Torn between Two Lovers: German Policy on Economic and Monetary Union, the New Hanseatic League and Franco-German Bilateralism*

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German governments and European Union (EU) member states forming the New Hanseatic League (HL) have had very similar preferences on EU / Eurozone financial support mechanisms. We would expect German and HL governments to be close allies on these matters. However, empirically, we detect differences. German governments have repeatedly resisted participating in HL joint positions on EU financial support mechanisms and accepted compromises with France. In order to explain this divergence we consider the relative explanatory merit of economic preferences, based on both material interests and economic ideas—here ordoliberalism—on the one hand, and norms of cooperation—here Franco-German ‘embedded bilateralism’—and geo-strategic interests on the other hand. We disentangle economic preference formation and the choice in favour of a political strategy to pursue these preferences. Economic preferences are one factor explaining the extent of concessions made by Germany to the HL countries and France. However, norms of cooperation and geostrategic interests explain the choice of German governments on how and with whom best to pursue their preferences. German governments have performed a balancing act between the HL and France, skewed towards the latter. The presence of economic crises increases the degree to which this balancing act is skewed towards France.

Introduction

On 5 March 2018, eight ‘New Hanseatic League’ (HL) governments—the Netherlands, Denmark, Finland, Sweden, the three Baltic states and Ireland—came out with a common statement against the idea of a European-level fiscal instrument championed by France. Instead, they emphasised the need for national fiscal buffers (Government Offices from Sweden 2018). Since then, this strategy of New Hanseatic League counter coalition-building and public announcements—‘going public’—became a recurrent feature in the EMU governance reform debates and decision making. In a June 2018 letter, twelve EU member state governments, the HL governments joined by Austria, Belgium, Luxembourg and Malta,
announced publicly their opposition to Franco-German proposals for the creation of a Eurozone budget (Financial Times 20 June, 2018; 22 June, 2018). This letter was joined with a number of unilateral statements of opposition by HL member state finance ministers. In November 2018, additional French and German government proposals on the Eurozone budget were followed by renewed HL opposition (EUObserver 21 November, 2018). In May 2020, France and Germany made a common proposal on a large-scale post-COVID-19 recovery fund to disburse grants of €500 bn., financed by joint debt instruments (French and German Governments 2020). Some of the HL countries—Netherlands, Denmark, and Sweden—joined ranks with Austria to submit a counter proposal (Financial Times, May 24, 2020). In the past, the Netherlands, the leading member of this informal group, made its voice heard by privileging informal bilateral consultation and coordination with its powerful German neighbour (Verdun 2021). The New Hanseatic League’s attempt to gain bargaining leverage and veto power by way of coalition-building and public announcements presented Germany with more difficult policy choices than the previous management of informal bilateral contacts.

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

Explicit German preferences on EU / Eurozone financial support mechanisms align closely with HL preferences with limited—albeit significant—divergence on policy design and implementation. A focus upon economic ideology and repeatedly stated preferences on EU fiscal integration (and a range of EMU-related issues) since the 1980s suggests that the HL and German governments should be close allies, notably on financial support mechanisms and the creation of a Eurozone budget. The similarity of their preferences made them both advocates of a ‘stability union’ as opposed to a ‘fiscal union’ that comes with substantial EU level fiscal instruments and fiscal capacity building including redistributive transfers (Hacker and Koch 2017). As the distance between their preferences on financial support mechanisms and the status quo is small, the choice of a ‘foot-dragging’ strategy and coalition-building among like-minded states would seem likely (Falkner and Schoeller 2021). At the same time, German governments have avoided joining the HL in these policy announcements, were never officially part of a coalition with the HL, and have maintained a certain diplomatic distance from the loose alliance. Empirically, we observe that
German governments have repeatedly accepted compromises with France and resisted joining with the HL coalition on EU fiscal support mechanisms. German governments have performed a balancing act between, on the one hand, closely coordinating with France and, on the other hand, bringing small northern creditor states on board with any Franco-German compromise. How can this apparent contradiction best be explained?

Our explanation is based on a two-step approach. We disentangle economic preference formation (and its sources) from the choice of a European policy strategy how best to pursue these preferences. With regard to the former, we consider both material interests and economic ideas, notably ordoliberal ideas; with regard to the latter, norms of cooperation, notably the Franco-German ‘embedded bilateralism’ (Krotz and Schild 2013) and geostrategic interest come into play. Thus, rather than juxtapose the explanatory value of interests and ideas, we juxtapose the explanatory merit of two sets of interests and ideas, one economic—what is best for the German economy—and the other focused upon political strategy—what form of international cooperation is best to achieve what is best for the economy.

