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**Article (Accepted version)
(Refereed)**

Original citation:

Schäfer, David (2016) *A banking union of ideas? The impact of ordoliberalism and the vicious circle on the EU banking union*. [Journal of Common Market Studies](#), 54 (4). pp. 961-980. ISSN 0021-9886

DOI: [10.1111/jcms.12351](https://doi.org/10.1111/jcms.12351)

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Available in LSE Research Online: December 2016

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A Banking Union of Ideas?

The Impact of Ordoliberalism and the Vicious Circle on the EU Banking Union

In: Journal of Common Market Studies, forthcoming (already available online in early view section)

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Abstract:

The establishment of the EU banking union reveals two major shortcomings of liberal intergovernmentalism. First, it fails to explain the preference formation of the most important actor – the German government. The banking sector was divided between public and private banks, and there is no clear-cut pattern about whose interests the German government promoted. Second, material bargaining power cannot account for German concessions despite favourable power asymmetries. This article seeks to demonstrate how an ideational frame can convincingly fill these gaps. Ordoliberal ideas were constitutive for German preferences. The manipulative use of ideas as strategic resources by the German government's opponents explains why it made significant concessions. Germany's government publicly acknowledged that breaking the 'vicious circle' between banks and sovereigns was the main objective of the banking union. This became a rhetorical trap used by a coalition of Southern European member states to force the German government to make concessions.

Acknowledgments:

I would like to thank Michele Chang, Sebastian Diessner, Kevin Featherstone, Gustav Meibauer, Frank Schimmelfennig, Uli Sedelmeier, Nicolas Véron and three anonymous reviewers for extremely helpful comments. All errors are mine.

Introduction

The EU banking union is the most recent grand bargain of European integration. It constitutes the most significant EU agreement since the Maastricht Treaty with a remarkable transfer of sovereignty to the European level, consisting of four major elements: A common rulebook as a means to harmonise regulatory standards in the financial sector; the Single Supervisory Mechanism (SSM), which establishes a joint banking supervision for the eurozone and potentially other EU member states willing to join; the Single Resolution Mechanism (SRM), to restructure or resolve failing banks; and a joint deposit guarantee scheme. With regard to the latter, however, member states only opted for a harmonisation of national schemes with more far-reaching options being considered at the time of writing.

How do we explain the outcome of the banking union negotiations? Comparative political economists would explain the preferences of member states and the creation of the banking union with the economic structure of the member states. However, key member states rejected a banking union still in 2011 and the structure of their domestic industries cannot explain why they ended up changing their mind (De Rynck, 2016, p. 120). Epstein argues that the internationalization of transnational banks has contributed to centralization, but banking has retrenched to national markets since 2008 (Epstein, 2014). Other scholars explain the creation of the banking union with the eurozone being at the verge of failing, and member states therefore agreeing to it in order to prevent the break-up of the currency area (see e.g. Schimmelfennig, 2015). However, crisis pressures may explain *why* governments take action, but it does not explain *what* action they take. Neo-functionalists are more specific and predict a fully-fledged banking union as part of a genuine EMU (see Niemann and Ioannou, 2015, p. 213), but in the absence of a deposit scheme and a fiscal backstop this kind of banking union clearly did not come about.

The ‘baseline theory’ (Moravcsik and Schimmelfennig, 2009, p. 67) of European integration with a particular strength in explaining EU grand bargains is liberal intergovernmentalism (Moravcsik, 1999). Yet, applying it to the banking union negotiations leaves us with two major unresolved puzzles for liberal intergovernmentalism. First, liberal intergovernmentalism explains the preferences of the member states by resorting to domestic interest groups. However, the preferences of the German government appear to match neither the interests of the domestic banking sector nor those of producer groups.

Second, liberal intergovernmentalism relies on an intergovernmental bargaining theory to explain interstate negotiations. It suggests that the outcome of the banking union negotiations is likely to reflect the German government’s preferences because of its superior bargaining power based on

its vast financial resources. Nonetheless, the German government made significant concessions on all four contentious issues of the negotiations. Liberal intergovernmentalism cannot account for these concessions.

This article invokes an ideational frame to solve the two puzzles that the banking union negotiations pose for liberal intergovernmentalism. It understands ideas¹ as being constitutive for preferences, as suggested in the works by Hall (1993) and McNamara (1998), as well as serving the purpose of manipulative strategic resources in negotiations, hereby following Schimmelfennig (2001) and Jabko (2006). First, against the background of a strong division of the banking sector in Germany, not material interests but ordoliberal ideas were the primary source of the government's preferences. This paper argues that there is strong evidence to support German finance minister Wolfgang Schäuble's assertion that the German government 'followed ordoliberal principles for the creation of the banking union' (Schäuble, 2014a). Second, the German government conceded because it was rhetorically entrapped. The most important idea was the 'vicious circle', which identifies the cause for the eurozone's problems in the 'deadly embrace' (De Grauwe, 2013a, p. 3) between banks and sovereigns: Contagion is seen to spread from one to the other and thereby impedes a return to growth. This idea gained prominence by the end of 2011 (Véron, 2011, pp. 9–10) and finally became the predominant idea to make sense of the crisis. The Euro Summit in June 2012 finally recognised its importance by concluding that it was 'imperative to break the vicious circle between banks and sovereigns' (Euro Summit, 2012, p. 1) and in order to do so settled on the creation of the banking union. A coalition of Southern European member states linked the goal of breaking the vicious circle with a specific institutional design of the banking union including at least some mutualisation, which ran counter to German preferences. Since the causal claims of the vicious circle were acknowledged by the German government (Merkel, 2012), the need for argumentative consistency made it vulnerable to demands for further mutualisation. It was thus ultimately forced to make concessions despite commanding superior material bargaining power.

