debt crises. To be effective such a

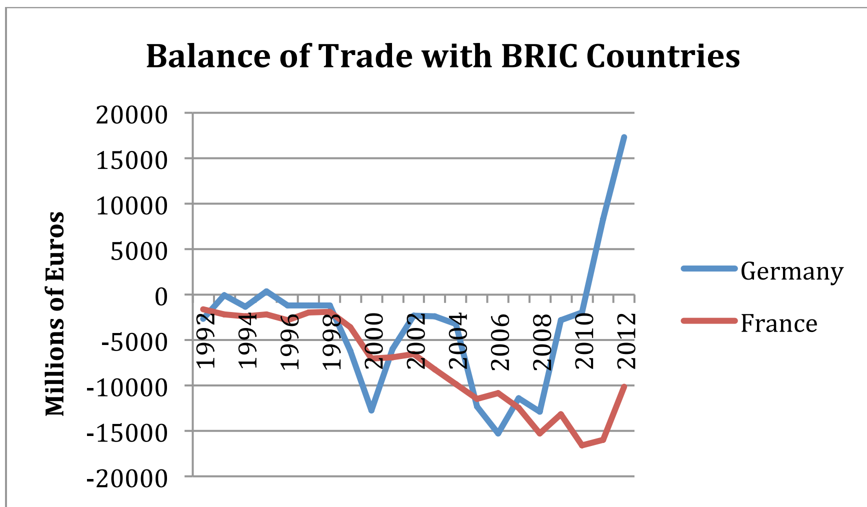
banking union needs to come with a single supervisory body, a single resolution body that is equipped with proper funds and a joint deposit-insurance program. The list of these critical features indicates that such a banking union would fundamentally break with German principles. Rather than being a compromise between French and German policy preferences, the presented plan for a banking union does not entail the provision of a jointly financed rescue fund, nor does it comprise a joint deposit insurance scheme. Following German wishes, banking risks are first dealt with inside the nation-state - a further indication that Germany is increasingly shaping the institutional reconstruction of the Eurozone.

To some degree the emerging differences in policy preferences reflect the emerging gap in the economic position of both countries, but it also seems to indicate that their respective political preferences have shifted since the start of the Eurozone crisis. According to the most recent PEW study (PEW 2013) 43% of the French population agreed in 2009 with the statement that European economic integration had strengthened the French economy. The figure for Germany was 50% at the time, a seven-percentage-point difference. In 2013, the figures for France and Germany are 22% and 54% respectively - a difference of a full 32 percentage points. A similar distance holds for their views on the EU as a political and economic organization. In 2007, 62% of the French and 68% of the German population had an overall favorable opinion of the EU. In 2013, only 41% of the French still have a positive attitude towards the EU; the figure for Germany has decreased, too, but is still at 60%. A former six-point gap in attitudes has grown to a 19-point gap.

The French population has not suddenly turned anti-EU. It seems reasonable to explain the current, largely negative attitude of the French public, with concerns about the economic shifts inside the EU and the Eurozone. In particular with the feeling that France is losing economic power to Germany (Mitchell/Kravcakova 2013) CANT FIND. Its mounting domestic economic problems serve to add to the discontent. For quite some time, France and Germany have been moving in opposite directions, as best exemplified by their respective current accounts. Whereas France experienced deficits in its current account over the whole period from 2006 to 2012, Germany was on the opposite end of the spectrum with overall very high surpluses. This divergence has its roots in long-standing competitiveness problems of the French economy. These encompass elements of poor price competitiveness, as well as problems to keep up in

the mid-segment of the technology race (Baudchon 2013)[8]. Whereas Germany's export sectors proved to be attractive for emerging market economies, France's export-oriented companies were much less able to diversify. This difference in diversification played out in the course of the financial crisis when German companies were able to drastically improve their export position with the BRIC economies, whereas France was stuck in a deficit (see Graph 1).

Graph 1



Data: Eurostat. Graph prepared by Jeff Mitchell

Unlike the German export sectors, it seems that the French export industries have lost global competitiveness, in terms of price competitiveness as well as in terms of product innovation. In Germany's case, economies outside the EU have, over time, become progressively more relevant; France, on the other hand, still sends a relatively higher share of its exports to other EU economies. In addition, France has lost its former competitive position with the Eurozone, and has had to register widening trade deficits with its traditional trading partners. This lack of competitiveness has gone hand in hand with steady net outflows of foreign direct investment. These problems have worked into the overall domestic economy. Early in 2013, the unemployment rate in France was

[8] The EU Commission points out that France is relatively well positioned in high tech sectors, mainly aerospace, but has problems keeping up with competitors inside and outside the EU in activities that require steady innovative improvements (EU Commission 2013).

10.8%, and thus exactly twice as high as in Germany. Simultaneously, public deficits continued to be high and forced France to enter the Excessive Deficit Procedure of the EU; in contrast, Germany enjoys increased tax receipts that help to bring down its annual budget deficit, and even could register a small surplus of .2% of its GDP in 2012 (Eurostat 2013)[9].