A particular and tension-ridden mix of economic preferences on the one hand and broader norms of cooperation as well as geostrategic interests pulls German policy makers in different directions—economic preferences towards like-minded smaller HL states, norms of cooperation and geostrategic interests towards France. What results is a ‘skewed balancing act’ and a ‘paper-thin harmony’ ensuring compromises with French governments. The normative foundations of Franco-German bilateralism and geopolitical concerns linked to this strategic partnership have—up to now—had a heavier weight than Germany’s short term material interests and ordoliberal predisposition on EU fiscal integration. We test empirically how far this ‘skewed balancing act’ shows up in the political strategy chosen by Germany to pursue its interests, notably in the observable government consultation and coordination patterns. Based on publicly available primary documents and interviews with relevant German and small state civil servants, we investigate empirically the German governments’ choice of interlocutors on EU fiscal policy developments, notably financial support, since the early phase of the Eurozone crisis in 2010 until mid-2020. We also examine the concessions made by Germany to France on EU / Eurozone financial support mechanisms.¹ We concentrate on the contentious issues of financial support mechanisms that triggered the coalition-building and ‘going public’ strategy of the HL countries. We leave aside debates on the reinforcement of fiscal rules where the preferences of Germany and the HL countries also tend to be closely aligned and where compromises with French governments are also frequent.

The next section of this article examines the expectations derived from the existing literature on EMU and European integration more generally and, specifically, German preferences. The third section provides an overview
of German consultation patterns, joint policy-making with HL and French governments, and German concessions to France on financial support mechanisms and compares the empirical record with our theoretical expectations on the German positioning between HL and French governments. The fourth section concludes by summarising our contribution to the literature on Germany and small states.

**Explaining Germany’s Balancing Act**

What expectations can be derived from the literature on German preferences on EMU-design issues and European integration more generally to explain to which side Germany leans in its ‘balancing act’ between HL and French governments?

We start with economic preference formation. We expect creditor and current account surplus countries to have a material economic interest to shift the burden of adjustment in dealing with the Eurozone’s crisis and its governance reforms to debtor and current account deficit countries. The governments of the creditor countries should emphasise national responsibility for fiscal policies and be part of the EU’s ‘stability union’ camp, as opposed to the ‘fiscal union’ camp. The importance of ordoliberal economic ideas, seen by many scholars as underpinning German preference formation and the actions of German governments during the Eurozone crisis, should lead to an advocacy for rules based systems, in particular strict rules regulating national fiscal policies in order to avoid moral hazard and to an opposition against risk sharing and transfer instruments with redistributive effects (Brunnermeier, James, and Landau 2016; Matthijs 2016).

It is difficult to disentangle empirically the expected effects of material interests and ordoliberal ideas as both point into the same direction. There is observational equivalence with regard to the observable implications of both theoretical explanations. Both imply an advocacy of strict rules and an opposition to risk sharing and fiscal capacity building at the EU level. Material economic interests and economic ideas come into conflict only in situations where following ordoliberal precepts in a rigid way could endanger the survival of the euro (Feld, Köhler, and Nientiedt 2015). In this case, sticking to ordoliberal ideas would come at high material cost as German longer-term export and broader economic interests are best served by preserving the Eurozone and the single currency.

On key controversial issues of EMU governance reforms, Germany found itself systematically closer to HL countries than to France, according to the EMU Choices dataset. This holds true for the government’s initial unwillingness to support a bailout for Greece (although supported by Denmark, Ireland, Latvia, Lithuania and Sweden), their common rejection of Eurobonds (although supported by Ireland), on proposals to increase European Financial Stability Facility (EFSF) lending capacity (supported by Estonia
and Sweden) and of the use of additional instruments (bond purchases or bank recapitalisation) by both the EFSF and the European Stability Mechanism (ESM). Across all fiscal integration issues investigated by the EMU Choices project (Wasserfallen et al. 2019), German government positions turned out to be even more hawkish than those of a number of HL countries and very close to the position of the Netherlands.³

We hypothesise that the strength of economic preferences, based either on material interests or on economic ideas, and their close alignment with HL countries should have a stronger impact on the willingness to make concessions on the substance of agreements compared to their impact on the choice in favour of a particular strategy how best to pursue these preferences in order to bring the outcome as close as possible to them. This leads us to our first hypothesis:

**Hypothesis 1:** The stronger the weight of economic preferences — compared to norms of cooperation and geostrategic interests — the less substantial the German concessions to France on financial support mechanisms.

It might be expected that German government preferences at the extreme end of the policy space lead it to consult with governments from like-minded states such as the Netherlands, Finland and other HL countries in order to coordinate common positions and proposals. However, for two different reasons, we argue that this has not happened. States have to choose an appropriate strategy of how best to pursue their economic preferences. Coordinating and building coalitions with like-minded partners is not the only available option. Another, especially for relatively powerful member states, is building bridges with opposing camps and performing a key role in bringing about compromises. In terms of preference attainment, the final outcome of such a strategic choice is not necessarily worse compared to digging in one’s heels in opposing coalitions. In bridge building, preferences in addition to the economic can also be taken into account by the government. In the case of Germany, firmly established norms of cooperation, especially the ‘embedded bilateralism’ with France, work against coalition building with like-minded smaller HL countries.

