Germany, the Eurozone crisis and the Covid-19 pandemic: Failing forward or moving on?

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Abstract
This article explores continuity and change in Germany’s policy towards economic and monetary integration, comparing its approach to the Eurozone crisis with its response to the economic challenges of the Covid-19 pandemic. As the largest EU member state with significant macroeconomic relevance for the whole of the Eurozone, Germany presents a critical case during both episodes. The article adopts an historical institutionalist approach to exploring policy evolution, identifying the key interests and ideas that have driven German policy. The analysis is based on the ‘failing forward’ argument, applied to German domestic politics. German policy has evolved through an incremental layering process that both facilitated and constrained the architecture of the Eurozone. The Franco-German proposal for a reconstruction fund in May 2020 seemed to conflict with a long-standing German opposition to mutualising debt. The article argues that it in fact represented a further stage in the process (layering and conversion) rather than a critical juncture or paradigm change in policy. However, the resultant Recovery and Resilience Facility may prove to be another incomplete policy response due to the deepening consequences of the pandemic and the interventions of Germany’s Federal Constitutional Court.

Keywords Economic and monetary union · Germany · Eurozone crisis · Covid-19 · Historical institutionalism

Introduction

Germany is a critical case for examining continuity and change in Eurozone policy over the period from the Great Recession to the Covid-19 pandemic. Its economic weight, export strength and production chains place it at the heart of both the Eurozone and the wider EU economies. Germany’s European policy has been especially
important to monetary and fiscal integration—the focus of this paper. Support for integration has been strongly conditional on its character being consistent with domestic fiscal ‘stability culture’.

The German government’s response to the Covid-19 pandemic appeared to take a new direction. The May 2020 Franco-German proposal for a €500 bn recovery programme seemingly crossed fiscal policy principles deemed inviolable during the Eurozone crisis. Earlier opposition to a ‘transfer union’ gave way to advocating EU-wide solidarity against the economic consequences of the pandemic, debt financing and support for grants to member states. It was Germany’s change of policy that altered the dynamics of policy-making within the EU, enabling agreement.

This apparent policy shift is the focus of this article. I explore how and why the German government apparently departed from its sound money policy trajectory to advocate, with France, a more solidaristic approach in response to the Covid-19 pandemic? More speculatively, was this move a one-off or part of a move to a new direction in EU economic policy?

The article is structured as follows. First, I set out the historical institutionalist toolkit for exploring policy continuity and change. Secondly, I place Germany’s policy regarding the two crises in the longer-term context of its enmeshment in the EU and its political economy. Thirdly, I offer an account of German policy in relation to the Eurozone crisis and the reform of fiscal governance. Fourthly, I turn to examining the explanations for the launch of the Franco-German initiative on European recovery, and whether it can be seen as a significant change to Germany’s long-term policy at EU level. Finally, I conclude.

I argue in the paper that Germany did not launch the initiative as part of a paradigm change, but rather as a form of ‘conversion’: repurposing policy instruments that might set in train a new policy logic or have unintended consequences. In developing this interpretation, I use a combination of the ‘failing forward’ argument (see Jones et al. 2016), but with German domestic politics as the level of analysis. I argue that domestic political constraints have resulted in Germany shaping intergovernmental agreements on fiscal, economic and monetary policy that have offered incomplete policy solutions (below). In pursuing this argument, I widen the domestic politics lens beyond ‘audience costs’—a focus on public opinion—as deployed elsewhere (see Howarth and Schild 2021; Schoeller and Karlsson 2021), to include the important role of the German Federal Constitutional Court (Bundesverfassungsgericht, BVerfG).

The paper is based on a diachronic analysis of Germany’s role in European monetary integration. It deploys process-tracing methods using primary and secondary literature, supported by interviews undertaken in the federal government in 2014 relating to the Eurozone crisis and more recent ones with the wider policy community.

Analytical framework: historical institutionalism

In exploring the contrasting German policy response to crises, the key concerns are with policy continuity and change. I turn to historical institutionalism (HI) to structure the analysis (Pierson 2004; Thelen 2004). Attentive to temporality, HI seems
well suited to examining the policy issues at hand. The basic assumption of HI is that patterns of policy evolution are normally slow-moving and incremental. Institutional arrangements and policy typically become increasingly embedded, as positive feedback and increasing returns accumulate (Pierson 2004: pp. 17–53). However, HI is not as crudely deterministic as that implies, for it has the scope to incorporate significant change through ‘critical junctures’ (Collier and Collier 1991; for a review, Capoccia and Kelemen 2007).

Thelen (2004: pp. 35–6) and Streeck and Thelen (2005) offered a different emphasis in considering the dynamics of time, underlining the greater frequency of gradual transformative change rather than big shocks that imply discontinuity. They identified five forms of change: displacement, layering, drift, conversion and exhaustion (see Box 1, adapted from Streeck and Thelen 2005: pp. 19–30). It is important to note the EU’s pattern of multi-level governance in accounting for change, for change in a large member state like Germany would likely have repercussions at EU level.