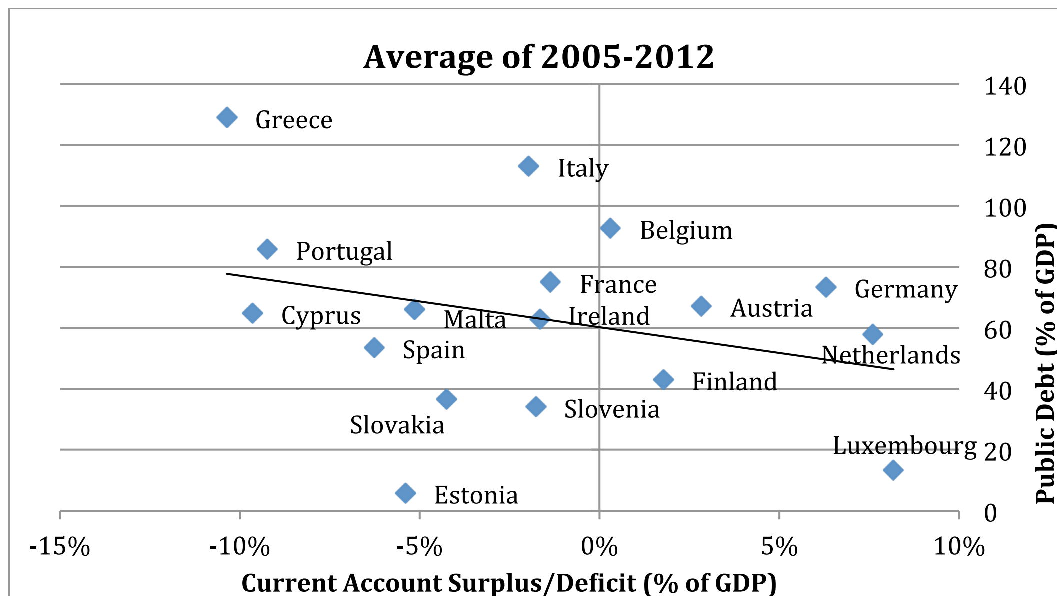
These differences have second-order policy implications in regards to policy choices in the Eurozone crisis. In order to improve its trade balance, France is eager to provide the troubled economies of the Eurozone with purchasing power, and thus favors growth-stimulating policies as an integral part of European crisis management. Stimulating economic growth is seen, in particular by the Hollande administration, as the best way to concurrently reform its accumulation regime Furthermore, France is strongly interested in a crisis management design that would imply policies in Germany that result in increased effective demand. Germany, on the other side, is not willing to offer unlimited burden sharing or to risk its starkly improved budget position. Any form of Eurobonds and demand increasing policies come with the danger of huge fiscal transfers that could potentially subvert Germany's enviable financial position. Consequently, Germany opts for domestic reforms in crisis-effected economies and is neither interested to make ample use of growth stimulating policies, nor to mutualize risks and debts.

Germany's comfortable situation is evident if we look at the combination of current accounts and public debt ratios in the Eurozone (Graph 2). Over the period spanning from 2005 to 2012, the Eurozone became divided into two camps. Eleven economies show on average a twin deficit; while six economies have current account surpluses, but also a significant public debt to GDP ratio. In economic terms, France and Germany belong

[9] Even though France as well as Germany have enjoyed record low yields for federal government bonds since 2009, only in the German case did those historically low interest rates result in improved budget figures. An attempt to calculate the monetary benefits of the decreased yield came to the result that between 2009 and 2013, the lower interest rates translates into an aggregate saving of 80 billion Euros (Boysen-Hogrefe 2013) . The more German government bonds turned into safe havens for intra-Eurozone capital flight, the higher the benefit. There is no doubt that the Merkel government enjoyed serious advantages from the crises of member economies within the zone. *Cui bono*, though, should not be confounded with causality.

to opposing groups. Even though they both show on average similar public debt ratios, they differ significantly in regards to their current accounts, France being a debtor and Germany being a creditor. This picture is getting more complex by including the credit claims of French and German banks. Before the global financial crisis in 2008, German, as well as French banks were strongly engaged in Eurozone economies that only shortly after turned into crises economies. French banks were in particular engaged in Italy (42% of all foreign credit claims), Greece (28%), and Portugal (14%). German banks had claims against Spain (28%) and Ireland (27%) (Lindner 2013)

Graph 2



Data: Eurostat

Since the crisis, banks from both countries have tried hard to reduce their exposure, and thus their risks by deleveraging. Any quick insolvency of one of the crises economies, or political strategy to include banks in haircut procedures, would have put these financial institutions under severe pressure. Hence, the strong interest of banks from both countries to keep debtors floating.

By defining a creditor economy as an economy with a structural current account surplus, we can see that the Eurozone divides nicely into a debtor-creditor continuum. Not all creditor economies have sound

financial positions[10]. Belgium for example, averages a small positive current account, but a substantial public debt ratio that is far above the ratio of Spain and Cyprus, and in the range of France. Even Germany has a much higher public debt ratio than for example Spain. Still, the current account is relevant as a surplus shows that even high debt economies are able to refinance. Graph 2 shows that the creditor club consists of Germany, Austria, Netherlands, Luxembourg, Finland, and Belgium. Given that at least three (Belgium, Austria, Germany) out of the six have public debt ratios above the Maastricht criteria, it seems reasonable to argue that governments of these economies have no interest in policies that result in a mutualization of debts. This is the same reason these countries should also be in opposition to the quantitative easing policies of the ECB, as the risks involved with this policy potentially lead to huge budget burdens.