Germany has developed a unique and increasingly dense network of intergovernmental relations with France. Generations of policy-makers and high ranking civil servants were socialised into the thickening norms of bilateral cooperation in the framework of a ‘regularised intergovernmentalism’ since the signing of the Elysée Treaty in 1963 (Krotz 2010). A number of formal institutions allow for bilateral coordination efforts, such as the biannual government consultations and cabinet meetings or the Franco-German Financial and Economic Council bringing together the ministers of economics and finance and central bank presidents. When the sovereign debt crisis approached its first climax in 2011, the ministers of finance, Wolfgang Schäuble and Christine Lagarde, decided to create a Franco-German working unit in both ministries of finance providing common analyses.
and coordinating the activities of the two ministries (Bundesministerium der Finanzen 2018). The bilateral Aachen Treaty, signed on 22 January 2019 renewed and strengthened the norms of bilateral cooperation by committing the signatories to ‘regularly consulting each other at all levels ahead of major European meetings in order to achieve joint positions and joint ministerial statements’ (Treaty of Aachen, Art. 2, authors’ translation).

There is no formal institutional equivalent in Germany’s relationship with smaller states on EMU issues. These normative institutional underpinnings of the Franco-German ‘embedded bilateralism’ should translate into a denser pattern of consultations with France and more pronounced efforts to agree Franco-German proposals on EMU reform issues including financial support mechanisms.

Expectations derived from (neo-)realism and German geostrategic interests also see German policy makers pulled closer to France than to the smaller EU member states, including the HL. German policy makers have prioritised the relationship with France for decades, enabling what Pedersen (2002) labels a ‘cooperative hegemony’, and ensuring decisive German influence over the direction of European integration—albeit shared with French governments. Other geostrategic concerns would place emphasis upon German interests in preserving the current membership of the Eurozone. The aim here is to preserve and strengthen the EU’s multilateral framework of cooperation and the Franco-German relationship within this framework. A key geostrategic preference of German governments is to avoid the construction of other coalitions that potentially undermine Germany’s powerful position in EU policy making (Webber 2019, 48–49). The implications of bilateral norms of cooperation and geostrategic interests point in the same direction—another case of observational equivalence. Hence, we do not disentangle them in our second hypothesis:

**Hypothesis 2:** The stronger the norms of embedded bilateralism and the stronger the geostrategic interest to preserve Germany’s key strategic bilateral relationship in Europe, the more substantial German concessions to France.

Close coordination and coalition-building with HL countries would reflect a deliberate German hegemonic political strategy of attempting to maximise German preferences based on a coalition with smaller and like-minded states. However, the adoption of this strategy would entail the risk of a Franco-German split. This strategy would testify to the limited explanatory power of the norms of embedded bilateralism and of the geopolitical interest of a close strategic relationship with France, ‘Germany’s indispensable ally in European policy-making’ (Krotz and Schild 2018).

We assess the validity of our two hypotheses by looking at (a) the density and regularity of consultations with the HL governments on the one hand and France on the other; (b) the existence and frequency of common
proposals with either HL governments or France; and (c) the significance of concessions made by Germany to the French partner. Very few and limited substantial concessions to French governments would testify to the power of economic ideas and material interests. A predominance of consultations with French governments, common proposals with the privileged partner across the Rhine and substantial concessions to France would, on the contrary, testify to the limited importance of ordoliberal convictions and material interests and to the prioritisation of the key strategic partnership with France, either for normative or geostrategic reasons.

In testing these two hypotheses, we sideline more typical analyses of German policy on small states in Europe rooted in a different set of ideational and geostrategic factors. These analyses focus, on the one hand, upon a ‘reflexive support for an exaggerated multilateralism’ (Anderson 1997, 85) which ensures acute German sensitivity to the preferences of smaller EU member states. This sensitivity increased after German reunification as a reaction to the renewed fears of German hegemony in Europe and to the rejection of the Maastricht Treaty by referendum in Denmark (see, for example, Bulmer, Jefferies, and Paterson (2000), 54 and 62–64). On the other hand, these analyses examine the extension of German influence over smaller member states as indirectly mediated through EU institutions (Katzenstein 1997, 260). Providing ‘voice opportunities’ to smaller member states through EU institutions makes German leadership or Franco-German co-leadership more acceptable or less unacceptable to them and serves the purpose of preventing balancing behaviour against German power in Europe (Grieco 1995). Furthermore, from a (neo-)realist perspective, coalition-building with like-minded states could be considered as the strategy of a hegemon. Our analysis does not challenge the analytical usefulness of studies focused upon German multilateralism. However, with regard to one of the major European economic policy challenges of our era, we argue for an analysis rooted in a combination of different ideational and geostrategic factors.

The next section looks empirically at indicators operationalising our dependent variable—the German balancing act between France and the HL countries: German consultation patterns with HL and French governments, common proposals with each of them and concessions made by Germany to France on financial support mechanisms.