The most insightful contemporary accounts of the banking union negotiations by Howarth and Quaglia (2013; 2014) implicitly share many liberal intergovernmentalist assumptions and logics by emphasising the importance of material interests and bargaining power. Their highly valuable contribution clarifies the most relevant material interests and the preference configuration in the negotiations. Nonetheless, their work critically underestimates the impact of ideas on both the domestic preference formation and the intergovernmental negotiations, which is otherwise widely

¹ Ideas are defined as cognitive or normative beliefs (Schmidt, 2008, pp. 306–307).

acknowledged in the literature (McNamara, 1998; Dyson and Featherstone, 1999; Jabko, 2006; Bonatti and Fracasso, 2013).

This article directs our attention to the distinction between two notable coalitions among the actors involved in the negotiations: a Germanic coalition including Germany, Finland, the Netherlands and some other mostly Northern European eurozone member states, and a Southern coalition composed of France, Spain, Italy, and other economically weaker eurozone member states. The latter were repeatedly supported by the Commission, the European Parliament and occasionally the European Central Bank. The analysis is confined to the most contentious issues of the negotiations, namely: (a) the scope of application of banking union, (b) the ‘bail-in’ provisions, (c) the establishment of the Single Resolution Fund, and (d) the decision-making procedure in the SRM.

Liberal Intergovernmentalism: economic interests and material bargaining power

Applying liberal intergovernmentalist insights to the banking union negotiations, we can derive two main hypotheses, relating to its two core components: preference formation and interstate bargaining. Firstly, with regard to the former, liberal intergovernmentalism argues that a state’s ‘[p]references reflect the objectives of those domestic groups which influence the state apparatus’ in a specific issue-area (Moravcsik, 1999, p. 24), hence in this case banking associations.

Germany’s three pillar banking system is composed of eight *Landesbanken* (regional banks), more than 400 *Sparkassen* (savings banks), around 1,200 cooperative banks, and 200 private banks. When counting the many small *Sparkassen* as one entity they constitute a powerful financial group with a market share of the German banking business of around 30% and more assets than Deutsche Bank (Howarth and Quaglia, 2014, pp. 130–131; Hardie and Howarth, 2013, p. 108; Seikel, 2014, p. 176). They engage in ‘patient lending’ to SMEs and have strong ties to politics. Both *Landesbanken* and *Sparkassen* benefitted massively from state guarantees for a long time. Strong networks across all political parties shielded the public banks against attempts to liberalise the German market. The *Sparkassen* remain of high significance to German politicians due to selective benefits for politicians such as board seats and governance financing. By contrast, the *Landesbanken* have lost ground in their battle to defend their privileges such as state guarantees due to pressure from the European Commission since the late 1990s (Seikel, 2014). Moreover,

the *Sparkassen* have their own resolution system which increases their importance to German politicians. The private banks include Deutsche Bank with a worldwide presence and Commerzbank with a notable European presence. The largest five banks account for 22% of the assets of all financial institutions (Hardie and Howarth, 2013, pp. 107–108). While the importance of the savings banks is based on their patient lending to SMEs, the large private banks and especially Deutsche Bank have a vital function in Germany's banking sector by providing funding for large scale projects whose volumes exceed the capacity of the savings banks and *Landesbanken*. While the public banks and especially the *Sparkassen* sought to defend their privileged position in the German market, the private banks perceived the banking union as an opportunity to create a level playing field. As it is reasonable to assume that the lobbying power of public and private banks is by and large equally strong, we also hypothesise that the government followed a compromise between both banking groups.

H1a: *The preferences of the German government follow the interests of German Sparkassen.*

H1b: *The preferences of the German government follow the interests of German private banks.*

H1c: *The preferences of the German government follow a compromise between German Sparkassen and private banks.*

If the government's preferences were in line with those of the public banks, we would, according to the banks' stated preferences, expect the government to advocate a limited scope excluding particularly the *Sparkassen*, and to promote weak and non-automatic bail-in provisions, a mere harmonisation of national funds and an effective SRM decision-making procedure. If the government followed the private banks, we would expect it to favour a broad scope, strong and automatic bail-in rules applying to all banks, a joint fund with contributions from all banks, and an effective SRM decision-making procedure. In regard to hypothesis 1c, it should be noted that not any possible preference in-between the two banking associations' ideal-points can count as compromise. Due to the division between private and public banks, their interests are located at the opposite extreme ends of possible ideal-points. Problematically, if anything in-between these opposite extreme ends counts as compromise, this would make it impossible to falsify the stated hypothesis. Thus to be more precise, the observable outcome has to be roughly in the middle between the two equally powerful banking associations' interests, so as to keep this hypothesis falsifiable. In other words, if on a scale from 0 to 1 the public banks are located at 0 and the private banks at 1, we would expect the government to be at 0.5. It would then advocate a moderate scope including *Landesbanken*, moderate bail-in provisions, some joint liabilities regarding the funds needed (e.g. credit lines between national funds), and, since in this last issue

there was no disagreement between both banking associations, a streamlined decision-making procedure without national vetoes.

Secondly, with regard to the second core component of liberal intergovernmentalism, the outcome of intergovernmental negotiations ‘reflect[s] the relative power of states – more precisely, patterns of asymmetrical interdependence’ (Moravcsik, 1999, p. 3). The German government possessed by far the highest bargaining power due to its vast financial resources and the size of its banking sector. In contrast to the Southern coalition, its preference intensity was low because of its ability to bail-out or resolve its banks autonomously, which effectively rendered no-agreement a feasible alternative (Howarth and Quaglia, 2014, pp. 130–131).

H2: The outcome of the banking union negotiations reflects the preferences of the German government.