As is well recognised, institutionalism risks an overly structural account of politics, so it is important to be alert to this risk by explicitly considering agency. The EU’s economic and monetary rules have been subject to abundant political debate since the issue came on the political agenda in 1969: over broad principles, rules and the specifics of their application. The dynamics have been endogenous within the EU but also shaped by external crises, notably the global financial crisis and the Covid-19 pandemic. The front-line protagonists providing agency are the member governments, but domestic political parties, public opinion, economic and financial interests, and—specific to Germany, the BVerfG—lie behind those governmental positions. Key vectors in EU debates have been different states’ approaches to political economy.

A final consideration when exploring policy dynamics between Germany and the EU is the idea of politics as a timescape. Goetz and Meyer-Sahling (2009) understood a timescape as the manner in which time is institutionalised in a political system along the polity, politics and policy dimensions (Bulmer 2009). Debates on EMU have been part of broader EU treaty reform, notably in the Maastricht Treaty, but also confined to more routine policy-making at the meso level. Exploring EMU as a timescape therefore requires attention to such different scales of policy-making. Further, as a multi-level polity the EU enmeshes with electoral cycles at the member-state level. For example, the German Council presidency, the declining fortunes of the Social Democrats within the 2018–21 Grand Coalition and the scheduled end of the Merkel chancellorship contributed to different dynamics in Germany’s relationship to the EU in 2020 compared with a decade earlier.

Applying the HI toolkit, I first explore the timescape of economic and monetary integration. When economic and monetary integration came onto the European agenda from 1969 fundamental division emerged between those states led by Germany that insisted on economic convergence as a precondition for monetary integration (so-called economists) and ‘monetarists’, led by France, who advocated early monetary integration to induce economic convergence. Over the last 50 years, contestation has recurred intermittently between German and French positions over the
political economy of EMU (Dyson and Featherstone 1999; Krotz and Schild 2013: pp. 183–211; Schild 2020a).

Links with a supranational budget have only been intermittent. In the first debates on Economic and Monetary Union (EMU), the MacDougall Report recommended the European Community moving towards fiscal federalism, with a central budget representing some 5–7 per cent of GDP (Commission of the European Communities 1977: p. 11). These recommendations were never realised and played no role in the Maastricht design of EMU. In more recent times, however, a Eurozone budget has been advocated by France in particular, although Germany and the Netherlands showed reluctance on this before the pandemic struck. The new EU Recovery and Resilience Facility (RRF) gave the policy timescape a different profile or ‘frame’ compared to during the Eurozone crisis because the prospect of collective borrowing shifted from the debate about Eurobonds/Eurozone to a special recovery fund linked to the Multiannual Financial Framework (MFF) negotiations (see Laffan and Lindner 2020: pp. 224–228).

The second step is to adapt the work of Jones, Keleman and Meunier relating to ‘failing forward’ (Jones et al. 2016). Their argument about the Euro crisis is that governments have repeatedly created incomplete solutions to policy. Intergovernmental compromises have come at the cost of incomplete contracts. However, ‘Eurozone member-state governments see the survival of the Euro as crucial to the survival of the EU as a whole’ (Jones et al. 2016: p. 1016). This situation reflects the embeddedness of the Eurozone over time, the accumulation of positive feedback and increasing returns (in line with Pierson’s analysis (2004: pp. 17–53). Hence, further integration became necessary to stabilise the existing system, creating a spillover logic associated with neo-functionalism. Failing forward was preferred to allowing the Eurozone system to fail altogether.

Jones et al. (2016) focus on the EU level of analysis. The third step that I take, by contrast, is to move down a level to examine the policy of Germany and how it is embedded in a set of domestic policy interests, ideas and institutions. As one of the key shapers of economic and monetary integration, I argue that Germany’s policy direction has been a significant contributor to the pattern of ‘failing forward’, because it has only supported gradual transformative change, such as layering or drift.

**Box 1: Forms of gradual transformative change**

*Displacement* pre-existing institutions or regime are pushed aside in favour of an alternative form. Actors would need to switch position, although given that the EU is an amalgam of different member-state logics, the changeover could come about through a new compromise, rebalancing government positions.

*Layering* the EU’s need for intergovernmental agreement (unanimity) on major-order decisions tends to instil vested interests in policy regimes, making it difficult to undertake fundamental change. Hence, the EU may have to work
around what cannot be changed through layering. However, the layering may set in train new logics and dynamics that eventually become more fundamental.

*Drift* policy appears to be stable but beneath the surface is becoming more and more (or, in a crisis, suddenly) inappropriate, creating a disconnect between the policy solution and the problem. The EU is arguably especially susceptible to drift because there may be intergovernmental deadlock preventing policy change until political actors simply have to recognise changing circumstances.

*Conversion* institutions are directed to new goals or purposes as new actors come in and see how the institutions can serve their goals. Political actors may also exploit unintended consequences arising from the design of a policy regime.

*Exhaustion* policy may eventually sow the seeds of its own destruction.