Germany’s Skewed Balancing Act between the New Hanseatic League and France

Consultation Patterns

According to the former head of the German Foreign Ministry’s planning staff, Thomas Bagger, ‘leadership for Germany axiomatically needs to be a
negotiated leadership” with partners in order to be functional and productive’ (Bagger 2013, 10). However, consulting with partners does not mean consulting with all equally: the density of informal consultation and coordination varies significantly. High ranking civil servants in the Federal Chancellery, the Ministry of Finance and the Federal Foreign Office stressed the importance of the ‘réflexe franco-allemand’, the ingrained habit to consult first of all the French partner at all hierarchical levels when dealing with Eurozone issues before turning to their counterparts from other member states (interviews 1, 2, 3, 5). During the Eurozone crisis, the informal patterns and habits of consultation and the informal formats of meetings, especially between Chancellor Merkel and the French President Nicolas Sarkozy (and later with François Hollande), proved particularly important for coordinating French and German positions and approaches (Jamet et al. 2014). They stand out from all other meetings with government leaders in terms of frequency and intensity. Table 1 provides an overview of highest level consultations on Eurozone issues between Chancellor Angela Merkel and French presidents on the one hand and the heads government of the eight Hanseatic League countries on the other from 2010 to 2019—both bilateral meetings and phone calls as documented on the Federal Chancellery’s website.5

Three findings are particularly noteworthy. First, Chancellor Merkel officially consulted not only with the French president, but also with the

Table 1. German chancellor consultations with heads of government and state on EMU issues (2010–2018).

| Year | FR | NL | IE | DK | SE | FI | LT | LV | EE |
|------|----|----|----|----|----|----|----|----|----|
| 2010 | 6  | 2  | 0  | 0  | 1  | 1  | 1  | 1  | 1  |
| 2011 | 10 | 1  | 2  | 1  | 0  | 1  | 0  | 0  | 1  |
| 2012 | 7  | 2  | 1  | 0  | 1  | 0  | 0  | 0  | 0  |
| 2013 | 3  | 1  | 0  | 0  | 0  | 0  | 1  | 0  | 1  |
| 2014 | 2  | 0  | 1  | 1  | 0  | 1  | 0  | 1  | 1  |
| 2015 | 1  | 0  | 0  | 0  | 0  | 1  | 0  | 0  | 0  |
| 2016 | 0  | 0  | 0  | 0  | 0  | 1  | 0  | 0  | 0  |
| 2017 | 2  | 1  | 0  | 0  | 0  | 0  | 0  | 0  | 0  |
| 2018 | 4  | 2  | 1  | 0  | 1  | 0  | 0  | 0  | 0  |
| 2019 | 2  | 0  | 0  | 0  | 0  | 0  | 0  | 0  | 0  |
| Sum  | 37 | 9  | 5  | 2  | 2  | 5  | 3  | 2  | 4  |

Source: own compilation.
The data was drawn from the news section of Chancellor Merkel’s (https://www.bundeskanzlerin.de/bkin-de/aktuelles) and of the Federal Government’s website (https://www.bundesregierung.de/breg-de/aktuelles/#/). Three selection criteria have been used. Firstly, the set time period ran from 2010 until the end of 2019. Secondly, only bilateral meetings/consultations have been included whereas trilateral meetings and official meetings on EU level such as Euro group or Council meetings have been excluded. Thirdly, the decision on whether to include a meeting or telephone call was based on the issues covered which were reported by attached press releases, press conferences and declarations. Meetings and telephone calls relating to EMU, to the Eurozone crisis, the crisis management or to any kind of preventive measures have been included. By contrast, meetings on issues of the common market or on broader European policy issues among which EMU issues are not necessarily to find have been excluded.
government leaders of the eight Northern creditor states—between 2 and 9 times—during the 2010–19 period. Second, the documented conversations Merkel had with successive French presidents outside EU-level meetings outnumber the combined consultations with all eight HL government leaders: 37 compared to 32. Among the HL leaders, the Dutch stand out as being the most consulted. This is in line with past experiences of close cooperation on EMU issues (Maes and Verdun 2005, 342; Verdun, 2021).

Third, in terms of variation over time, the consultations with France were most frequent during the presidency of Nicolas Sarkozy which coincided with peak periods of the crisis from 2010 to 2012.

At the level of ministries of finance, the same consultation pattern emerges. Germany consulted by far the most intensively with France. During the most acute periods of Eurozone sovereign debt crisis management, in spring 2010 and the second half of 2011, and during the Greek crisis in 2015, severe time constraints often left little time for consultations with partners other than France. During the most critical moments of the Greek crisis, German Minister of Finance, Wolfgang Schäuble, met his French counterpart Michel Sapin five or six times at the margin of Eurogroup meetings and exchanged many SMS messages. The need to narrow down the huge differences between French and German positions on the management of these crises encouraged the German government to opt for privileged consultations with France.

In non-crisis periods, the German Ministry of Finance was able to widen its net of consultations to involve more actively the governments of smaller member states. Consultations with HL countries intensified from 2012 onwards and dealt with mid to long-term projects including Banking Union and the creation and reform of the ESM. On these, German officials consulted HL officials to obtain information on their positions before consulting French officials. However, this did not serve the purpose of coalition-building with HL countries; priority was given to France ‘for historic reasons’ (interview 5, authors’ translation). And once Germany had fleshed out common positions with the French partner, it kept to them loyally when consulting with HL governments at a later stage. These common positions worked to restrict the negotiation space available for HL government officials in their consultations with Germany—which was, for a number of them, including the Dutch and Finnish, the most important consultation partner even in advance of other HL countries (interviews 4 and 6).

