The ‘Reluctant Hegemon’: Germany in the EU’s Post-Crisis Constellation

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The global financial crisis of 2008–2009 undoubtedly represents a cornerstone moment for the European Union. It has plunged the eurozone into an existential crisis with an as of yet uncertain outcome. The crisis has dramatically accentuated the structural sovereign debt problems and the systemic economic weaknesses in individual eurozone countries, predominantly in Southern Europe. The crisis in these countries has reached proportions which could still lead to at least a partial breakup of the single currency if it remains unresolved in the long term. This would in turn have profound consequences for the future of the Single European Market and the EU as a whole.

1 The Decline of Working Partnership Options for Germany

To a certain extent the crisis has only accelerated developments which were bound to occur sooner or later. This is especially the case in relation to the emerging changes in the EU’s internal power dynamics. Here the crisis has accentuated the division between the strategic interests of the larger member states, most of all the big three Germany, France and the United Kingdom. In the late 1990s Berlin, Paris and London seemed to have developed significant correspondences in their strategic interests to be able to form a leadership triangle in the EU. The centre-left governments led by Gerhard Schröder, Lionel Jospin and Tony Blair initially displayed a mix between pragmatism and vision, which seemed to make it possible to achieve a threefold working partnership between Berlin, Paris and London. Schröder had declared his intention to expand the Franco-German alliance towards a leadership triangle in the EU (Schröder 1998a: 102) and Blair welcomes this. On

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this basis major institutional reform in preparation of the impending historic wave of enlargement towards new members in Central and Eastern Europe seemed possible (Bensaid 1998). With Britain under Blair showing a greater willingness to engage constructively in negotiations on the development of crucial policy areas, such as defence and security, even further limited integration had become a realistic prospect.

This optimistic phase however subsequently turned out to be short-lived. By the early 2000s the strategic interests of the three countries had started to drift apart. The Franco-German partnership, which had acted as a leadership axis during the first three decades of the integration process became noticeably strained by the fact that after reunification in 1990 the larger Germany had become a politically equal partner for France. After the end of the Second World War French leaders had become accustomed to the fact that their counterparts in the semi-sovereign West Germany would almost by default seek agreement with France on European policy issues (Cole 2001: 68). In the larger Germany, which was substantially burdened by the rising costs of unification, it became obvious that public opinion was no longer willing to support the reflexive Europeanism which had characterised the Bonn Republic. The latter had manifested itself in an excessive multilateralism where the West German political elite had essentially denied a distinction between the German national interest and the wider European interest. West German foreign policy was hence dressed in a distinctly European language (Hyde-Price 2000: 124). Bonn's European policy approach was by default in favour of deepening the economic and political integration, even if this frequently resulted in a rising financial burden for the Bonn Republic (Anderson 1997: 86; Wittlinger 2010: 91–92). The financial costs of European integration were simply outweighed by the economic benefits of being part of the Common Market which provided a vital export market for German manufacturing goods. Moreover, West Germany was in effect semi-sovereign due to the constraints of the reserved rights the WW2 Western Allied Powers had over its external affairs. The multilateral setting of the European Community and in particular the Franco-German partnership allowed Germany to exercise leadership without raising fears of a renewed German dominance in Europe. This led to the bizarre situation that the West German central bank, the *Bundesbank*, established a strong influence over the country's European policy. It acted as the safeguard of the national economic interests by pursuing a rigid policy of price stability which supported the German export market (Heering 2007: 92). This frequently brought it in conflict with the federal government whose representatives had to make efforts to calm the concerns of European partners who did not approve of the *Bundesbank's* stability policy (Le Gloannec 2001: 124). The tensions between the central bank and the federal government were particularly strong during chancellorship of Helmut Schmidt (1974–1982). Schmidt frequently clashed with the *Bundesbank* governor over economic policy priorities (Lohmann 1998: 405), especially over the bank's refusal to back Keynesian policies to stimulate growth during difficult economic periods (Kaltenthaler 1997: 272).

The *Bundesbank* contributed to the mounting divisions which caused the Franco-German tandem to gradually drift apart in the aftermath of German reunification.