**Background: Germany’s ‘sound money’ approach**

Germany’s role in confronting the Great Recession, the Eurozone crisis and the Covid-19 pandemic necessitates a look back into some of the defining features of the Berlin Republic. Two fundamental principles established in the early years of the Federal Republic were its adherence to a social market economy imbued with a fiscal stability culture; and the new state’s political and economic integration into European integration and the Atlantic Alliance (Bulmer and Paterson 2019: pp. 21–52). German preferences on European economic and monetary integration entailed drawing a balance between these principles.

The social market economy was influenced by the ideas of ordo-liberalism, based on the Freiburg School, and with characteristics that distinguish it from neo-liberalism and Keynesianism (Hagemann 2017). The distinctive form of market capitalism drew from the negative lessons of Germany’s hyper-inflation of the early-1920s but much less on the unemployment of 1931–33 that had helped the Nazi seizure of power. This selective learning established the roots of Germany’s conservative approach to debt (Dyson 2014: pp. 264–266): its ‘stability culture’ or ‘sound money’ policy (Howarth and Rommerskirchen 2013). European market integration provided a major platform for the development of West Germany’s successful manufacturing trade and emergence as an ‘extraordinary trader’ (Hager 1980), with periods of substantial trade surpluses.

The character of the German political economy evolved over the subsequent period enormously, including with the changes wrought by German unification in 1990. In 1999, Germany was termed ‘the sick man of the Euro’ due to weak growth, stubborn unemployment and the economic consequences of unification (The Economist 1999). For a variety of reasons, the economy subsequently rebounded (Dustmann et al. 2014; Audretsch and Lehmann 2016). By the 2010s, it was running a significant export surplus helped by an ‘over-sized’ manufacturing sector built on production chains integrated across the EU. Its public finances by the time of the Eurozone crisis reflected a comparatively good performance in EU terms on public debt and deficit, although considered too high by German standards (Streeck 2009).
From a left-critical perspective, these foundations led Germany to assume a ‘hegemonic ascendancy’ in the EU arising from: the economic strength of German capital, supported by the suppression of labour costs; the development of core-periphery relationships in the EU; and the assumption by France and the UK of a disproportionate share of Europe’s foreign and defence policy costs (Lapavitsas 2019: p. 21). Support for this evaluation can be found in two economic reports from more mainstream German sources. The first identified Germany as the biggest beneficiary of the single market over the period 1992–2012, in terms of aggregate or per capita GDP gain in income (Bertelsmann Stiftung 2014: pp. 29–30). A report on twenty years of the Euro (1999–2019) came to the remarkable headline finding that ‘Germany has gained by far the most from the introduction of the Euro; almost €1.9 trillion between 1999 and 2017. This amounts to around €23,000 per inhabitant’. Interestingly, it found the benefits to be especially pronounced from 2011, after the Eurozone crisis broke (Gasparotti und Kullas 2019: p. 7). For the sake of balance, Germany has also been the major contributor to financial transfers, via the EU budget, financial assistance institutions (including the Eurozone rescue funds) and the European Investment Bank (Kullas et al. 2019): a sum of €137.7 bn over the shorter period of 2008–17.

Whilst there can be little doubt that Germany is the EU’s/Eurozone’s economic powerhouse, its diplomatic behaviour revealed only limited evidence of acting as a hegemon (Paterson 2011; Matthijs 2016; Schil 2020b; Bulmer and Paterson 2019: pp. 167–200; Webber 2019: pp. 51–53). Germany’s commitment to European integration remained part of its raison d’état (Staatsräson). Whilst the European policy of Chancellor Merkel (2005–2021) was characterised by pragmatism and an intergovernmental approach1, a strong preference for multilateral policy action remained.

German policy in the period prior to the Eurozone crisis was guided by clear conditionalities to balance out the principles of sound money and support for integration. They applied during the pro-integrationist chancellorship of Helmut Kohl (1982–1998) during the design of the Maastricht model of monetary union. Amongst the conditions insisted on by the German government and/or the Bundesbank were a commitment to independent central banking along the lines of the German Bundesbank; the primacy of price stability in the mandate of the European Central Bank (ECB); economic convergence prior to taking the final step to a single currency; rejection of common liability (the ‘no bail-out’ clause, Article 125 TFEU); the prohibition of monetary financing of states’ public debt (Article 123 TFEU); and a fiscal discipline system that afforded as little as possible political discretion (Dyson and Featherstone 1996; Issing 2008; Krotz and Schild 2013: pp. 194–199; Bulmer and Paterson 2019: pp. 172–173).2

1 Merkel’s intergovernmental approach (‘the union method’) had been spelt out in her speech at the College of Europe, Bruges on 2 November 2010.

2 Further supporting evidence of the concrete impact of German policy in line with these principles is to be found in Dyson and Featherstone (1999: Chapter 9), while insightful testimony from key German policy-makers on negotiating conditionalities is to be found in Waigel (1997).
The stipulations crystallised two German policy objectives: to embed its stability culture in the Eurozone system; and to avoid exposure to financial liability. These goals also served to maximise the chances of the single currency being as stable as the Deutsche Mark, ‘to reassure a sceptical public opinion at home that the single currency would be at least as strong as the D-Mark’ (Dyson and Featherstone 1999: p. 431; see also Schoeller and Karlsson 2021).