According to participants involved in HL coordination, both the French and German governments are kept informed by the HL group on their work, but the German more closely than the French (interviews 6 and 7).
the German minister more often than the French. The role of the German minister of finance in the HL group coordination is the one of a close external partner with no involvement in the drafting of HL position papers. Hence, the German relationship with the HL is a tacit alliance built on shared material economic interests and ideas, but without active involvement.

According to the representatives of HL countries interviewed, the increased frequency of Franco-German consultations on European issues after the election of Emmanuel Macron to the French presidency in 2017 was among the factors, in addition to the Brexit referendum, that encouraged their closer coordination (interviews 4 and 6). Hence, these increased consultations can be considered as a case of counter coalition-building. Closer HL coordination placed Germany in an increasingly central role between France and the HL countries. Starting from a Franco-German compromise, the German government could tilt the balance more towards the HL and its own ordoliberal preferences. The debate and negotiations on a Eurozone budget from 2017 provide an example of this pattern (see below).

**Common Proposals and Declarations**

The greater importance that German governments assign to coordination with France is also demonstrated by the larger number of joint statements, proposals and declarations on EMU reform issues made with French governments compared to HL governments. Table 2 summarises the common German initiatives with both the French government and the HL governments from the start of the Eurozone crisis in early 2010 to 2020. The results are clear cut. There are only two joint German-HL member state statements during the period: both jointly issued with the Dutch and Finnish governments. The 25 November 2011 statement underlines the commonality of their crisis interpretation and preferences for strict fiscal rules (see the source given in Table 2). The second joint statement defines a common German-Dutch-Finnish approach on Banking Union issues, most importantly on the use of European Stability Mechanism (ESM) funds for direct bank recapitalisation. This contrasts with eleven joint public Franco-German statements and position papers on EMU reforms and one leaked non-paper, most of which had a substantial impact on Eurogroup deliberations and decision-making.

**German Concessions on Financial Support Mechanisms**

The idea of a Eurozone fiscal capacity came on the European agenda in 2012, promoted by the Commission (European Commission 2012) and taken up in the Five Presidents’ Report on the completion of EMU (Juncker et al. 2015).
Table 2. German initiatives and position papers on EMU reforms since 2010 with France and New Hanseatic League governments (2010-2018).

| Year | Common papers, proposals, declarations |
|------|-----------------------------------------|
| 2010 | Joint letter of Chancellor Angela Merkel and President Nicolas Sarkozy to the Presidents of the European Council and the European Commission, 6 May 2010 (1) Position paper on the governance of the euro area, issued at the occasion of the Franco-German Economic and Financial Council of 21 July 2010 (2) Declaration ‘Renforçons le gouvernement économique européen’ at the occasion of the informal bilateral summit at Deauville, 18 October 2010 (3) |
| 2011 | Joint letter from Nicolas Sarkozy, President of the Republic, and Angela Merkel, Chancellor of Germany, to Herman Van Rompuy, President of the European Council, 17 August 2011 (4) |
| 2011 | Joint Statement of the Ministers of Finance of Finland, the Netherlands and Germany, 25 November 2011 (5) |
| 2012 | Joint Statement of the Ministers of Finance of Germany, the Netherlands and Finland, 25 September 2012 (6) |
| 2013 | Position paper ‘France and Germany – Together for a Stronger Europe of Stability and Growth’, 30 May 2013 (7) |
| 2015 | Franco-German Contribution to the Strengthening of the EMU (8) |
| 2018 | Franco-German Meseberg Declaration, 19 June 2018 (9) Joint Proposal on the architecture of a Eurozone budget within the framework of the European Union, 16 November 2018 (10) |
| 2019 | Franco-German non-paper ‘Eurozone Budgetary Instrument – possible ways forward after the December 2018 Summit’, 21 February 2019 (11) |
| 2020 | A French German Initiative for a Recovery Fund from the Coronavirus Crisis, Berlin/Paris, 18 May 2020 (12) |

Sources: (1) https://archiv.bundesregierung.de/archiv-de/joint-letter-of-chancellor-angela-merkel-and-president-nicolas-sarkozy-to-the-presidents-of-the-european-council-and-the-european-commission-350710.html. (2) http://www.astrid-online.it/static/upload/protected/Gouv/Gouvernement-economique-europe_papier-franco-allemand_21_07_10.pdf. (3) www.franco-allemand.fr/Renforcons-le-gouvernement,5764.html. (4) https://uk.ambafrance.org/French-and-German-leaders-defend.html. (5) https://www.bundesfinanzministerium.de/Content/EN/Pressemitteilungen/2011/2011-11-25-Joint-Statement.html. (6) https://vm.fi/en/article/-/asset_publisher/joint-statement-of-the-ministers-of-finance-of-germany-the-netherlands-and-finland. (7) https://archiv.bundesregierung.de/resource/%20blob/656922/605420/02e43343a1528ea03230aee170f715a1/2013-05-30-dt-frz-erklarung-englisch-data.pdf. (8) https://ec.europa.eu/commission/sites/beta-political/files/french-german_contribution_1_de.pdf. (9) https://www.diplomatie.gouv.fr/en/country-files/germany/events/article/europe-franco-german-declaration-19-06-18. (10) https://www.consilium.europa.eu/media/37011/proposal-on-the-architecture-of-a-eurozone-budget.pdf. (11) https://www.euratix.com/wp-content/uploads/sites/2/2019/02/French-German-Contribution-on-a-Eurozone-Budgetary-Instrument-2.pdf. (12) https://www.bundesregierung.de/resource/blob/975226/1753772/41a445a1ca91d4f7146eeb2b39ee72b/2020-05-18-deutsch-franzoesischer-erklarung-eng-data.pdf?download=1