France has settled in the debtor camp, even though this reality has not yet been accepted politically[11]. In terms of crisis policies, though, it should not come as a surprise that France would like action to be taken by the creditor economies. The impetus for them is on creditor economies to make use of their fiscal space, as well as by pushing domestic demand via productivity-oriented nominal wage increases. Unlike in the past, Germany now has more potential allies who are keenly interested in defending their national positions. Rather than expend the generally difficult to attain fiscal maneuverability by supporting troubled economies, they opt for traditional austerity policies in the debt-ridden economies[12].

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[10] The terms 'creditors' and 'debtors' are often used very loosely in public debates. 'Creditors' are perceived as nation-states with sound public finances and positive current accounts. In such a perspective not even Germany would belong to the camp of 'creditors' as its public debt ratio is far above the 60% Maastricht criteria.
[11] My thanks go to Nicolas Jabko, who explained to me, in depth, that France's political elite is not accepting such this status. Indeed, the interest rate for French government bonds is at a historical low, despite downgrades in France's credit rating. I decided to stick to my interpretation as the actual figures seem to me more important than the fluctuating evaluations of financial markets. In other words, as long as France can't overcome its competitiveness and unemployment problem, the chances are that bond rates will go up.
[12] The most recent French-German plan for a separate president of the Eurozone should not be read as a compromise. The installation of a separate presidency may be close to the long-standing French demand of an 'economic government' but such a presidency would come to German terms. There is no reason to expect a

If we assume for the moment that governments of deficit economies are not in favor of harsh austerity, as such a policy implies an increase in unemployment, and thus high political costs, then it seems reasonable to conclude that these governments favor a broad range of burden sharing programs, in particular forms of Eurobonds. In the European Council such a cluster of deficit economies-governments could at best aggregate 125 votes. This is a far cry from the 255 votes needed to get a qualified majority. If governments would vote along the deficit-surplus axis, Germany would not need an alliance with France to enshrine its austerity approach to the EU.

The option to selectively go with other partners has implications for the French-German axis. Unlike in the past, it may be at least as important for the German government to consult with other creditors, as with consulting with the French government. The result is not a total dissolution of the French-German axis, but simply a downgrading of the relevance of French-German leadership for designing an adequate crisis management that allows the inclusion of other partners[13].

Unintended Consequences of National Preferences

Despite the shifts in the balance of power in the Eurozone, we are not experiencing the launch of a 'Fourth Reich' in Europe. At the same time, the Eurozone crisis has demonstrated that 'Europeanization' is more of an intellectual construction then a political reality. When crisis dawns, member states revert back to their national interests. The recourse to national preferences, led by Germany, is guiding the reforms of European institutions as well as the crisis management of the Eurozone. The outcome so far is a paradox. On the one hand, the many reforms put in place since 2011 on the European level have drastically reduced national power in regards to budget policies ('European Semester'; 'Fiscal Pact' 'Debt Brake'…) and thus strengthened EU institutions. The guiding principles of these reforms, on the other hand, reflect policy preferences

turnaround of German principles. What can be expected, though, is more flexibility in implementing those principles and norms.

[13] Vassallo (2013) and Gros (2013) are more optimistic about the policy relevance of the French-German axis. In my view, the governments of both countries seem to have more and more problems developing inclusive policies that are attractive for a large group of Eurozone member states.

of the creditor club, namely of Germany. In this sense, a 'Germanification' of the Eurozone has become reality.

What looks like a coherent policy approach should not be confounded with an adequate and successful policy approach[14]. As I will argue, Germany's supposedly coherent and rational crisis strategy came with unintended consequences that endanger the political, as well as the economic integrity of the overall currency project. Of the utmost importance for the Berlin-Frankfurt consensus is the political and legal enshrinement of austerity. From a creditor perspective it is rational to provide political insurance to avoid the trap of moral hazard that occurs in the case of a bail out of debtors. Article 125 (1) was meant to deal with this problem:

1. The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project.

The escalating financial crisis in Greece in late 2010 made this article politically obsolete. Since then, the rescue programs and crisis packages organized by the Troika (the European Commission, ECB and International Monetary Fund) come as an exchange of financial assistance for political control of public policy in debtor economies. Creditor economies that were providing the bulk of financial guarantees were only willing to do so, if the governments of debtor economies agreed to severe curtailing of political autonomy. The core of the exchange can best be described as money for austerity, or as the *Berlin-Frankfurt consent.* The German government insisted from the very beginning of the unfolding process of crisis management that financial assistance needed to be reciprocated by serious and far-reaching policy corrections on the side of debtors. Such an

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[14] In an interview with the weekly news magazine 'Der Spiegel' Chancellor Merkel was asked whether she follows a grand scheme for Europe's future. Her reply is worth citing: 'I really believe that it is reasonable and promising for us to work our way out of the crisis step by step, because the one overarching solution doesn't exist. But, of course, you can only take these steps if you have an idea of the direction you are taking' (Der Spiegel Online 2013).

exchange was seen as necessary not only for economic policy reasons, but also in order to legitimize financial support with the political constituencies. For good reason, the German government understood the Greek crisis as a crisis caused by fiscal flagrancy. The problem though, was that this interpretation was made as the template by which all Eurozone crisis economies were looked at. Austerity consequently was the universal policy response to crisis. Given that in all cases but Greece the actual problem was not public debt but private debt, it can be concluded that the blurred view was a primary fundamental flaw in the crisis management approach.