It was the German Finance Minister, Theo Waigel, who pressed for a Stability Pact to ensure Eurozone member states would respect the rules once EMU was operationalised. The negotiation of what became the 1997 Stability and Growth Pact saw the German government further try to limit political discretion in response to continuing concerns from the Bundesbank and domestic public opinion (Heipertz and Verdun 2004: p. 768).

When the Eurozone crisis hit as a consequence of major external shock (the global financial crisis) and member states not adhering to the rules, EMU’s lack of resilience became clear. For instance, the absence of common liability and prohibition of monetary financing to tackle the crisis bore a strong German imprint. Thus, reforms were needed to address design failings and lack of resilience that had reflected German preferences.

Germany’s economic policy practice also contributed to the lack of resilience, namely when it breached the EDP and obstructed the Commission’s attempt in November 2003 to enforce sanctions. Germany’s federal budget deficit had grown due to a period of low growth and the costs of unification. The government, by now a Red-Green coalition led by social-democratic Gerhard Schröder, had adopted a more intergovernmental approach to the EU (Jeffrey and Hyde-Price 2001). Refusal to submit to the EDP was arguably the main manifestation of this position. As Hellmann put it (2006: p. 175), ‘… driven by domestic political interests, the government chose to pursue narrowly defined national interests’. The French government, which had been a long-standing critic of the rules, happily joined with Germany to construct a blocking minority in the Council of Economics and Finance Ministers (Heipertz and Verdun 2005: p. 991). In 2005, the rules of the SGP were relaxed. Having pressed for the SGP as part of rule-based fiscal discipline, Germany was amongst the first to face the sanctioning procedure but blocked that and contributed to a relaxation of the SGP itself: weakening an already flawed regime (Tooze 2018: p. 101).

Germany and the Eurozone crisis: no to a ‘transfer union’

The global financial crisis did not at first impact the Eurozone as such. The direct consequences in Germany were instability in a small number of mainly state banks (Landesbanken). The slump in exports (down 18 per cent) hit the German economy hardest in 2009, triggering the deepest recession in the Federal Republic’s history (down 5 per cent) (Zohlnhöfer 2011). In response, the federal government, the first Christian Democrat-Social Democrat coalition under Chancellor Merkel, launched two Keynesian-inspired counter-cyclical packages amongst a range of unusually interventionist measures by German standards. They included tax cuts
and significant use of short-time labour arrangements (Kurzarbeit) covering up to 1.5 million workers. Clearly, a crisis could bring about a departure from sound money policy.

At the same time, however, Germany was introducing a ‘debt-brake’ system to block the growth of debt at all levels of government. The result of a longer-term commission and complex negotiations between the federal and state governments requiring a constitutional amendment, the system would take till the end of the 2010s to be fully effective. The federal structural deficit would be confined to 0.35 per cent of GDP. The transition to the new rules began at federal level in 2011 (Zohlnhöfer 2011). The juxtaposition of debt brake reforms with unprecedented interventionism made for a rather incoherent economic-policy mix in 2009.

The emergence of Greece’s debt and deficit problems at the start of the Eurozone crisis came on top of a period where unprecedented sums had been transferred from West Germany to eastern states (the new Länder) as a consequence of unification (Tooze 2018: pp. 97–98). The EU’s Agenda 2000 reforms had seen Germany as a major contributor to comparable transfers to Central and Eastern European (CEE) states. Little wonder, therefore, that the prospect of another ‘transfer union’ was unwelcome in Germany and defined the ensuing domestic debate. Chancellor Merkel’s attitude to the growing Greek fiscal problem over the period from late-2009 was that it was for Athens to resolve and that the rules had to be adhered to.

As in the negotiations leading to the creation of EMU, Germany’s Eurozone crisis policy was characterised by adherence to stability culture, requiring rescued states to put their finances in order on the basis of strict conditionality, and insisting on the necessary reforms shoring up the Eurozone institutions. Notably, these reforms followed the pre-existing logic and principles of EMU, over which Germany had been influential. The risk of moral hazard was invoked: states should not be seen to be rewarded if they have broken the rules, so strict conditions were needed to incentivise policy change.

The government followed the principle of ultima ratio: measures were to be taken at last resort. The rationale was to ensure Greece (and subsequent rescued states) made fundamental policy reform, thus meeting Berlin’s conditionality. Understandable as the insistence on stability culture was domestically, the policy was described as ‘Merkel’s folly’ (Jones 2010). Her initial failure to offer support to Greece allowed the financial markets’ concerns to build over time and then peak in May 2010, when Greece’s government needed to re-finance maturing bonds. At that point, the crisis became systemic, threatening both contagion and the potential stability of northern European banks that had lent to Greece.