French interest in such a fiscal capacity had been longstanding and had antecedents in French support for the creation of a fund to support EC/EU member states with significant current account problems dating back to the 1950s (Howarth and Schild 2017). More surprisingly, the Merkel government lent its cautious support to the creation of a fiscal capacity. However, the Merkel government had a specific kind of instrument in mind. The German idea of ‘contractual arrangements’ between the European level and national governments was to combine financial incentives and rewards with a commitment by the recipient to undertake structural reforms. By contrast, the governments of France and Southern European countries in the ‘fiscal union camp’ sought the creation of a budget to serve stabilisation purposes by providing transfer payments in situations of...
crisis. Given the outright French refusal to accept the idea of European-level control over and interference with its domestic structural reforms (interview 5), the idea of a Eurozone fiscal capacity—and with it the proposal on ‘contractual arrangements’—disappeared from the European agenda until 2017.

After his election to the French presidency in May 2017, Emmanuel Macron forcefully made the case for a Eurozone specific budget to perform allocative, redistributive and macroeconomic stabilisation functions (Macron 2017). The German Grand Coalition responded by promising to ‘support the specific budgetary resources for economic stabilisation and social convergence and for the support of structural reforms in the Eurozone, which can be the point of departure for a future investment-related budget for the Eurozone’ (Coalition Agreement 2018, 12–13).

A more explicit and concrete support for a Eurozone budget came with the Franco-German Meseberg declaration of 19 June 2018 and the ‘French German roadmap for the Euro Area’ (French and German Governments 2018a, 2018b). The declaration specifies the goal of setting up a ‘Eurozone budget within the framework of the European Union to promote competitiveness, convergence and stabilisation … starting in 2021’ (French and German Governments 2018b). This was praised by some German observers as amounting to a major concession to France (Enderlein and Guttenberg 2018). However, the budget figure proposed by Chancellor Merkel (Merkel 2018) was considerably lower—in the lower two-digit billion € range—than President Macron’s proposal of several percentage points of Eurozone GDP or several hundred billion euros (Macron 2017). The Franco-German roadmap ‘acknowledge[s] that there is a need for a genuine macroeconomic stabilisation function in the Eurozone, without transfers’, thus clearly indicating where German concessions to France reach their limit. Furthermore, the roadmap notes the option to supplement national unemployment insurance in situations of ‘a severe economic crisis … by a stabilisation fund at the Eurozone level’ (French and German Governments 2018b). This fund, advocated by Finance Minister Scholz, but not by the entire German government (Handelsblatt, November 25, 2018), could lend—not transfer—funds to the national insurance systems in need. By subscribing in principle to the French idea of a Eurozone budget, the German government proved willing to add a new fiscal instrument to the Eurozone’s toolbox, thus compromising in the direction of the ‘fiscal union’ coalition. However, the German government continued to oppose the creation of a permanent transfer system.

The creation of a fiscal capacity for the Eurozone serving a fiscal stabilisation function found little support among the HL governments. In their first common public statement, coordinated by the Dutch government, HL governments made the case for ‘building up fiscal buffers in national budgets to allow room for national fiscal policies’, thus implicitly rejecting the idea of a Eurozone budget to perform this function (Government Offices of Sweden
The Dutch Minister of Finance, Wopke Hoekstra, qualified the Eurozone budget proposal as being a solution without a related problem and warned against a ‘transfer union’ (ZDF.de 2018).

The German government could have dropped the proposal when it met with HL resistance. However, instead of openly siding with HL governments, the German finance minister continued to work with his French counterpart. They agreed upon a joint ‘Proposal on the architecture of a Eurozone Budget within the framework of the European Union’, published on 16 November 2018 adding some detail to the roadmap as regards to its legal basis, its governance and its possible sources of revenue (French and German Governments 2018c).

In their joint proposal, the French government made an important concession to Germany by agreeing to link the negotiations on the Eurozone budget to those on the EU’s multiannual financial framework (MFF) negotiations. Negotiating a Eurozone budget in the MFF framework would have given all 27 EU member states a veto right on the issue. Germany conceded to France that other sources of revenue such as tax revenues and regular contributions by Eurozone member states, to be transferred to the EU budget and based on an intergovernmental agreement (IGA) among them, could increase the Eurozone budget beyond funds coming from the EU budget alone. The proposal of an IGA to reinforce the Eurozone budget met, however, with predictable resistance from HL governments.

When the Eurogroup drafted its report on EMU deepening in December 2018, the HL governments succeeded in preventing the inclusion of a stabilisation function to be performed by a Eurozone budget; hence the label ‘budgetary instrument for convergence and competitiveness’ (BICC) (Eurogroup 2018). The Eurogroup agreed to provide the BICC only €17 bn. over the 2021–27 period: ‘a budget of homeopathic insignificance’ (The Economist, 23 May, 2020). The compromise can be seen as a remarkably successful example of the HL’s strategy of ‘foot-dragging’, coalition-building and ‘going public’ which effectively buried the idea of a meaningful Eurozone budget—fully in line with German preferences (Schoeller 2021).