During the negotiations on the concrete implementation of economic and monetary union (EMU), which followed the signing of the Maastricht Treaty, the Kohl government was under strong pressure from the *Bundesbank* to ensure that monetary stability would be maintained under the single currency. The government therefore insisted on the introduction of a stability and growth pact for eurozone ('Maastricht criteria') and the establishment of a politically independent European Central Bank, which closely resembled the model of the German *Bundesbank* (Busch 2005: 103–105). François was keen to accompany monetary union with deeper economic policy integration and was supported in this ambition by the French socialist Commission president Jacques Delors. Mitterrand gave up his initial reluctance towards the reunification of the two German states (Guérin-Sendelbach and Schild 2002: 35) when Kohl signalled his willingness to embed the larger Germany into a single currency which would eventually be accompanied by deeper economic integration (Webber 1999: 22; Bulmer 1997: 70). Subsequently Mitterrand however had to realise that the Kohl government was reluctant to accompany the successful export of the *Bundesbank* model to the European institutional level (Bulmer et al. 2000: 41–42) with the harmonisation of economic and social policies.

The disagreements over the configuration of EMU turned out to be a major strain on Franco-German relations, which culminated at the Amsterdam EU intergovernmental conference in May 1997. Amsterdam witnessed an unprecedented public disagreement between the French and German leaders when chancellor Helmut Kohl rejected the proposals made by the newly elected French socialist prime minister Lionel Jospin to harmonise employment policy in the EU. Jospin's proposals were also rejected by British Labour prime minister Blair, who supported Kohl's opinion that policy harmonisation would increase the financial burden on member states. Jospin was hence reluctantly forced to accept the European Employment Strategy (EES) compromise, which prioritised labour market liberalisation on the basis of the non-binding open method of coordination of national policies (Moss 1998: 246). Kohl's refusal to follow French calls to combine monetary union with concrete economic policy harmonisation illustrated that the strategic interests of France and the larger Germany were drifting apart. French leaders reacted by repeatedly questioning the design of EMU, most of all the debt limits of the stability and growth pact and the political independence of the European Central Bank (Guérot et al. 1998: 134). As a result, Germany refused to back the French candidate Jean-Claude Trichet for the post of president of the newly established European Central Bank in 1998. The Kohl government instead opted for Wim Duisenberg, a former adviser of the International Monetary Fund and the Dutch Central Bank. Duisenberg, who had built a reputation for himself as a supporter of the German *Bundesbank's* monetary stability policy, was considered as a guarantor of the political independence of the European Central Bank. The refusal of the Kohl government to accommodate French demands illustrated that the times where Germany was willing to follow the French lead in shaping the EU were over. This became even more pronounced when a younger generation took over the leadership in Berlin in September 1998. The SPD/Green Party coalition led by

Gerhard Schröder showed little hesitation towards articulating what it perceived to be Germany's national interests. It quickly became clear that Schröder would adopt a much less visionary and a far more practical approach to European issues. He in effect applied a cost-benefit analysis to German European policy and openly declared that since German reunification 'our European payments stand in competition with the internal German transfers' (Schröder 1998b). Schröder consequently sided with British prime minister Tony Blair in calling for a fundamental overhaul of the EU's institutions and policies to prepare it for the upcoming enlargement towards new member states in Central and Eastern Europe. Part of this was the demand to acknowledge Germany's increased population size by boosting the number of votes Germany has in the European Council. German foreign minister Joschka Fischer had asked for this in the context of putting forward general proposals on the future institutional design of the EU (Fischer 2000). The French government, which held the EU Council presidency during the months leading up to the crucial Nice intergovernmental conference in December 2000, refused to accommodate the German demands. This caused the unprecedented situation that France and Germany did not present joint proposals for the implementation of major institutional reforms in the run-up to Nice. Chancellor Schröder also had substantial disagreements with French president Chirac over his proposals for institutional reform. The general view amongst member states seemed to be that French president Chirac had pursued a unilateral approach in the preparation of the Nice conference which failed to accommodate the variety of interests in the EU (Froehly 2002: 5). This was most openly expressed by Tony Blair whose verdict on the intergovernmental battles at the summit was: 'We can't go on like this'.