Delay as a tactic had the likely disadvantage of placing policy-makers behind events in terms of response. Reluctance and hesitancy were consistent with the incomplete contracts that became evident during the crisis. A comprehensive solution would have required recapitalising European banks, for they were in the firing line; Eurobonds or some other treaty-consistent way of buying the debts of the weakest Eurozone states; asset purchasing by the European Central Bank; and fiscal rules

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3 Interview, Federal Finance Ministry, 13 November 2014.
to reassure the creditor states (Tooze 2018: p. 331). Marsh (2013: pp. 117–120) suggests that stability would also require measures to enable burden-sharing, revenue-raising and be overseen by a stronger political union. However, Germany’s approach to the Eurozone crisis was embedded in the logic of domestic fiscal policy debates. The narrative from Berlin was one of debtor states having to do their homework and put their house in order (see Matthijs and McNamara 2015). There was no sign of the Keynesian measures that had been deployed domestically in response to the global financial crisis. Thus, the measures taken entailed ‘failing forward’ in that the system was patched up for the medium term rather than comprehensively.

Jones et al. (2016) have argued that the crisis revealed fundamental failings in the Eurozone system, and the choice was to unwind or reform it. In choosing the latter, a significant deepening of integration occurred, albeit with further incomplete solutions. ‘Governments refuse to agree to domestically unpopular reforms until they are convinced by further eruptions of the crisis that it is absolutely necessary to do so …’ (Jones et al. 2016: p. 1016). Thus, incomplete structures arising from intergovernmental negotiations created functional spillovers that led to further crises (1017).

The first phase of the crisis (until Summer 2011) was characterised by hasty firefighting: the creation of the temporary and permanent rescue funds; the rescues of Greece, Ireland and Portugal. The German government blocked the use of Eurobonds to mutualise debt. When other states advocated the partnering of the single currency with the solidarity of common debt financing, Chancellor Merkel’s counter-argument was that the Euro needed partnering instead with a common economic policy (Kornelius 2013: p. 236). She insisted that the experience of the International Monetary Fund was needed in rescue arrangements. Germany was also important in the intergovernmental form taken by the rescue funds—the short-term European Financial Stability Fund and the later European Stability Mechanism. Established as bodies in international law rather than EU institutions, the risks were reduced of an adverse ruling on treaty compliance at the BVerfG.

Merkel and her government’s domestic considerations were parliament, the BVerfG, the public and, later on, the German Bundesbank. Parliamentarians wanted more voice and some successfully brought a case before the BVerfG that they had been given insufficient time to consider the Greek rescue. However, there was also the issue of maintaining the governing majority in parliament. FDP Eurosceptics forced a non-binding internal membership referendum, held in December 2011, on whether to support the ESM. Further, due to opposition or abstentions amongst its own deputies the government had to rely on support from pro-European opposition parties to secure a parliamentary majority in six votes (Wimmel 2013: p. 129). Public opinion opposed Eurobonds and supported fiscal constraints on debtors (Schoeller and Karlsson 2021: pp. 199–200).

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4 The extent to which German policy on the Eurozone was influenced by ordoliberalism is contested: see Nedergaard and Snaith (2015) and Hien and Joerges (2018) for starkly contrasting interpretations.

5 The ESM necessitated a revision to Article 136 of the Treaty on the Functioning of the EU in order to give proper constitutional authority in the face of the BVerfG.
The second phase from Summer 2011 entailed reform to the Eurozone architecture. In part driven by the Four Presidents’ Report, it saw the legislative reforms known as the Six-Pack (2011) and the Two-Pack (2013) that entrusted the Commission with fiscal oversight powers (see Hodgson 2020). The priority of the German government was to strengthen the fiscal rules of the Eurozone, and culminated in the Treaty on Stability, Coordination and Governance (or Fiscal Compact), agreed in December 2011 at the European Council. Member states had to introduce balanced-budget rules, resembling German domestic reforms. By this (‘Merkozy’) stage, President Sarkozy had reconciled himself to Germany policy, having earlier advocated Eurobonds. This phase included the July 2012 speech by ECB President, Mario Draghi, that promised the bank would ‘do whatever it takes’ to preserve the Euro that finally stabilised financial markets. That Bundesbank President Jens Weidmann opposed this decision inside the ECB positioned the Bundesbank as a critic of ‘unorthodox’ ECB monetary policy, encouraging legal challenges before the BVerfG. The ECB’s actions meantime took the heat off Council agreement on more comprehensive reform, thus facilitating ‘failing forward’.

Germany’s policy was of crucial importance to the way in which the Eurozone crisis was tackled. Policy was hesitant. It was firmly based around transferring domestic stability culture, including a rules-based approach, to the European level. Chancellor Merkel constructed the crisis as resulting from profligacy over debt. However, she also recognised the importance of EMU: ‘if the Euro fails, Europe fails’. With the support of northern European allies, and with debtor states facing serious financial uncertainty, the power asymmetries enabled this policy to hold sway. Veto power and the hegemonic ideas of stability culture resulted in austerity policy for the debtor states, although it was ultimately Draghi’s ‘whatever it takes’ that brought financial-market stability.