Evidence for the importance of Germany’s material bargaining power in the banking union agreement would be a high similarity between German government’s preferences and the outcome of the negotiations. Hence, the *Sparkassen* would be excluded from the scope, there would be strong and automatic bail-in rules, only a harmonisation of national resolution funds, and member states could veto bank resolutions.

Domestic preference formation: Explaining preferences with the interests of the German banking sector

After having established the liberal intergovernmentalist hypotheses in the last section, they will now be tested empirically. We start with the first step in liberal intergovernmentalism, i.e. the domestic preference formation, and turn to the interstate bargaining in the next section. The first of the four main contentious issues was the question of which banks the rules of the banking union should apply to. The German banking sector was divided on this question (Financial Times, 2012a). Both *Landesbanken* and *Sparkassen* lobbied to be excluded (BVR/VÖB/DSGV, 2012, p. 1; BVR/VÖB/DSGV, 2013, p. 5), while the private banks wanted to have them included as a means to put an end to more favourable conditions for public banks on the German market (BDB, 2013a, pp. 3–4). The association of major industrial producers, for its part, was concerned about the banks’ lending capacity, which points to a preference for the exclusion of the *Sparkassen* (BDI, 2014). The German government advocated a very limited scope

even excluding the *Landesbanken* from the SSM (Financial Times, 2012a). Its preferences appear to match the interests of *Sparkassen* and *Landesbanken* in this case, which is evidence for the hypothesis 1a. Yet, if the public banks were indeed much more powerful, we would expect the government to consistently represent their preferences across all four issues. We will see below if that was the case.

The bail-in rules were the second contentious issue of the banking union negotiations. They apply to all EU member states. A ‘bail-in’ refers to the obligation of investors to bear part of the costs of a bank resolution or restructuring. The German banking sector was again divided. *Sparkassen* and *Landesbanken* were opposed to strong and automatic bail-in rules (BVR/VÖB/DSGV, 2013, p. 6) and received lukewarm support from the industrial lobby which was concerned about a lower lending capacity (BDI, 2014, p. 1). The private banks were more favourably inclined, provided the bail-in would apply to all banks in order to create a level playing field (BDB, 2013b). In contrast to the scope, we see that on this issue the government’s preference overtly matches that of the private banks because it advocated strong bail-in rules with a high degree of automaticity (Agence Europe, 2014a; Agence Europe, 2013a; Financial Times, 2013a). With one match for each of the banking associations, we can conclude that so far it seems the government did not follow any of the two groups consistently. We do not have strong evidence for the compromise hypothesis either as in none of the two contentious issues the government’s preference matched that of a compromise between both associations.

The third contentious issue was the question whether there should be a joint bank resolution fund or a mere harmonisation of national funds. The German government was faced with considerable pressure from the public banks to reject a joint resolution fund. They considered their own institutionalised security system sufficiently resilient (BVR/VÖB/DSGV, 2013, p. 12). Provided that all banks would have to contribute, the private banks welcomed the idea of a joint fund (BDB, 2014; BDB, 2013a, pp. 2–4), as did the producers (BDI, 2014, p. 3). The German government advocated a network of harmonised national funds to ensure control over the resources (Agence Europe, 2013a; Howarth and Quaglia, 2014, p. 129; Schäuble, 2013). This clearly matches the public banks’ preference again.

Fourthly, the governments negotiated who should have the decision-making power on bank resolutions. Both the German private and public banks (BDB, 2013a, p. 4; BVR/VÖB/DSGV, 2013, p. 10) and the producers (BDI, 2013, pp. 6–7) insisted on decision-making effectiveness and preferred an impartial committee over an involvement by the Council or Commission. A Council involvement would have made decision-making very complex. However, the German government strongly objected to allocating the final decision-making power about bank

resolutions to the European Commission. It was concerned about a conflict of interests between the Commission’s role as state-aid watchdog and bank resolution authority. The German government preferred the Council to decide about bank resolutions (Agence Europe, 2013a; Agence Europe, 2013b; Financial Times, 2013b). This case is particularly puzzling for interest-based accounts because the diverse interest groups were united in their opposition to the government’s preference. None of the material interest hypotheses explains the government’s preference on this issue.

In sum, there is weak evidence that the material interest hypotheses explain German preferences. As the government’s preferences match the interests of the *Landesbanken* and *Sparkassen* in only two of the four cases, it did not consistently follow them (hypothesis 1a). Also there is only one match between the government and the interests of the private banks, which means that the government did not follow the private banks either (hypothesis 1b). The compromise hypothesis is disconfirmed in all four cases because in no case the government’s preferences correspond to a compromise between both associations (hypothesis 1c). There are random matches, but no clear pattern emerges. We can conclude that a liberal intergovernmentalist account produces unsatisfactory results in explaining German preferences.

Interstate negotiations: Explaining banking union with material bargaining power

After having attempted to explain German preferences in the last section, we now test if liberal intergovernmentalism is more successful in explaining the outcome of the interstate negotiations on the four contentious issues.

The German government’s preference for a very limited scope of the banking union was contested by a broad counter-coalition of member state governments. While several of them acknowledged that the ECB could not oversee all banks directly, the German government was isolated in its attempt to establish a two-tier system. The counter-coalition led by France, the European Parliament, the Commission and the ECB advocated that the SSM should have final responsibility for all banks in (at least) the eurozone through direct or indirect supervision (Agence Europe, 2013b; Agence Europe, 2013a; Howarth and Quaglia, 2013, pp. 112–113).