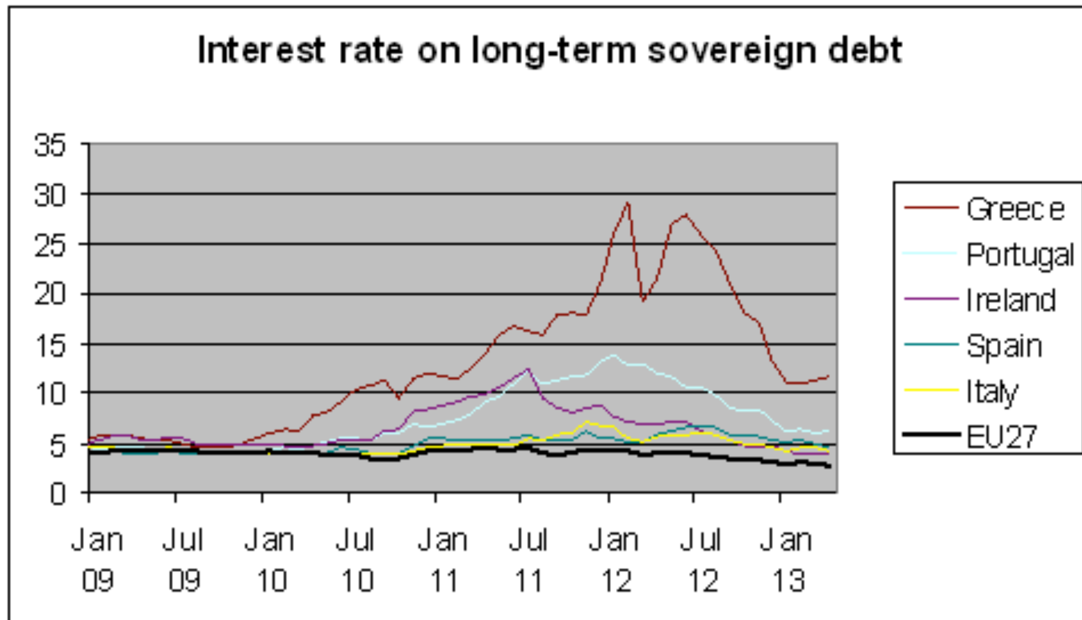
The Eurozone crisis has been accompanied from its very start by a debate about the economic rationality of the chosen austerity policy. This debate has become increasingly heated, and moved beyond the economic policy arena. A 'Harvard camp' of economists whose inputs were influential for the policy debate favors austerity, mainly with the propagation of 'expansionary contraction'. Detailing the expansionary contraction hypothesis of Giavazzi/Pagano (1990) Alberto Alesina, with a number of varying co-authors, made the empirically founded case that austerity even in times of crisis is the superior crisis policy. This proposition got additional political traction with the work of Reinhart/Rogoff and their now infamous 90% rule. The economic historian, turned economic pop star Niall Ferguson completes this camp of prominent 'austerians'. The analytical and political views of this camp are mainstream; in the case of the German academic economic profession they are actually shared by 90% of mainstream economists[15]. Compared to this vast camp, proponents of an opposing view were smaller in numbers but louder in their voices, not least thanks to the tireless interventions of Paul Krugman and the like. Armed with insights already presented by John M. Keynes, this camp argues that austerity risks the fallacy of decomposition. In the situation of a balance sheet crisis not all sectors of an economy can deleverage simultaneously. Given the high debts of the private sector it is crucial that that sector correct its balance sheet. The public sector needs

[15] This number should not be taken too literally as it only represents a back-of-the-envelope calculation that is based on the ongoing debate. Often, the new party 'Alternative für Deutschland' is seen as the political party of academic economists. May this as it may, the German debate is not at all about the macroeconomic rationality of front-loaded austerity. This recipe is widely accepted in the German profession. The debate is mostly about the legality of ECB politics (see below) and the best way to safeguard German interests in a dissolving Eurozone.

to accompany these private sector corrections by accepting an increase in its debt ratio if a recession is to be avoided. In other words, austerity is a self-defeating approach under certain conditions. This view has received indirect support by research from the International Monetary Fund (IMF). Their research indicated that in situations of a liquidity trap, when central banks already operate on the lower bound for monetary policy, the government multiplier is much stronger than usually assumed. In other words, austerity works fairly quickly through the macro economy and generates negative growth effects.

The immediate effects of heavy front-loaded austerity programs seem to confirm these critical voices. By early 2012, twenty out of 26 member states were under the Excessive Deficit Procedure due to their violation of the 3% deficit-to-GDP criteria. In addition, The Eurozone has entered a recession, and particular economies like Greece, Spain, Portugal and Italy which have experienced severe and long-lasting austerity programs have also suffered from a corresponding shrinking GDP, and large increase in unemployment. Financial markets have carefully observed these developments, sometimes with fear but also as an opportunity to make political actors move. Over the period 2010 and 2012 it was the 'stick' of financial market actors that pushed political actors out of their procrastination and made them act.

Graph 3



Yields on long-term government bonds, Jan 2009 to April 2013. Data source: Eurostat.