Amidst all this, it is important to remember the domestic political imperatives. History, as Timothy Garton Ash put it, was hanging on Angela Merkel but she had to deal with the ‘four big B’s’: the populist sentiment of Bild (Germany’s main tabloid) and the differing political shadows cast by the Bundestag, the BVerfG and the Bundesbank. The French government lacked influence, especially after its own debt rating was lowered, such that the traditional German and French camps were unevenly matched. Intertemporal bargains entailed the near-term crisis receiving all attention, while longer-term solutions made limited headway. That can was kicked down the road, in line with ‘failing forward’. Then, other crises seized the EU’s attention, notably Russian destabilisation of eastern Ukraine (2014–5) and the migration crisis (2015–16).

The overall character of German policy was layering: largely building on its pre-existing logic regarding EMU despite clear indications that the arrangements did not suit the economic model of all EU countries. Innovations like banking union followed the logic of blocking the risk of German financial liability, as elsewhere in the Eurozone architecture (see also Verdun 2015). There was very little recognition.

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6 When operationalised by the European Commission in the European Semester process, the German government came to consider that there was rather too much use of political discretion in applying the legislation, especially during the Jean-Claude Juncker’s Presidency from 2015 (Schmidt 2020: pp. 195–202).
in Germany that its trade surpluses were part of the problem; other states had to improve their competitiveness. Moreover, the solution served German trading interests well, reinforcing the policy trajectory (Gasparotti, Kullas 2019). However, the political divisions and adverse consequences for the EU’s legitimacy were serious, as were the economic consequences of austerity (Schmidt 2020; Crespy 2020).

The Covid-19 pandemic: a German policy change?

In the ensuing period, both the EU (through the Five Presidents’ Report) and President Macron had pushed for reforms to make EMU more sustainable. Macron had proposed the creation of a Eurozone budget (for details, see Howarth and Schild 2021: pp. 218–9). However, Germany was only prepared for it to be modestly funded rather than becoming a vehicle for macroeconomic stabilisation, resulting in no EU-level accord. Some of the hesitancy on the part of Merkel’s government came from its long-standing policy trajectory on EMU, but its own shaky political foundations played a significant role. It had taken nearly six months to form a renewed grand coalition of Christian and Social Democrats. Further, the Eurosceptic Alternative for Germany was the strongest opposition party. During this period, the Christian Democrats lost their way in finding a party leader to succeed Merkel, while the Social Democrats haemorrhaged votes to the Greens. The governing coalition lost momentum for a period: its policy on the Eurozone during this period corresponded to drift. Only the Eurogroup’s October 2019 agreement on the principles of a budgetary instrument for convergence and competitiveness (BICC) could be seen as German acceptance of further layering (Dias and Zoppè 2020).

The initial stages of the Covid-19 pandemic saw member states acting individually. An export ban by some states on personal protective equipment (PPE) while northern Italy was overrun by the pandemic in March 2020 was condemned for lack of solidarity (Hall et al. 2020). As the economic consequences worsened, the scale of interventions by member states quickly increased. However, states’ ability to do so depended on their pre-existing asymmetrical debt and deficit situations, including the after-effects of the Eurozone crisis. Concretely, Germany could afford far more costly interventions in its economy than could Italy, Spain or Greece, which had limited fiscal headroom (Gulliën et al. this issue).

At a joint press conference on 13 March 2020 with CDU Economics Minister Altmaier, SPD Finance Minister Scholz pointed out that Germany’s good fiscal situation was for precisely such circumstances, and already promised ‘targeted, timely and temporary’ assistance to boost the economy (Bundesministerium der Finanzen 2020a). Ten days later, Scholz proposed to the cabinet a massive €156 bn supplementary domestic budget and other measures. As the policy response gradually expanded, including Germany suspending its domestic debt rules, the huge implications became evident not only for the asymmetries inside the Eurozone but, with the EU’s suspension of its state aid rules, for the single market (Chazan 2020a).

At EU level, the possibility of debt relief via ‘Coronabonds’ was advocated by nine states led by Italy, France and Spain, but resisted by northern states including Germany but led by the Netherlands. The German position reflected its
long-standing opposition to mutualising debt (cf. Eurobonds) and the associated transfer to the EU of fiscal powers, for which the BVerfG’s rulings had emphasised domestic parliamentary sovereignty. Instead it advocated the use of the ESM, but the likelihood of conditions being attached was opposed in Italy (Armingeon et al. this issue). EU measures focused initially on deploying the resources of the ESM, the European Investment Bank and SURE (Support to mitigate Unemployment Risks in an Emergency), while the ECB launched a massive €750 bn pandemic emergency purchase programme (PEPP) to buy bonds and keep member states’ borrowing costs down.

While these measures were being agreed, the ground was shifting in the German debate. A group of leading German economists called for ‘European crisis bonds’; greater openness to such measures became clear in the Social Democrats; differences of view appeared within the Christian Democrats; even the authoritative Council of Economic Experts was divided (Chazan 2020b). The view began to take hold that, whatever the nature of past debts accumulated in southern Europe, the pandemic was nobody’s fault, and if the EU could not show solidarity under these exceptional circumstances it would be disastrous; for instance, encouraging Eurosceptic forces in Italy, perhaps to emulate Brexit. Germany’s vested interests in the EU as a vehicle for its industrial exports was at risk (see also Armingeon et al. this issue).