Table 1: Negotiations on the scope of the banking union

Germany’s position	Parties aligning to Germany	Position of the counter-coalition	Parties forming the counter-coalition	Outcome of the negotiations
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Restrict scope to large banks	Slovakia	All banks covered by SSM	All member states except Germany+Slovakia; Commission, ECB	Scope limited to 'significant' banks, emergency clause for ECB
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The outcome of the negotiations is a restriction of the scope of the SSM and SRM to 'significant'² banks, i.e. most importantly those with assets exceeding 30 billion euro or 20% of the host member states' GDP. 120 banks holding 85% of bank assets in the eurozone are covered by the SSM and SRM. This excludes the savings banks except for one institute, but includes all German *Landesbanken* with one exception (Gros and Schoenmaker, 2014, pp. 2–3; European Central Bank, 2014; Howarth and Quaglia, 2014, p. 131). The ECB may at any time assume supervision powers for non-significant banks as well in order to ensure the consistent application of supervisory standards. National supervisors still maintain considerable leverage, but following a key demand from France and the Southern coalition, the final responsibility is with the ECB (Gros and Schoenmaker, 2014, p. 3). Furthermore, contrary to the government's stated preference all *Landesbanken* except one are subject to direct ECB supervision (Howarth and Quaglia, 2013, p. 112). While one could argue that including the *Landesbanken* was a strategic concession, this argument is not convincing in regard to the role of the ECB as 'indirect supervisor' (Gros, 2014, p. 2) of the *Sparkassen* which 'departed significantly from Germany's original position' (Epstein and Rhodes, 2014, p. 18). Against the background of Germany's powerful negotiation position, intergovernmental bargaining theory cannot account for these concessions.

Secondly, the German government was the main advocate of strong and automatic bail-in rules. It was supported by Finland and the Netherlands (Finance Ministries, 2012), some other member states, the European Parliament and the ECB. They called for an application of bail-in rules already in 2015 and very limited discretion regarding the application of the rules (Agence Europe, 2014a; Agence Europe, 2013a; European Central Bank, 2013a; Financial Times, 2013a). The member states of the counter-coalition shared the goal of shifting costs from taxpayers to banks. They were, however, reluctant to increase the burden on banks as this was expected to delay the economic recovery. They sought an entry into force in 2018 only and more discretionary powers (Agence Europe, 2014a; Financial Times, 2013a; Howarth and Quaglia, 2014, p. 134).

Table 2: Negotiations on bail-in rules

² More precisely, a bank is 'significant' if at least one of the following criteria is met: (1) the bank assets exceed 30 billion euro, (2) they exceed 5 billion euro and simultaneously 20% of the host member state's GDP, (3) the bank is among the three 'most significant' banks in the country, (4) it has 'large' cross-border activities or (5) receives direct financial assistance from the ESM or EFSF (Art. 6 (4), Regulation 2013/1024/EU).

German position	Parties aligning to Germany	Position of the counter-coalition	Parties forming the counter-coalition	Outcome of the negotiations
Early bail-in (2015 or 2016)	Austria, Denmark, Finland, Latvia, Netherlands, UK; ECB, EP	Bail-in not before 2018;	Bulgaria, France, Luxembourg, Poland, Portugal, Spain	Bail-in rules apply as of 2016
Strict application of bail-in	Belgium; Denmark, Finland, Netherlands; Commission	More discretion and exemptions to bail-ins	France, Greece, Italy, Luxembourg, Portugal, Spain, Sweden, UK	Significant discretion and several exemptions

According to the negotiation outcome the bail-in rules enter into force in 2016. After 8% of a bank's total assets have been bailed-in, public authorities still have some flexibility to decide upon mobilising further funds from their own national budget³. The application of bail-in rules is subject to a 'wide array of discretion' (Buch *et al.*, 2013, p. 24). Once again, this outcome runs counter to German preferences.

Thirdly, the German government was isolated in its rejection of a joint fund. By contrast, the vast majority of eurozone member states and the European Parliament supported the Commission's proposal to create a joint resolution fund (Agence Europe, 2013a; Agence Europe, 2013c; Bloomberg, 2014).

Table 3: Negotiations on the Single Resolution Fund

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

The negotiations finally settled on a joint fund of 55 billion euros, which is seen as one of the German government's biggest concessions during the negotiations (Gros, 2013, p. 2). The banks of each member state pay into national compartments that will be mutualised over an eight-years-period. Mutualisation starts with 40% in the first year, increases to 60% in the second year and the remaining 40% will progressively be mutualised in the remaining six years⁴. Power-based accounts would not expect a concession on this issue: as the contributions from the German financial sector are indispensable for the creation of a joint fund, the government's bargaining power is particularly high.

³ See Bank Recovery and Resolution Directive (BRRD), 2014/59/EU, Art. 44.

⁴ Agreement on the transfer and mutualisation of contributions to the Single Resolution Fund, 8457/14, 14 May 2014.

Fourthly, the objection of the German government and some mostly Northern European member states to allocating decision-making power at the European Commission was challenged by the majority of member states. The Commission secured a certain support in the Southern coalition by presenting itself as guarantor of an effective decision-making procedure (Agence Europe, 2013d; Financial Times, 2013b) and such effectiveness was indeed a top priority for a large majority of member states, the ECB, and the European Parliament (Agence Europe, 2014b; Howarth and Quaglia, 2014, pp. 134–137).

Table 4: Negotiations on SRM decision-making

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

The negotiation parties finally agreed that resolution decisions are made by the Resolution Board in its executive session composed of the chair, the vice chair, four independent experts, and representatives of the relevant national authorities. The ECB and the Commission are observers. The Council's veto powers are restricted to specific reasons and subject to approval by the Commission, which is again distant to the German ideal-point (Gros, 2013, p. 2).

To conclude, the German government made significant concessions on all four contentious issues. They are critical and exceed what one could consider merely strategic concessions. We can therefore conclude that liberal intergovernmentalism neither explains German preferences nor the outcome of the interstate negotiations successfully. There is weak evidence for the hypothesis 1a, b and c as well as for hypothesis 2.