Financial market actions resulted in 'panic attacks' that generated strong increases in the yield of government bonds from 2010 to the end of 2012. The political actors responded to this pressure but only with small responses, and often in ways that required further policy changes down the line. The result was a speculative attack-crisis response-speculative attack pattern that added to the overall uncertainty of the future of the Eurozone (Hübner 2012) Rather than overcoming the crises, the dominating austerity approach led the crisis economies into even deeper slumps and moved the overall Eurozone into a recession zone. Moreover, inadequate fiscal policies strengthened the role of financial markets that once again played their role as key evaluators of the crisis management responses, and were able to push governments to further action. The most relevant non-intended outcome of the austerity operations was the transformation of the ECB from an inflation-chasing central bank, to a creditor of last resort for Eurozone economies. It was the disastrous effect of the misguided fiscal policy approach, in combination with the speculative attacks of financial markets that forced the ECB to unorthodox actions that went far beyond its mandate. In other words, the German-inspired austerity approach drastically transformed the institution that was supposedly designed as a clone of the Bundesbank.

Since the launch of the Euro the ECB was seen as the institutional

representation of trust, confidence and stability of the newly launched currency. Actually, gaining trust was the key goal of monetary policy actions at the ECB from its very start (Hübner 2002). In order to allow the ECB to follow through with its mandate, the bank was set up as a highly politically independent institution. Given that the set-up of the ECB was guided by German policy preferences, the bank can be seen as the agent that secures the policy mandate set by the principal. Ongoing economic and political processes indicated the requirement for the ECB to move towards a strong actor position. When the financial crisis of 2008 hit, the ECB had already been forced to follow other central banks by executing a strongly accommodating monetary policy to support expansive fiscal policy programs. Still, this policy decision was a far cry from the ECB's policy turn in the course of the Eurozone crisis. In a more superficial way one can argue that the real changeover came with the change in presidency from Trichet to Draghi, even though this change was not so much driven by the change in leadership than by functional requirements. In a situation when fiscal policy was confined by political constraints it was up to the only institution with potentially unlimited firepower to contain the spreading crisis effects, the ECB. In swift steps the ECB blew up its balance sheet and with its Outright Monetary Transactions program and the automatic stabilizer TARGET2 it was able to recreate trust on the side of financial markets. When Mario Draghi eventually declared that the ECB was willing to do whatever it takes to rescue the Eurozone the bank became the ultimate guardian of the currency union.

This transformation of the ECB met harsh resistance on the side of German central bankers, political representatives and via the loud outcry of professional economists, and also on the side of the public at large. Fairly quickly, Axel Weber, the unofficial German successor of ECB-President Trichet stepped down as president of the Bundesbank and thus as the unofficial successor of Trichet; this early retreat was also followed by the early retirement of the chief economist of the ECB, Jürgen Starck. Chancellor Merkel sent Jens Weidmann, her chief economic advisor and a former student of Axel Weber, to Frankfurt. He quickly turned into the most outspoken policy hawk and fanatically questioned and objected to all ECB action in regards to its new role as creditor of last resort. This critical attitude towards the ECB is more than a simple idiosyncrasy of a number of central bankers. These attitudes very much reflect on the analytical narratives that have dominated economic discourse in Germany

for some decades.

The Bundesbank used its statement in the hearing of the German Constitutional Court debating the legality of the European Stability Mechanism, for a fundamental critique of ECB policies. In clear contradiction to Mario Draghi's statement that the ECB would do anything necessary to preserve the Eurozone the Bundesbank stated:

> "Given that we still deal with sovereign nation-states, the current composition of the currency union can't be guaranteed – at least not by the central bank. Hypothetically, this could only be done if the central bank would agree to unlimited lending in order to avoid that an economy leaves the union. Such an action, however, is not part of the mandate of monetary policy[16]" (Bundesbank 2012)

In this view, the ECB went far beyond its monetary policy mandate and acted in a legal grey zone[17]. We can assume that Weidmann is as outspoken at the meetings of the Governing Council of the ECB as he is in his public statements. The Governing Council, consisting of the seventeen heads of national central banks plus the six members of the executive board, seems to make decisions by consensus. If we assume that national interests guide members of the Governing Council to some degree, and if we also take into consideration that each member has one and only one vote, then it seems reasonable to conclude that the German representative will try to build a coalition to support his position. Potential partners are heads of central banks of economies that belong to the current account surplus camp. Surplus economies should have the intrinsic interest to defend their advantageous competitiveness position, and thus will not favor programs that offer rescue funds without harsh political pressure placed upon them. However, it is obvious that Germany's chances to block policies potentially favored by representatives of deficit economies are slim in a one-country-one-vote

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[16] My translation.

[17] Jörg Asmussen, German member of the Executive Board and close friend to Weidmann, recently countered in public: "When we started this program (OMT, kh) the Eurozone was close to falling apart in an uncontrolled manner. At this time the ECB was the only fully operational European institution, and it was up to the ECB to demonstrate to speculators not to quarrel with the ECB. The Euro will be defended" (FAZ, 10 June 2013). The fact that it was not yet necessary to start OMT shows that the clear-cut statement of Draghi was successful.

system. Graph 2 shows that 13 out of the 17 member economies belong to the deficit camp. Public statements also indicate that the majority of the executive board, including German representative Jörg Asmussen, favor the various easing programs of the ECB. Under these circumstances, Weidmann only can keep up the rhetoric and accept that he cannot form a coalition that would reverse the current policy of the ECB.