The negotiations on the Eurozone budget provide a telling example of Germany’s balancing act between the HL countries and France. Berlin made an important concession to Paris in agreeing in principle to the creation of a Eurozone budget with a stabilisation function. An official alliance on the matter was solidified through the June 2018 Franco-German roadmap and the November proposal, suggesting a clear skew toward the French position. However, by insisting upon a scaled down version of the budget, accepting to remove any mention of a stabilisation function and linking it to the MFF negotiations—thus minimising the risk that it could evolve into a permanent transfer scheme—the German government was able to win over HL governments to support what can be seen as a symbolic instrument.
A significant German concession to France, however, came during debates over how to finance the economic recovery from the COVID-19 pandemic. In the early stages of the crisis, France produced a deep split when openly siding with Italy, Spain and six other Eurozone members in a letter advocating a common debt instrument for the Eurozone with joint liability (‘coronabonds’) — a discussion immediately dismissed as a ‘phantom debate’ by the German minister for economic affairs, Peter Altmaier (Financial Times, 26 March, 2020). On 18 May, however, the French and German governments produced a common initiative on a temporary recovery fund of €500 bn (Krotz and Schramm 2021). To the surprise of many observers, the German government made two important concessions. Making a U-turn from its long-standing position, it advocated grants instead of loans for the member states most affected by the pandemic. Having refused fiscal transfers for years, it now suddenly called for very substantial, albeit temporary transfers. The German government broke another taboo by supporting the issue of common EU debt to finance the recovery fund. This did not imply joint liability. However, Germany would be liable up to its share of the ECB’s capital (27 per cent) and thus €135 bn. German concessions to France when elaborating this initiative were far more important than the French concessions to Germany—France accepted to link the recovery fund to the EU’s budget and the MFF instead of setting it up outside the Union’s budget (cf. The Economist, 23 May, 2020). This contrasts with the Franco-German compromise building on a Eurozone budget on which German government concessions to France can be best described as symbolic.

The Franco-German proposal was in major parts taken up by the Commission in its ‘Next Generation EU’ recovery fund, presented on 28 May, which included €440 bn. in grants to be financed by debt issuance backed by future EU budgets. In the wake of this overhaul of the MFF, the introduction of a separate Eurozone budget line—the BICC agreed in 2018—was dropped without public debate (Financial Times, 29 May, 2020).

Explaining the Skewed Balancing Act

Overall, we observe a much higher density of consultations and a larger number of common statements and proposals with France compared to those with HL countries. The extent of German concessions made to France on Eurozone financial support mechanisms is open to debate. We agree with the widespread view that Germany was more influential and that France had to make more concessions to Germany than the other way round in Eurozone governance reforms, reflecting the power asymmetries that characterise the bilateral relationship (Bulmer and Paterson 2018, 185). Before the COVID-19 pandemic, German concessions to France on
fiscal capacity building were mainly of a symbolic nature. The German concessions on the COVID-19 recovery fund were, however, asymmetrically in favour of France—although this fiscal instrument is not restricted to the Eurozone. The German U-turn on the use of grants in financial support mechanisms and on how to finance them provides us with strong evidence that (short term) material interests and ordoliberal convictions give way when the survival of the European integration framework is at stake. Geopolitical interest prevailed as the EU faced its ‘toughest challenge in history’ (Angela Merkel), the major concern being ‘that the economic crisis will destroy the European single market and even threaten the future of the EU’ (a senior adviser to Chancellor Merkel’s CDU, quoted in Financial Times, 22 May, 2020). The ideational influence of a younger generation of economists in the German ministry of finance might have played a facilitating role in this U-turn. Both the deputy finance minister, secretary of state Jörg Kukies, and the ministry’s chief economist, Jakob von Weizsäcker, were not imbued with the German ordoliberal tradition and both had economic training in France (Financial Times, 9 June, 2020). Whether this reflects a broader ideational shift strong enough to make itself felt beyond extreme situations of crisis remained to be seen, however. Moreover, the German Federal Constitutional Court’s ruling from 5 May 2020 on the ECB’s Public Sector Purchase Programme provided an incentive for the government to act on the fiscal side as this ruling created the potential for more tightly set limits to future ECB purchases of government debt.

The ‘skewed balancing act’ leaning towards France reflects German geostrategic interests in maintaining a close bilateral relationship in order to ensure ongoing German influence in European integration and broader European macro-economic and political stability. It also reflects the strong normative underpinnings of the ‘embedded bilateralism’, as German governments of all political orientations perceive the long-term quality of the bilateral relationship and a strong Franco-German core to guarantee EU cohesion as being an integral part of German ‘state reason’ (Krotz and Schild 2013, 9).