The Impact of Ideas on the Banking Union: ordoliberalism and the vicious circle between banks and sovereigns

This section explores if the ideational frame is more successful in explaining both German preferences and the outcome of the interstate negotiations. The literature allows us to distinguish two major causal mechanisms for the impact of ideas: ideas as source of preferences and ideas as strategic resource in negotiations. Starting with the former, Hall argues that policy-makers semi-automatically follow ideas for understanding problems and finding solutions to address them

(Hall, 1993, p. 279). Ideas constitute actors' preferences and their underlying interests. Actors may even internalise ideas, i.e. take their claims as granted and adjust policy accordingly (Checkel, 2005, pp. 812–813).

The most relevant set of ideas for the German government's preferences in EMU negotiations are ordoliberal ideas. Their core concern is to align responsibility and liability. Joint liability without joint responsibility is believed to cause moral hazard. Hence, a mutualisation of funds must go along with a transfer of sovereignty from national governments to the EU level. A stable currency 'begins at home' (Dyson and Featherstone, 1999, p. 275) with sustainable economic and fiscal policies at the national level. Rules and market pressure preventing moral hazard are 'sacrosanct' (Nedergaard and Snaith, 2015, p. 1101). Ordoliberals emphasise the need for a 'strong state' that creates and maintains markets by providing the legal and institutional framework for efficient markets, but does not assume economic activity itself (Bonatti and Fracasso, 2013, pp. 1024–1032; Bulmer, 2014, p. 1246; Siems and Schnyder, 2014, pp. 379–382). Especially the German Finance Ministry has a long tradition of ordoliberal ideas which have acquired the status of internalised beliefs (Nedergaard and Snaith, 2015; Bulmer, 2014, p. 1257; Kaltenthaler, 2002, p. 72).

These considerations allow us to derive the following hypothesis about domestic preference formation.

H3: The preferences of the German government follow ordoliberal ideas.

If the German government's preferences follow ordoliberal ideas, we would expect it to prefer aligning responsibility and liability on the national level. In principle, responsibility and liability can also be aligned on the supranational level. However, this would require that there is no possibility of joint funds (joint liability) being used to compensate for national policy failures (national responsibility). To make the case for a more supranational banking union from an ordoliberal perspective, the pooling of responsibility would have to go far beyond joint supervision and require a political union, which continued to be out of sight during the banking union negotiations. Therefore, we would expect the government to advocate a strictly limited scope, a network of national funds with no or only very limited cross-national liability, and national vetoes in the SRM decision-making as safeguard against joint liability. The government would also advocate strong and automatic bail-in rules in order to shift resolution costs from taxpayers to banks as another measure to align responsibility and liability. An ordoliberal banking union would stabilise EMU and put an end to bank bail-outs financed by the taxpayer to an extent that would be impossible in a purely national context, all the while keeping national governments liable for their banking sector.

Another stream in the literature emphasises the strategic use of ideas in negotiations. According to the concept of ‘rhetorical action’ (Schimmelfennig, 2001, pp. 62–66), an actor’s goals have to meet the standard of legitimacy in a political community. Actors are able to enhance their bargaining power by adding (cheap) legitimacy to their position or constrain the negotiation position of other actors by defining ‘no go’ areas of illegitimate behaviour (Schimmelfennig, 2001, p. 63; Jabko, 2006, pp. 5–8).

An idea which the German government professes to share is that of the vicious circle between banks and sovereigns. The concept describes the ‘deadly embrace’ (De Grauwe, 2013a, p. 3) between sovereigns and banks. When states provided financial support to banks, they increased their own indebtedness. This in turn devalued sovereign bonds mainly held by banks. When banks requested another bail-out, they triggered the vicious circle again. ‘If one of the two falls off the cliff the other one is pulled down also’ (De Grauwe, 2013a, p. 3). The vicious circle is also closely intertwined with an increasing financial fragmentation in the eurozone and resulting difficulties for the ECB to transmit its monetary policy. The vicious circle idea suggests (at least some) shared liability for bank failures. However, this runs counter to preferences held by the German government. It has consistently opposed mutualisation during the eurozone crisis (Epstein and Rhodes, 2014, p. 23). Yet, it had previously acknowledged the existence of the vicious circle (Merkel, 2012) and therefore could not credibly argue against its solution. The Euro Summit in June 2012 explicitly linked the creation of the banking union with the aim to break the vicious circle between banks and sovereigns (Euro Summit, 2012). Negotiators of the SSM and SRM described the role of these Euro Summit Conclusions in the negotiations as ‘words of God’ and ‘bible’⁵; all negotiators in the Council were bound by the commitment of the heads of state or government to break the bank sovereign link. If the vicious circle was used to rhetorically entrap the German government, we would expect the banking union negotiations to entail significant concessions on behalf of the German side.

Against this background, we hypothesise the outcome of the interstate bargaining as follows:

H4: German concessions on significant aspects of the banking union exceed the side payments that the material bargaining power of the Southern coalition could extract if the latter can justify its demands with reference to ideas that the German government professes to share.

⁵ Two interviews in the Spanish Treasury, 23 September and 15 October 2015.

For this hypothesis to be supported, we would expect the outcome of the negotiations to reflect concerns about the banking union's capacity to break the vicious circle as a salient standard of legitimacy. The institutional design regarding scope would ensure an effective banking supervision with uniform supervision rules. The bail-in provisions would be weaker and provide for some discretion in order to reduce the burden on banks that would cause further fragmentation of the financial market. There would be a joint fund for bank resolutions and the SRM decision-making procedures would allow for a timely decision to be reached over a weekend.