The German government does not publicly share these outspoken critiques of the ECB[18]. On the contrary, the Merkel government seems to understand that the ECB is the only institution that can prevent a dissolution of the Eurozone in the current situation. This current condition is one in which the multilevel governance regime of the EU is seemingly unable to design broad and adequate crisis management regime. Finance Minister Schäuble on the occasion of the Supreme Court hearing pointed out that 'the federal government sees no sign that the measures taken by the ECB so far have done damage to its mandate"[19]. As a matter of fact, the ECB acts as a strong ally of the Merkel government's piecemeal strategy. The various easing programs of the ECB buy Eurozone government's highly valuable time to move along their own political time axis, and to enact reforms that are enormously contested politically. For Germany this implies acquiring more political time to form a 'coalition of the willing' that favors radical makeovers of the political institutional setting of national growth regimes. Given that the ECB pushes as strong as Germany and other surplus camp governments for strict austerity policies in combination with far reaching structural reforms, in particular in the areas of labor markets and social policy, it is clear that Frankfurt and Berlin share the same fundamental principles.

Mario Draghi rightly claims that with the latest OMT policy, it was the ECB that saved the day and avoided the breakdown of the Eurozone in a time of escalating panic (Draghi 2013). Avoiding the collapse of the common

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[18] This does not hold for the coalition parties. CDU/CSU and to an even greater extent the Free Democrats, are very outspoken in their anti-ECB sentiments. Rainer Brüderle, head of the parliamentary faction of the FDP, wrote a letter to Mario Draghi and demanded that the ECB president personally represent the ECB in the Supreme Court hearing about the legality of the ESM, and the bond purchase program of the ECB.
[19] See Financial Times, 13-06-2013, 8:46 AM. As trained lawyer Schäuble chooses his words careful and qualifies this statement by using 'so far'.

currency however, is not synonymous with solving the crisis. The Latter needs much more than an unconventional monetary policy; in particular it needs coordinated government actions that deal with the roots of the crises. Moreover, the policy turn of the ECB is not without economic as well as political risks. Since late 2010 the bank has drastically extended its balance sheet and added low quality items to its balance (see graph 4). The ECB started to engage in long-term financing operations and was actually bailing out troubled governments. This policy change coincides nicely with the turn towards fiscal austerity and the start of panic attacks on the side of financial markets. It became the job of the ECB to act as creditor of last resort by providing financial injections in credit-starved economies. The operations required from the Bank resulted in it accepting collateral of low quality in exchange for liquidity. Its balance sheet increased enormously, and so did the public concern over the quality of this steep in liabilities, an increase that was seen as a process that was turning the 'good' ECB into a 'bad bank'. The German debates in particular characterized the OMT as a money printing exercise that had the potential for a huge rise in inflation rates[20]. Empirically, the opposite has materialized. The average inflation rate of the ECB is slightly below the 'target' inflation rate; despite the growth of central bank money the credit channels for the private business sectors are still clogged.

The problem of the politics of quantitative easing are of a different nature and mainly have to do with the well-known problems of sending misleading signals to financial markets. Record low interest rates and huge purchases of government bonds are stimulating financial markets, and thus potentially could start a new asset bubble (Bank for International

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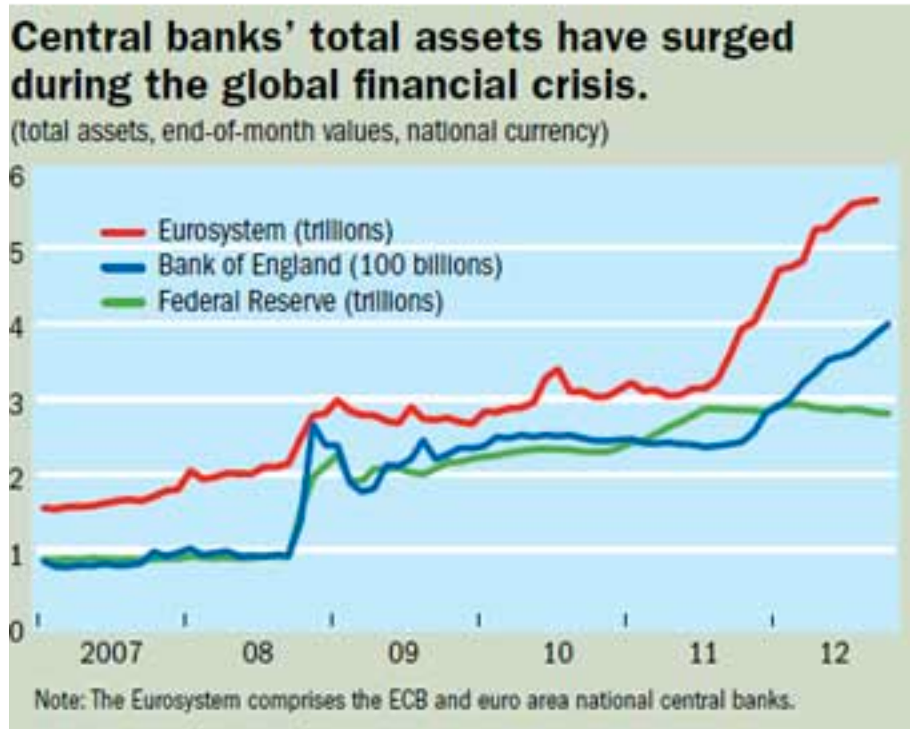
[20] Jens Weidmann used the Goethe festivities in Frankfurt in September 2012 for a fundamental statement on the responsibility of central banks in dealing with permanent political pressures, and of the temptation for governments to ask for the monetization of public deficits. "If central banks can potentially create an unlimited amount of money out of thin air, how can we ensure that money remains scarce to preserve its value?' asked Weidmann. His answer is straightforward: '…central banks were subsequently established as independent institutions, with the mandate to safeguard the value of money, in order to explicitly keep the government from co-opting monetary policy' (Deutche Bundesbank 2012). – The hearings at the Constitutional Court in June 2013 were an impressive documentation of the dominating intellectual debate among German academic economist. The vast majority of these economists argued that the ECB is violating article 123 and operates a policy that comes with high risks in terms of potential inflation, and public debt increases for Germany.