**Conclusion**

In this article, we test two hypotheses to explain the ‘skewed balancing act’ that German governments perform in managing their relations with HL and French governments on EU fiscal capacity-building, and specifically a Eurozone budget. Hypothesis 1 postulates that the stronger the weight of economic preferences—compared to norms of cooperation and geostrategic interests—the less substantial the German concessions to France on fiscal integration. Hypothesis 2 links the strength of the norms of Franco-German embedded bilateralism and German geostrategic interest to
substantial German concessions to France. Empirically, we examine the density of German consultation patterns and the number of joint public statements with French and HL governments, as well as the importance of German concessions to French governments on EU/Eurozone financial support mechanisms.

The empirical evidence is mixed. German economic preferences, based on material economic interests of a creditor and current account surplus country and on ordoliberal ideas, have been largely aligned with those of HL governments on EU/Eurozone fiscal capacity-building and explain the limited concessions to France on the Eurozone budget. However, faced with HL counter coalition-building, robust bargaining and foot-dragging on the Eurozone budget, German governments have prioritised the bilateral relationship with France. We see German geostrategic interests, the density of the bilateral institutional fabric and the norms of cooperation underpinning it—Franco-German ‘embedded bilateralism’—as providing the key explanations for this empirical record. The long-standing Franco-German pattern of privileged cooperation, predating the emergence of the New Hanse, continued and prevailed. According to our interviews, the HL coordination can in part be explained by the expectation of a renewed Franco-German bilateralism following the election of Emmanuel Macron in 2017, a case of counter coalition-building (interviews 4 and 6). This strategy was highly successful, as the Eurozone budget proposals were first watered down to insignificance and then shelved in May 2020. HL government coalition-building served German interests. The German government’s preference of avoiding a Eurozone ‘transfer union’ was supported by the HL which could express more forcefully the policy preferences it largely shared with Germany. The HL could thus put ‘forward German initiatives, which are easier to digest if proposed by a small member state’ and act as “flank players” which frees up Germany to seek to create middle ground with other partners”—notably France (Zunneberg 2017b, 3). In a ‘normal’ (non-crisis) period, HL governments succeeded in reducing a contentious risk mutualising idea—the Eurozone budget—to insignificance, without the German government having to take the blame. HL efforts allowed the German government to make limited or only symbolic concessions to the French government, preserving the ‘paper thin harmony’ with France which is at constant risk of collapse. These limited concessions satisfied HL governments by accommodating their preferences, thus gaining their acceptance for Franco-German compromises.

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

Our article provides value-added to the literature on Germany and small states in three ways. First, we examine a topic—European financial support mechanisms—that is both of immense political and economic importance to the future development of the EU but also largely neglected in the literature. Second, we examine German policy towards the HL and France as a balancing act that can only be explained in terms of a combination of ideational and geostrategic factors. Third, in doing this, we sideline more typical analyses of German policy on small states in Europe rooted in an examination of German multilateralism.

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DISCLOSURE STATEMENT

No potential conflict of interest was reported by the authors.

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NOTES

1. Due to the similarity in preferences between Germany and the HL, we concentrate here on the German concessions to France. French concessions to Germany are less important for our argument on the German balancing act.
2. See the aggregated EMU Choices dataset, available at: https://emuchoices.eu/data/emup/. The dataset is based on interviews with decision makers and primary and secondary sources on government positions in negotiations.
3. In a survey conducted in all 28 EU member states among policy professionals and experts in 2016, those in Germany and the Netherlands perceived the other country as being ‘the most like-minded and most responsive’ (Zunneberg 2017a, 2).
4. Philippe de Schoutheete, a former Belgian ambassador to the EU, saw a ‘[f]irm accent on the Franco-German relation without alienating smaller countries’ as being one key German European policy orientation. He continued:

   As a former representative of a small country in the European negotiating process for a number of years, I can say without hesitation that, of all our big neighbours, Germany has been the most sensitive to the preoccupations, sometimes complexes, of smaller states, and especially its neighbours. (quoted in Franck and Vandevivere 2000, 138)

5. We recognise that the number of official consultations documented on the Chancellor’s website is only a small percentage of a much larger number of bilateral communications with other government leaders in that many phone calls to foreign counterparts are not documented. However, our German interviewees confirm that the density and frequency of contacts with counterparts from the HL countries are not underestimated by focusing upon this source. Further, it is likely that informal contacts via phone with other government leaders involve relatively even more communications with the French president because of the relative importance of the bilateral relationship. With regard to the content of these consultations, the information officially given does not always allow us to distinguish between different types of Eurozone issues covered. However, we assume that financial support issues ranked high due to their highly controversial nature.
6. Information provided by e-mail from Wolfgang Schäuble’s office (9 Apr. 2020).

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(1) Interview, senior official German Ministry of Finance, Berlin, 14 March 2012.
(2) Interview, senior official, German Foreign Office, Berlin, 14 March 2012.
(3) Interview, senior official, German Chancellery, European department, 14 March 2012.
(4) Interview, senior official, Ministry of finance of a HL country, Brussels, 11 January 2019.
(5) Interview, former senior official from the German Ministry of finance, Brussels, 11 January 2019.
(6) Interview, senior official from the Ministry of finance of an HL country, 14 January 2019 by phone.
(7) Interview, senior official Ministry of Finance of an HL country, 15 April 2019, by Skype.