Domestic preference formation: the impact of ordoliberal ideas

Do ordoliberal ideas explain German preferences? Regarding the scope of the banking union, the German government's *quid pro quo* for a sharing of liabilities was tighter control of national banking systems. It was in doubt about the effectiveness of direct ECB supervision for all 6.000 banks in the eurozone – a doubt which could be dismissed as purely tactical, but which was indeed acknowledged by the ECB as well (Financial Times, 2012a; Schäuble, 2012a). It considered ECB oversight over banks with systemic importance the most effective policy to ensure effective control over critical parts of the banking system. The German Finance Minister Schäuble: 'It is crucial that the new system be truly effective, not just a façade. (...) This also means that it should focus its direct oversight on those banks that can pose a systemic risk at a European level' (Schäuble, 2012b). The ordoliberal core claim to ensure responsibility and liability resonates with the government's preference for an effective system prioritising banks with systemic importance. There were also more general doubts if ECB supervision is indeed desirable for small locally operating banks. The current German banking system with a high number of small savings banks 'is widely seen as having been a key ingredient of the post-war German economic success story' (Hardie and Howarth, 2013, p. 118) and indispensable for maintaining Germany's economic model (Bonatti and Fracasso, 2013, p. 1028; Hardie and Howarth, 2013, pp. 103, 108). However, there is not necessarily a clear-cut economic rationale to favour public over private banks (IMF, 2013). Hardie and Macartney (2016) further underline that while public banks heavily draw on their social utility rhetorically, there is little evidence that it is nearly as high as they claim (see also Cassell, 2016; Véron, 2011, pp. 4-5). Yet, the concern that the country's economic structure could be negatively affected by the banking union plans did not resonate with internalised beliefs about the utility of the German banking system and also influenced the government's preferences (Schäuble, 2012c; Financial Times, 2012b).

Secondly, we observe a match between the German government's advocacy for strong and automatic bail-in rules with the implications of ordoliberal ideas. In contrast to bail-outs, bail-ins increase the liability of investors for their investment decisions and reduce moral hazard in the financial sector. It also reduces moral hazard on the interstate level: strong and automatically applied bail-in rules make it less likely that pooled resources are needed to cover the resolution costs of failing banks in other member states (Siems and Schnyder, 2014, pp. 365–368; see also European Central Bank, 2013a). It realigns responsibility and liability, which is also reflected in the discourse of Finance Minister Schäuble: 'We now have European-wide bail-in rules and a resolution fund financed by banks. Both measures are reasonable from an ordoliberal point of view' (Schäuble, 2014a). Furthermore, '[t]he best way to break the link between banks and states is to ensure that enrolling taxpayers to rescue banks becomes the exception rather than the rule' (Schäuble, 2013). The ordoliberal preference for realigning responsibility and liability coincides in this case also with the taxpayers' interests to shift resolution costs from the public purse to the banking sector.

The impact of ordoliberal ideas is also evident in the third case, the Single Resolution Fund. The German government resisted a joint fund because a fully mutualised SRF would be prone to triggering moral hazard. Member states with lenient banking supervision prior to the crisis could effectively be rewarded for their policy failures with access to joint funds (Siems and Schnyder, 2014, p. 385). While a joint fund would create a joint liability for bank failures, member state governments would still have significant national responsibility for their banking sectors. Schäuble again stressed realigning responsibility and liability: 'We made sure that we do not set the wrong incentives in the creation of the banking union and the bailout funds. We said we have to restore the old principle: Who gets the opportunity also has to take the risk (...). This principle is also valid for banking regulation. This, ladies and gentlemen, is ordoliberalism' (Schäuble, 2014b). However, an outright rejection of the fund became indefensible because of the German government's isolation. Schäuble thus agreed to a joint fund, but ensured a compromise on ordoliberal terms: several safeguards, such as the separation into national compartments and the eight years mutualisation period, seek to minimise the risk of moral hazard: 'As a member of the German government I can ensure that the German banks contribute to the funds. I cannot be held responsible for Danish or Italian banks. (...) Therefore: as long as the contributions are not paid in, the liability remains with the member states' (Schäuble, 2014b). The German government's opposition to a joint fund was motivated by its concerns with moral hazard and, more precisely, a mismatch between responsibility and liability, as suggested by ordoliberal ideas.

Lastly, ordoliberal ideas account for the government's reluctance to allocate decision-making powers to the European Commission. The government was again concerned with aligning responsibility and liability. Even after handing over supervision powers to the European level, the health of banks still depends critically on the policies of national governments. Hence, if a government wants to prevent the use of joint funds (joint liability) for national policy failures (national responsibility) it requires veto rights in the decision-making procedure. This was particularly important as some member states sought using the fund for retrospective bank recapitalisations (Howarth and Quaglia, 2013, p. 112). Schäuble stated: 'We do not want Europe to decide and member states to pay. Liability and responsibility must be aligned' (Der Spiegel, 2013). While joint supervision pools responsibility to a significant extent, it falls short of a full sharing of responsibility in a political union; against this background, ordoliberal ideas help explain the preference for national veto rights through an involvement of the Council, serving as safeguards against a disproportionate sharing of liability.

We see across all four issues that the German government's preferences match the observable implications of the ideational approach. The ordoliberal core claim to align responsibility and liability guides German preferences. Overall, this is strong evidence for hypothesis 3.