Settlements 2013). However, in a situation where national governments are politically hampered to design encompassing crisis management policies, the ECB has no alternative than to stay the course, even if this policy nourishes a new asset bubble.

Graph 4



National governments and the ECB have moved to a 'bad equilibrium'. Governments see the reduced pressure from financial markets as a political opportunity to slow down the economically and politically painful restructuring programs; the ECB needs to stick to its deterrent approach while simultaneously keeping up its pressure on governments not to give in to 'reform fatigue'.

Cracks in Leopard Politics

The German crisis approach may have emerged slowly and in a piecemeal fashion, but it never deviated in principle from the basic policy convictions that were already put in place at the launch of the Euro. What looks initially like a fundamental revamp of economic governance, proves to be a makeover that sticks to the same basic policy pillars. The German-pushed Stability and Growth Pact already involved the principle that violators of rules need to be put under surveillance; this principle has been

renewed and to some degree tightened in the course of the launch of various rescue facilities and programs. Moreover, it seems that the political acceptance of the violation of article 125, and even more so the quiet acceptance of the transformation of the ECB from a price stability-oriented institution to the creditor of last resort of the Eurozone, has only strengthened the conviction that in exchange for these concessions, strong political and legal commitments are required from debtors that would prohibit moral hazard. Thus, conditionality has become the key ingredient of the policy menu. This approach has been replicated by the ECB. The central bank insisted that governments first turn to the emergency mechanism provided by the EU (see below) that comes with strong conditionalities, before the bank would consider engaging in government bond purchases[21]: "OMTs can be applied only if governments accept policy conditionality that leads to reforms. At the same time, it was the requirement of effective conditionality embedded in OMTs discourages governments and parliaments from requesting a programme unless strictly necessary" (European Central Bank 2013). It needs to be noted that so far not a single troubled bond has been purchased under OMT, and an actual test of this instrument is still lacking. Financial markets have been kept at bay since Draghi announced the willingness of the ECB to defend the Eurozone. It will be up of the further economic and political development of the zone if and when a practical test occurs.

What have been labeled as 'structural reforms' are a package of far-reaching changes of labor market institutions and practices, as well as welfare state programs that aim to decrease costs and add flexibility, and thus enhance competitiveness[22]. These policies are not new but have been an integral part of the potential adjustment buffers from the very start of the common currency, if only for logical reasons (Hübner 2002). A currency union by definition loses the exchange rate as an adjustment mechanism and thus needs to rely on flexible wage relations in order to deal with asymmetric shocks. In other words, in a world without the exchange rate tool, constrained national fiscal policy due to the Stability

[21] Draghi labeled this as the 'two-pronged approach' where any ECB action on secondary markets depends on the willingness of debtors to accept strong conditionality.

[22] The Economic Adjustment Program (EAP) contained within the agreements which countries that moved under EU umbrellas signed onto, includes many more items, in particular concrete changes to established tax regimes. The Core of the EAPs are structural reforms in labor markets and all aspects of welfare states.

and Growth Pact, and unified monetary policy, the only remaining adjustment variable is the wage relation. It turns out that these structural reforms were mostly neglected by Eurozone economies. The so-called 'Hartz IV Reforms' in Germany were closest to such a reform package. Rather than punishing other economies with its requests for conditionality, the German insistence on structural reforms in other member economies in exchange for financial support is prolonging a policy approach that has been part of the German agenda since the launch of the Euro: Frankfurt meets Berlin.

From a macroeconomic perspective, the Frankfurt-Berlin consensus is a contradiction in itself. Austerity as the core of structural reforms is a self-defeating mechanism; government bond purchases by the ECB lift investor sentiment and contribute to asset bubbles. Asset bubbles in a low growth environment are incentives for the misallocation of resources, and thus work against the stability targets of austerity. In other words, the less effective EAPs EAP? are, the more action is needed from the side of the ECB, and the more distant a crisis solution becomes. The hesitant and overall inadequate policy response of national governments, and the Commission, puts the ECB in a difficult situation. The less governments of member states are coming up with adequate policies, the more the ECB needs to meddle in economic policy affairs, and thus to stretch the interpretation of its mandate. The purchase of government bonds helps financial institutions in their efforts to clean up their balance sheets, but does not prepare the ground to restructure the crisis economies, nor does it disentangle banking crises from sovereign crises. National governments and the ECB are trapped in a 'bad political equilibrium'.