French President Macron and his Finance Minister, Bruno Le Maire, moved towards some kind of EU coronavirus rescue fund, dropping the terminology of Coronabonds, and sought to bring the German government on board. Close relations between Le Maire and German counterpart Olaf Scholz revived the Franco-German partnership that had faltered over the last years on the question of a Eurozone budget (Chazan et al. 2020). By April, they were both opposed to the Dutch government’s attempts to impose conditions on loans. This represented a major change in intergovernmental dynamics compared to during the Eurozone crisis. Momentum developed that led to the May 2020 Franco-German proposal for a €500 bn recovery fund, which itself evolved into the EU’s RRF of €750 bn as part of the package deal linked to the new MFF for 2021–27. How can this apparent turn in German policy be explained?

Most obviously, the gravity of the pandemic’s economic consequences was challenging Eurozone governance and the single market and thus striking at the heart of the European project and Germany’s already-challenged interests. The pandemic presented a potentially more acute challenge for the German economy than the Eurozone crisis. That said, the German economy’s relative strength would have enabled it to take advantage of the relaxation of state aid rules in a distorting manner. The German government’s response was not entirely anticipated. Despite intensive bilateralism between Macron and Merkel as well as between finance ministers, Macron reportedly learnt of some aspects of Germany’s support only shortly before a joint video-conference (Mallet et al. 2020). Berlin apparently was willing for all the fund to be disbursed as grants, although this was not what was agreed by the EU with the eventual RRF.

Also of key importance were a number of domestic factors, not least of which being the 5 May 2020 ruling of the BVerfG (Bundesverfassungsgericht 2020). This
related to the ECB’s Public Sector Purchase Programme (PSPP), initiated in 2015 as part of the follow-up to Draghi’s ‘whatever it takes’ measures amidst the Eurozone crisis. Four separate petitions to the BVerfG had held that the PSPP violated constitutional rights by virtue of breaching the EU’s prohibition of monetary financing (Article 123 TFEU) as well as the principles of conferral and of proportionality. The BVerfG ruled that the PSPP had exceeded the powers of the EU (Schwarzer and Vallée, 2020: p. 2). The salient concerns were, first, the lack of control by the Bundestag and the federal government over the independent ECB (!), following the BVerfG’s long-standing confederal understanding of the EU. Secondly, whilst ruling that the ECB had not breached Article 123 TFEU, it questioned whether the PSPP went beyond the Bank’s price stability mandate. Thirdly, it ruled that the Court of Justice of the EU (CJEU), to which it had earlier made a preliminary reference, failed in its judgement to meet necessary standards for democratic legitimation within Germany and therefore did not apply. Not only was this ruling an unprecedented rejection in Germany of a preliminary ruling of the CJEU, it challenged the law of EMU. Further, it underlined the incomplete architecture of EMU (Schwarzer and Vallée, 2020). More broadly, the judgement reinforced the view that reliance on the ECB alone to provide the ‘big bazooka’ had run its course; politicians needed to take responsibility themselves. Here was a specific cue for the German government to take action.

Other domestic factors related to the broader climate. Since the Eurozone crisis, the reification of fiscal rules had subsided. Indeed, some economists were questioning it in 2019 because of the constraints placed on vital public investment (e.g. Michael Hüther, Director of the German Economic Institut: see Hüther and Südekum 2019). Politically, by April 2020 Merkel’s approval ratings were rising as she guided the public through the pandemic, on which Germany at the time was performing comparatively well in terms of infection and mortality rates, and the Eurosceptic AfD’s ratings were down (Deutsche Welle 2020). A poll for Der Spiegel found two-thirds of the German public approved of the €750 bn fund proposed by the European Commission, building on the Franco-German initiative (Der Spiegel 2020). An earlier more experimental survey from April 2020, when coronabonds were still being considered, had suggested that German voters considered ‘the costs of a euro breakup [to] weigh more heavily than the costs of debt mutualization’ (Baccaro et al.2021: p. 3).

Two aspects of the form and development of the RRF were helpful to securing domestic political acquiescence. First, the linking of the fund to the MFF process helped de-toxify matters in domestic politics. The Grand Coalition had already committed in the coalition agreement to contribute more to the EU budget, although the main reason had been the budgetary consequences of Brexit (Koalitionsvertrag 2018). In terms of ‘failing forward’, Germany was moving towards a more solidaristic policy but, in process terms, it was part of the 2020 agreement on the MFF process rather than an open-ended Eurozone reform. The RRF was for the EU-27 and the centrepiece of NextGenerationEU, a temporary recovery instrument to tackle the economic fallout of the pandemic. Interviewees from within Berlin policy circles confirmed that the RRF was intended to be a one-off rather than anything more enduring. Moreover, the process of reaching agreement fell not just to the EU
institutions but specifically to the German presidency (July-December 2020)—a further component to the policy timescape—which allowed it close oversight and some credit to be taken for the resultant policy.