Interstate negotiations: breaking the vicious circle as standard of legitimacy

This section tests if ideas can solve the puzzle for power-based approaches of German concessions in the interstate negotiations on banking union. As we will see, drawing on the joint objective of breaking the vicious circle was a powerful tool to extract concessions from the German negotiators. The government had previously committed to this joint objective and this became a rhetorical trap; the need for argumentative consistency made the government vulnerable towards demands for an institutional design of the banking union which ensures its capacity to effectively break the vicious circle. Regarding negotiations on the scope of the banking union, a division in the German government facilitated creating a rhetorical trap. Whereas Finance Minister Schäuble had already rejected subordinating all banks to a joint supervisory scheme in the ECOFIN meeting prior to the Euro Summit in June 2012, Chancellor Merkel agreed – albeit reluctantly – to a 'single' supervisory system (Euro Summit, 2012, p. 1). This summit statement was commonly interpreted as implying that no banks could be effectively excluded. Schäuble openly questioned this commitment and pushed back on this issue in the negotiations (Schäuble, 2012a; see also Epstein and Rhodes, 2014, p. 17). The Southern coalition reminded Schäuble of Merkel's commitment in the Euro Summit Conclusions: 'We have no mandate for a dual system of supervision, which would call into question the existence of a single

system for some banks' (Moscovici, cit. in Reuters, 2012). The Irish finance minister Noonan recalled that '[t]he single supervisor is the core element of banking union and a vital step in breaking the vicious link between the banks and the sovereigns' (Financial Times, 2013c). Moscovici emphasised the fundamental importance of having some kind of centralised supervision for all banks: 'In the end it must be the ECB that has the responsibility on the whole. Otherwise, there is no real system of banking supervision.' (EU Observer, 2012). The ECB also framed a scope encompassing all banks as constituting a pre-condition for an effective banking union (European Central Bank, 2013b). Reminding the German government that it acknowledged the goal to break the vicious circle made use of a rhetorical trap and pressured it towards making a concession on the emergency clause.

We see a similar mechanism at work when explaining the German government's concessions regarding bail-in rules. In the current situation, strict bail-in provisions were expected to have a detrimental effect on Southern European economies because of an increased burden on banks and a higher risk of contagion leading further financial fragmentation (De Grauwe, 2013b). According to Moscovici, 'Banking union means putting an end to the financial fragmentation of Europe' (Moscovici, 2013). The Italian Finance Minister Saccomanni reminded Schäuble of the importance of the banking union to measuring up to these expectations: 'All the finance ministers agreed that an important step to reactivate financing activity on markets is the completion of the banking union project' (cit. in Reuters, 2013a). Again, the German government's previous commitment to the goal of breaking the vicious circle made it vulnerable and weakened its ability to insist on strict bail-in rules without appearing inconsistent.

Thirdly, while all member states had vowed to the objective of breaking the vicious circle, reaching this goal without any mutualisation and risk-sharing was largely unrealistic. Confronted with the German government's continued opposition to a joint resolution fund, the Southern coalition started to question the government's commitment to this shared objective. The Italian Finance Minister Saccomanni stated: 'I am also confident that we also share a common goal, which is precisely the one for which the Member States have decided to set up the Banking Union: to break the nexus between banking and sovereign risks and restore the orderly functioning of the Single Market for financial services. In order to break the nexus I recalled, we have to establish a system which is effective (...). It has to rely on common financial resources' (Saccomanni, 2013, p. 1). The ECB argued: 'By pooling resources, the [SRF] will be able to protect taxpayers more effectively than under national arrangements, and thus break the adverse nexus between banks and their respective sovereigns' (European Central Bank, 2013b, p. 8). This

standard of legitimacy significantly constrained the German government's bargaining power on a key aspect of the banking union. The German government's long-held normative commitment to multilateral solutions, which, however, seems hardly reconcilable with the German government being isolated (Bulmer, 2014, pp. 1248–1250), increased its vulnerability to manipulations of the standard of legitimacy. Even though Germany successfully attached strings to the funds, the Southern coalition reached their priority objective by appealing to a shared normative standard.

Fourthly, the German government's insistence on a fuller involvement of the Council would have rendered decision-making complicated and questioned the banking union's effectiveness. The Commissioner responsible, Michel Barnier, criticised the procedure as 'too complex' (Financial Times, 2013d). The Irish Finance Minister Noonan was sceptical about its effectiveness: 'In resolving a bank, one would want to be able to do it over a single weekend at the maximum. So anything that is too cumbersome, with various layers to it, won't be effective' (Reuters, 2013b). According to Mario Draghi, '[e]verybody knows that these decisions must be taken instantly (...). We can't have hundreds of people debating whether a bank is viable or not' (cit. in EU Observer, 2013). Likewise, Italian finance minister Saccomanni stated: 'A credible SRM is first of all a system that is actually able to make quick decisions and to swiftly manage any resolution procedure' (Saccomanni, 2013, p. 1). Once again, the isolated German government was vulnerable towards these demands. In order to maintain argumentative consistency with its commitment to break the vicious circle, the German government was forced to make concessions.

Across all four issues, the same pattern is evident: The German government's preferences were putting at risk the banking union's capacity to break the vicious circle between banks and sovereigns. Yet, the heads of state or government had previously agreed on this goal. Consequently, despite strong power asymmetries the German government was vulnerable towards demands to agree to an effective banking union as this corresponded to the standard of legitimacy among negotiators. We conclude on strong evidence for hypothesis 4.

Conclusion

This article's analysis of the banking union negotiations has identified key shortcomings in the ability of approaches based on material interests and bargaining power to explain the agreement on a banking union in Europe. It suggests instead that an ideational frame can fill these gaps both with regard to national preference formation and interstate bargaining.

The following two tables conclude the above analysis by comparing the observable implications of each hypothesis with the preferences of the German government (table 5) and the outcome of the banking union negotiations (table 6).