The Nice summit had made it obvious that the Franco-German couple was no longer able to find enough common ground to exercise joint leadership in the larger EU which then already comprised of 15 member states. In the larger EU progress was most likely to be found through shifting short-term working partnerships between the larger member states (Grabbe 2001: 2). The EU's emerging variable leadership geometry opened a new opportunity for other member states to exercise influence on the EU policy agenda. The failure of France and Germany to exercise joint leadership created a void which needed to be filled. For a limited period it seemed that the UK under Blair would be willing to realise this opportunity by exercising a new constructive approach towards European issues. Even before he had become prime minister Blair spoke of his ambition to ensure that the UK would adopt a leading role in the enlarging EU (Blair 1995). He subsequently took joint leadership with French president Chirac to push towards the development of military crisis reaction capabilities for the EU in response to the European failure to resolve the refugee crisis in Kosovo without military support from the United States. Blair put his engagement in the area of defence and security in the context of his ambition to turn Britain into a bridge between European and American interests (Blair 2000). Blair also substantially engaged in the discussions on the future of the EU's institutional framework. While he still did not share the German vision of a federal Europe, Blair strongly supported the German red-green coalition in its aspiration to reform EU institutions and policies towards greater transparency and

efficiency (Grabbe and Münchau 2002: 17). The area where Blair managed to exercise most influence, apart from defence and security, was however in pushing forward a reformed policy agenda for the Single Market. Here the controversial Blair-Schröder paper, which the two leaders published in June 1999, proposed a profoundly different perspective on the future of employment and welfare state models than the one that the French socialist government of Lionel Jospin had promoted. Jospin warned the EU not to head down the path towards becoming merely a free trade area and called for the establishment of a 'genuine body of European social law' (Jospin 2001). In contrast Blair and Schröder promoted a liberal reform programme which advocated greater labour market flexibility, deregulation and the reform of welfare systems towards greater efficiency and activation of the unemployed. Schröder's support for Blair's 'third way' economic agenda provided the backbone for the reformed Single Market policy framework which the EU implemented in the early 2000s.

The 2000 Lisbon Strategy promoted the development of a 'knowledge driven-economy' and a reformed social model for Europe based on deregulated labour markets, worker flexibility and welfare-to-work strategies. It was substantially influenced by the reformed social democratic policy agenda which Blair and Schröder promoted in cooperation with Commission president Romano Prodi, himself a dedicated centre-left reformer. Critics of the approach branded it as a copycat of the new economy in the United States (McCann 2010: 39), where the Clinton presidency had boosted growth and job creation by introducing welfare-to-work policies, deregulating the financial industry and promoting jobs in the high-tech electronics industry. The agenda of the progressive left in Europe was substantially influenced by the economic agenda of Bill Clinton's 'New Democrats' through personal contacts between senior members of the Blair government and the multilateral discussions within the *Progressive Governance Network*, which was launched in 1999 (Gould 1998: 235).

Under these circumstances the parameters for the establishment of a lasting strategic working partnership between Germany and the UK seemed to be ideal. Blair emphasised this in 2001 when it seemed that a leading role in the EU had become a core ambition of his government's programme. Speaking at the SPD party conference in Nuremberg in November 2001, Blair delivered a tour de force of his European policy priorities and repeatedly emphasised the proximity of London's and Berlin's approach on strategic European issues: 'Britain and Germany—Labour and SPD—stand as one' (Blair 2001).