There is no doubt that the governance structure of the Eurozone, as well as of the EU, has undergone impressive changes since the crises started. What was introduced after quite some procrastination as a temporary 'shock and awe'- mechanism in the form of the European Financial Stability Facility (EFSF) soon became the permanent crisis institution the 'European Stability Mechanism' (ESM) which can mobilize higher amounts of financial support than the temporary mechanism could. Even more far-reaching are the changes in the fiscal institutional setting of the EU, as well as the Eurozone. Most comprehensive is the so-called 'Six Pack' and the 'Treaty on Stability, Coordination and Governance' (TSCG). The former is an EU secondary law that entered into force on December 2011 and is meant to strengthen the SGP, as well as to ensure stricter application of the fiscal rules. Increased fiscal surveillance is paired with

gradual strengthening of financial sanctions up to -5% of GDP for Eurozone member economies, which is also reinforced with the application of reverse qualified majority voting. This means that the Commission can recommend fines that are accepted as long as a qualified majority in the Council does not vote against it. The TSCG is an intergovernmental agreement that has been signed by 25 EU members (all but the UK and Czech Republic) and is binding for Eurozone member economies. Its core is the 'Fiscal Compact' that entered into force on January 2013 after Finland became the 12th economy of the Eurozone that signed off on it. The Compact demands that countries introduce laws limiting the structural government budget deficits to 0.5 % of GDP; moreover, it demands the introduction of 'debt brakes' into their constitutions. Temporary deviations from the balanced budget rules are allowed in exceptional economic circumstances however. National governments are required to present their budget plans to the Commission in the 'European Semester', and may have to make revisions if Commission and Council raise concerns about the viability of national budgets. Overall, the Compact introduces rule-binding procedures and adds a dose of automatic surveillance, not least due to the fact that the European Court of Justice can impose financial sanctions up to .1% of GDP if a country violates the balanced budget rule.

The emerging new economic governance seems to have moved authority from the national levels to Brussels, mainly to the Commission. A closer look shows, however, that most of the changes strengthened intergovernmentalism as the Council carefully guarded its vested interests and made sure to 'call the shots'. From the start of the crisis management the European Council has confirmed its role as principal via its actions and by delegating tasks to the Commission. As Chang (2013:266f.) nicely summarizes: "…the potential for agency slack (by the Commission, kh) was thwarted by the use of police patrols by the member states. Public letters with instructions for those constructing the legislation were continually used. In addition, more extreme versions were introduced with task force and intergovernmental treaty to re-intergovernmentalize legislation that could have been done within the context of the existing treaties and the community method". The fear of losing national sovereignty and risking incalculable financial burden became the guiding principle for the makeover of economic governance. The most recent debate about the setup of a European banking union highlights how some member states, mainly Germany, want to keep the

main elements of the banking union in the hands of national regulators, and thus in their political domain (Reuters 2013).

This return of intergovernmentalism generally favors the creditor camp over the debtor camp. In particular, it implies a stronger role for Germany whose policy preferences have become the standard of the Eurozone. Lately, output legitimacy of those preferences has come under stress, in particular in the debtor camp. The enormous social and economic costs of the austerity approach not only led to social protest in debtor economies, but also concerns about the political and social limits of this policy. Commission President Barroso made the point that austerity "…is fundamentally right…but has reached its limits in many respects". And he added:" A policy to be successful not only has to be properly designed. It has to have the minimum of political and social support") (European Commission 2013). Lazlo Andor, EU Commissioner for Employment, Social Affairs and Inclusion, pleaded jointly with speakers of the European Parliament and the OECD for a drastic course change that would entail productivity-oriented wage increases, as well as the introduction of adequate minimum wages (Andor et al 2013). In its ex post evaluation of the 2010 arrangement with Greece, the IMF self-critically claimed that the social costs of front-loaded austerity programs were underestimated, and led to mistakes in the design of the overall program (IMF 2013). In a situation where the empirical underpinnings of austerity have already come under serious pressure with the so-called Reinhart/Rogoff affair (Hübner 2013) statements like the ones from Barroso and Andor, as well as the critical self-reflection by IMF staff can be read as attempts on the side of the agent to change the agenda of the principal. The Commission, in agreement with the Council, most recently gave Spain and Portugal, as well as France, more time to deal with the deficit target; Germany started a charm offensive with Spain by offering an apprenticeship program for young Spanish workers that would result in 5000 (temporary) positions.

In the greater scheme though, such decisions are cosmetic. The Council and in particular the German government are outspoken about their intention to stick to the basic principles of their crisis management, and are only willing to show some flexibility in regards to the interest rate and repayment period. What is currently a minor crack in the established crisis management strategy, however, has the potential to become a political irritant. The economic as well as political rationale for austerity is no longer uncontested in the debt-ridden economies; under pressure comes also the unwillingness of the Merkel government to eventually accept that

rescuing the Eurozone requires real burden-sharing. However, given the firm enshrinement of policy preferences in German parties, one should not expect that the CDU/CSU-SPD coalition would change the fundamental German approach. What can be expected, though, is an increase in political flexibility, not least in order to accommodate difficult political constellations in Italy and France. The 'civil war' between ECB and Bundesbank may be dampened but will probably not come to a standstill. The German Constitutional will decide the outcome of this 'war' directly or indirectly with its verdict on the legality of the ESM and OMT programs of the ECB. Previous decisions of the Court suggest that the Court will not declare these programs and mechanism as illegal, but will come up with qualifying conditions for future actions. Rather than giving the ECB the 'green light' the Court may define more explicitly the conditions under which the ECB can act as a creditor of last resort. If these qualifications are restrictive then only two scenarios are viable. If no other European institution is prepared to act as a policy substitute for the ECB, then the Eurozone will fall apart in case of new speculative attacks. Alternatively, the German government could be able and willing to change its fundamental policy approach, and to accept, for example, some form of Eurobonds as well as the creation of a 'true' banking union. Such a turnaround that accepts the mutualization of debts would eventually undermine the bad equilibrium that characterizes the current crisis management of the Eurozone. Time will show.

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