Table 5: Observable implications of each hypothesis for preference formation, in relation to the German government's preferences

	H1a: Public Banks	H1b: Private Banks	H1c: Compromise banking sector	H3: Ordoliberal ideas	Preference of German government
1: Scope	Limited	All-encompassing	Moderate scope: Excluding <i>Sparkassen</i> , including <i>Landesbanken</i>	Limited	Limited
2: Bail-In	Weak and non-automatic bail-in	Strong bail-ins, but with discretion	Moderate bail-in	Strong and automatic bail-in	Strong and automatic bail-in
3: SRF	National funds	Joint fund	National funds with some joint liabilities or joint fund with significant safeguards	National funds	National funds
4: SRM Decision-Making	Effective	Effective	Effective	National vetoes	National vetoes

Table 6: Observable implications of each hypothesis for interstate bargaining, in relation to the outcome

	H2: Power (German preference)	H4: Ideas (vicious circle)	Outcome
1: Scope	Limited	Joint supervision for all banks (to reach critical scope of BU)	Limited scope, but ECB intervention clause
2: Bail-In	Strong and automatic bail-in	Weak bail-in (to reduce burden on strained banks) with significant discretion (to prevent systemic crises)	Moderate bail-in with some discretion
3: SRF	National funds	Joint fund (to separate banks and sovereigns)	Joint fund (55bn €)
4: SRM Decision-Making	National vetoes	Decision-making possible over a weekend (for effective BU)	Streamlined (albeit complex) decision-making with very limited MS veto rights

In contrast to H1a, H1b and H1c, explaining the preferences of the German government with the interests of the most powerful domestic interest group produces unsatisfactory results. While the public banks' preferences could explain the government's preferences regarding scope and

SRF, they fail to account for the bail-in rules and the SRM decision-making. The private banks match the government's preference only regarding bail-in rules, but not at the other three issues. The compromise hypothesis is disconfirmed across all four issues. The producers' preferences match those of the government only as far as the scope is concerned. Remarkably, all interest groups fail to account for the SRM decision-making. This leads us to conclude that material interests cannot account convincingly for German preferences in the banking union negotiations. This case presents strong evidence against the hypotheses H1a, H1b, and H1c.

To confirm fully the liberal intergovernmentalist hypothesis H2, the outcome of the negotiations would have to follow the German government's preferences, owing to its material bargaining power and low preference intensity. While liberal intergovernmentalism accounts for the centrality of the German government in the negotiations, it is also evident across all four cases that the government made significant concessions. It 'failed to prevent agreement on the critical components of the banking union' (Epstein and Rhodes, 2014, p. 23). These concessions go beyond what could be interpreted as strategic concessions and cheap side-payments. The outcome disconfirms hypothesis H2.

Ideas do explain what interest-based accounts cannot explain. The German government's preferences match the observable implications of the ordoliberal paradigm on all four contentious issues. Key principles of ordoliberalism, such as aligning responsibility and liability influenced German positions on the scope, bail-in, SRF and the SRM decision-making procedure. The preferences of the German government support hypothesis H3.

The strategic use of the idea of a vicious circle between banks and sovereigns persuasively explains how the German government was forced into concessions on key aspects of the banking union. Its power in the negotiations stems from a recognition by the German government (Merkel, 2012; Schäuble, 2013), affirmed not least in statements of the Euro Summit (Euro Summit, 2012, p. 1) or the European Council (European Council, 2012, p. 8). The Southern coalition successfully relied on this idea as a shared standard of legitimacy that the negotiations needed to adhere to. It prescribed an institutional design of the banking union running counter to German preferences. There is evidence across all four cases that manipulating the standard of legitimacy to include breaking the vicious circle shifted the outcome in a direction that makes it more likely for the banking union to ultimately break the said circle. This lends support to hypothesis H4.

While there is strong evidence for an impact of ideas, this article acknowledges parallel drivers. There are occasional matches between the observable implications of ideas and some material interests, something that is almost unavoidable in cases with large diversity of preferences. As the

government neither consistently followed the public nor the private banks nor a compromise, these occasional matches appear random; this weakens a material interest explanation significantly. Nevertheless, it cannot be fully excluded that matching material interests influenced the government to some extent as well.

Ordoliberalism's focus on 'put-your-own-house-in-order-strategies' and preventing moral hazard is occasionally aligned with the interests of the German taxpayer. Does this mean ordoliberal ideas are merely camouflage for taxpayers' powerful material interests? A taxpayer account indeed has some explanatory power. For instance, the taxpayers' interest in making banks and not taxpayers liable for bank failures is an obvious parallel driver for the German preference for bail-ins. It potentially also explains why the Single Resolution Fund is funded by banks and not out of government coffers (even though this was no contentious issue). On the flipside, it is difficult to explain German preferences in their entirety with the interests of taxpayers since they do not speak to all of the four issues. The most contentious question of the SRM negotiations was whether there should be a joint resolution fund or a network of national funds, but all parties agreed early on that any fund would be financed by banks. As no taxpayers' money was to be involved, we would expect taxpayers to be rather indifferent towards this issue. Likewise, it is difficult to identify the taxpayer as the critical motivator behind the German preference for a limited scope as well as a Council involvement in bank resolution decision-making, especially as the funds used for bank restructuring are not tax money, but contributions from banks. In sum, the taxpayer account is useful for some aspects of the negotiations, but suffers from severe limitations. Ordoliberal ideas give a more complete and convincing picture. Overall, this article provides further evidence for ideas as long-standing features in EMU negotiations from Maastricht (Jabko, 2006; McNamara, 1998; Dyson and Featherstone, 1999) up until crisis management (Bonatti and Fracasso, 2013; Siems and Schnyder, 2014). Both their constitutive and strategic-manipulative roles in the banking union negotiations are only the most recent cases manifesting their impact. These results suggest that ideational paradigms will remain crucial for understanding the governance of the economic and monetary union.

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