In the end Blair's engagement with the European agenda turned out be a rather short-lived affair. In this respect the terrorist attacks on the US mainland on 9/11 became a turning point. By 2002 Blair's political efforts concentrated on supporting US president George W. Bush's war on terror and the UK became embroiled in the controversial military invasion of Iraq. The military campaign caused a profound divide in the EU between the countries who supported Blair's course and those who refused to engage in the mission. The most outspoken opponents turned out to be France and Germany. Blair's former political ally Schröder placed his categorical refusal to participate in the Iraq invasion at the top his programme for re-election in

2002. Schröder argued that engagement in Iraq would be against the principle of German foreign policy to use military as a last resort (Schröder 2003). The division pushed France and Germany once again closer together. At the Franco-German summit in September 2003 French president Chirac and chancellor Schröder began to intensify efforts to improve the coordination of their European policies. They nevertheless subsequently struggled to regain the leadership initiative in the EU, which had just expanded to ten new members and now represented an even wider range of national interests. Moreover, both countries became increasingly preoccupied with resolving their worsening economic performance with sluggish GDP growth, rising unemployment levels and budget deficits. Already in 2002 France and Germany became the first two eurozone members who broke the debt limits determined by the eurozone stability and growth pact. Both countries borrowed in excess of three per cent of their annual GDP between 2002 and 2005. Their structural deficit started to exceed the Maastricht debt ceiling of 60 % by 2003 and both have never managed to reduce it below this limit since then (Eurostat 2013a). France and Germany never faced any financial penalties for breaking the criteria. Chirac and Schröder convinced the Prodi Commission to apply a lenient approach towards them. This resulted in a substantial loss of credibility, especially for Germany, who had effectively designed the pact in the first place (Hay and Wincott 2012: 158; Giddens 2006: 33).

The declining German economic performance stood in stark contrast to that of Britain, which had witnessed an ongoing economic boom since the second half of the 1990s. New Labour's investment in active labour policies and education, combined with a laisser-faire regulatory culture for the financial sector, created record levels of growth and jobs, predominantly in the area of financial services. In contrast, Germany plunged into recession in 2002 and only managed to return to sluggish growth rates before 2006. As a result, many economists in Germany and elsewhere predicted that the German coordinated model was unsustainable under the conditions of globalisation. This assessment was based on a supposed lack of flexibility of the German labour market, in combination with a generous and costly welfare system which rewarded inactivity rather than to encourage the unemployed to get back to work (Sinn 2004; Streeck 2009). The Schröder government reacted by introducing profound structural reforms of the German labour market and benefits system under the *Agenda 2010*, which contained the controversial *Hartz* labour market reform package (Kemmerling and Bruttel 2006).

The early 2000s were hence characterised by the bizarre situation that the influence of France and Germany in the EU started to decline while the British influence increased noticeably. This occurred in spite of Blair's waning engagement in European affairs after the Iraq war. The role model character of New Labour's 'third way' economy in terms of economic growth and job creation gave Blair the upper hand when it came to proposing the way forward for the EU Single Market. Based on Britain's strong economic track record since 1997, the handwriting of Blair and his New Labour confidantes Gordon Brown and Peter Mandelson was consequently more than obvious in the review of the EU's Single Market policy strategy, which took place under the Barroso Commission. Former Portuguese

prime minister José Emanuel Barroso was Blair's desired candidate for the position of Commission president after Romano Prodi. Barroso not only had sided with Blair over the military intervention in Iraq but had also made himself a name as a liberal reformer at home. The fact that Blair managed to push Barroso through against Belgian prime minister Guy Verhofstadt, the preferred candidate of Chirac and Schröder, can be interpreted as 'a symptom and a cause of the consolidation of the UK as a central player in the European Union, at the expense, to some degree at least, of France and Germany' (MacDonald 2005: 191). Barroso reciprocated the favour by appointing Blair's political spin doctor Peter Mandelson, himself a firm advocate of 'third way' politics, as Trade Commissioner (Banks 2004). Under Barroso's leadership the Commission also implemented the central ideas of New Labour's economic policy into the revision of the Lisbon Strategy. The revision concentrated not only on increasing labour market flexibility but also on promoting the relaxation of the regulations for lending practices in the financial industries across the Single Market. The purpose of this was to facilitate consumer credit and mortgage lending and to stimulate economic growth in similar fashion as this had occurred in the United States (European Communities 2004: 26–27).