Seen from an HI perspective, after the period of drift in addressing key issues of reforming the Eurozone the pandemic accelerated the pace of change. However, the policy timescape shifted from the Eurozone to the EU’s budgetary system, potentially connecting them. In this context, the exceptional measures agreed to tackle the economic emergency caused by the pandemic most closely resembled conversion: the budgetary system was directed to new goals. Undoubtedly, a precedent was set through revenue-raising via bonds. The key question for the future is whether political actors are able to effect a more thorough conversion of the role played by the EU’s public finances and link them explicitly to a stabilisation role for the Eurozone. This step has not been achieved as yet. The ‘frugal four’ (Austria, Denmark, the Netherlands and Sweden) and, quite likely, Germany remain as veto players for any potentially transformative move in the future. With the specific steps having been taken in the context of budgetary policy, it seems difficult to consider the changes brought about by the coronavirus pandemic to be a ‘critical juncture’ or a transformational form of conversion towards a fiscal union.

One step is worth underlining, however: the EU budget has always been funded through own resources without borrowing. The step to borrow on the financial markets is potentially significant: so much so, that a challenge by over 2000 individuals before the BVerfG in March 2021 against the mutualisation of debt led to it requesting the Federal President to refrain from signing off the enabling legislation that had just passed through the German parliament (Tagesschau 2021). The request for an interim injunction was rejected, although the legal challenge remains (Chazan 2021). Budget Commissioner Johannes Hahn, confirming the one-off nature of the intervention, argued that it was covered by Article 122 TFEU, which provides for budgetary interventions in the event of exceptional circumstances (Moore 2021). Petitions are also before the BVerfG on the ECB’s Coronavirus PSPP scheme.

Conclusion: failing forward rather than moving on

At first blush, the Franco-German initiative for a reconstruction fund appeared to represent a break from Germany’s traditional stability culture and its aversion to taking on financial liability (cf. Ladi and Tsarouhas 2020). However, the form that the fund took, allied to the MFF negotiations and as part of a set of specific measures related to the pandemic, indicate otherwise. Of course, Finance Minister Scholz’s claims that the EU had to seize its ‘Hamiltonian moment’ caught the headlines (Dausend and Schieritz 2020). However, the parallels with Alexander Hamilton’s mutualisation of war debt in 1790, thereby consolidating America’s economic, monetary and political integration, are highly debatable, given the one-off nature of the agreement (see also Schwarzer and Vallée, 2020: p. 6). The agreement did not create a fiscal union for the EU or Eurozone. It is for these reasons, and because of the shift of the policy timescape to budgetary policy, that I judge the resultant package of
measures to amount to a form of conversion, adapting the budgetary policy framework in light of the pandemic emergency.

In line with HI, though, this reform might start a new dynamic either by political actors exploiting the situation or as a result of unintended circumstances. The full economic consequences of the pandemic remain unclear. It is, therefore, worth recalling the words of Pierson (2004: p. 82): ‘Slow-moving processes may be cumulative, involve threshold effects, or require the unfolding of extended causal chains’. The pandemic could yet provide one of these threshold effects, should even more fiscal redistribution take place and become an established part of the policy trajectory.

A lot of different components would have to fall in place for a real Hamiltonian moment, with its implication of shared debt, new income resources for the EU and an overhauled architecture of EMU. Consistent with this article’s focus on Germany ‘failing forward’, how might this happen domestically? First, it would have to go hand in hand with the abandonment of the balanced-budget rule (the ‘schwarze Null’) and the domestic debt brake. As noted above, the former is currently suspended. Helge Braun, the minister responsible for Merkel’s chancellery, even floated the possibility of balanced-budget rule being repealed; only to be rebuked by the CDU parliamentary party (Gathmann et al. 2021).

German domestic politics changed after the September 2021 election. Merkel’s grand coalition was replaced by a three-party, ‘traffic-light’ coalition led by Chancellor Scholz (SPD) and comprising Alliance 90/The Greens, arguably the party most sympathetic to departing from a fiscal straitjacket, with the FDP, which was especially opposed to a ‘transfer union’ during the Eurozone crisis, and whose leader—Christian Lindner—became the new finance minister. Their coalition agreement referred to strengthening EMU, debt sustainability and making the SGP more simple, transparent and enforceable. It suggested a difficult political balancing-act rather than the seeds of a Hamiltonian moment.

However, there is a further unpredictable factor: the BVerfG. Its May 2020 ruling signalled a collision between its long-standing confederal interpretation of the EU, where member states remain in charge, with the more federalist practices of the ECB, backed up by the CJEU. Schwarzer and Vallée (2020) suggest that this collision of thinking can only be addressed through a constitutional reform, perhaps in both the EU and Germany. Their conclusion on how to settle matters with the BVerfG (2020: p. 6):

It is economically, politically, and legally necessary that the architecture of the Euro area is finally completed, including filling the need for stronger fiscal integration and provision of democratic legitimacy at the EU level

If those steps were to happen, they could bring an end to ‘failing forward’, leading the EU to ‘move on’. However, the domestic and EU contingencies of achieving these reforms are substantial.

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