2 The Impact of the Financial Crisis: From Problem Case Towards New Hegemon

In spite of the UK's good economic record and the resulting boost to its influence in setting the EU's policy agenda, the New Labour government never managed to realise its ambition to secure a permanent leadership for their country in the EU. This was due to a substantial rise of euroscepticism in the UK in response to the EU's plans to establish its own constitution. The constitutional treaty, which a convention with representatives from all member states and EU institutions had drafted under the leadership of former French president Valéry Giscard d'Estaing in 2004, was met with profound scepticism at home. Even Gisela Stuart, one of Britain's chief negotiators in the convention, publicly voiced her concerns about the final document (Stuart 2003: 2). Blair initially proposed to hold a public referendum in response to the mounting criticism of the constitution in the UK. When it was rejected by public referenda in France and the Netherlands in 2005 and ratification procedures were subsequently put on hold, the British referendum became obsolete and the EU drifted into an semi-existential crisis. At first it seemed that none of the larger member states was willing to take control of the European vessel which was effectively drifting along rudderless in 2005/06. The French president Jacques Chirac was substantially weakened and practically politically paralysed in the EU by the rejection of the treaty which he had strongly supported. Gordon Brown, who succeeded Blair as prime minister in 2007, argued that no further major treaty changes would be necessary and that the EU could continue to operate on the legal basis of the 2001 Nice Treaty (O'Donnel and Whitman 2007: 262). Brown's stance became symbolic for the European policy approach of his rather brief premiership, which was overshadowed by a systemic

banking crisis in the UK which quickly emerged as a ripple effect from the sub-prime mortgage crisis in the US. Brown therefore restricted his engagement in the EU to supporting joint initiatives towards with the purpose of implementing more effective supervisory and regulatory standards. Here he initially showed more initiative than other EU leaders (Traynor et al. 2008). The crisis revealed that the New Labour's third way economic approach had given too much leeway to the financial sector and actually tolerated similarly precarious lending practices as those that emerged in the US. Brown, who had been responsible for the cornerstones of New Labour's economic policy as Chancellor of the Exchequer for a decade between 1997 and 2007, subsequently acknowledged that the light touch regulation of the financial industry was a mistake because markets had failed to show moral standards (Brown 2010: 66). The decline of Brown's economic credentials and the loss of the British economy's role model character in Europe with rising unemployment and a swelling public deficit, effectively ended the period when the UK had a relatively strong influence on the EU's policy agenda.

The resulting leadership gap was filled by Angela Merkel, who in 2005 became Germany's first female chancellor and only the second chancellor of a grand coalition government between the CDU/CSU and the SPD in Germany's history. Merkel stepped into the fray and rescued the EU's constitutional process. Under the German EU Council presidency in the first half of 2007 Merkel led the negotiations on the transformation of the constitutional treaty towards the Lisbon Treaty. Merkel's ability to rescue core provisions from the failed constitutional treaty against widespread scepticism amongst other EU member states was considered as a substantial achievement (Müller-Brandeck-Bocquet 2011: 618–619).

When the effects global financial crisis swept across Europe and severely affected individual countries in the eurozone, most of all Ireland and the Southern European economies, Merkel quickly found herself under substantial pressure to take the lead in developing a concerted response to the events with the aim of restoring market confidence. Surprisingly for many of those who had previously predicted the swift decline of the *Modell Deutschland*, the German economy went through the crisis relatively unscathed. This was the result of a combination of factors, amongst them a lower degree of reliance on the global financial markets than the liberal economies of the UK and Ireland. More importantly however, the German model turned out to be more adaptable to change than was widely assumed. By 2006 the positive effects of the profound labour market and welfare reforms which the red-green coalition under Gerhard Schröder had implemented in 2003 became obvious. Germany's annual GDP growth increased to 3.6 % and unemployment started to fall. During the peak of the crisis (2007–2010), when many other eurozone countries saw a steep rise in unemployment, Germany's unemployment rate decreased from 10.1 to 7.3 %. It has been falling ever since to a new low of 5.5 % in 2012 (Eurostat 2013b).

Figure 1 shows that after 2006, with the exception of 2009, the German economy grew by between one and 4 % per year at a higher rate than the average growth rate in the eurozone-17.

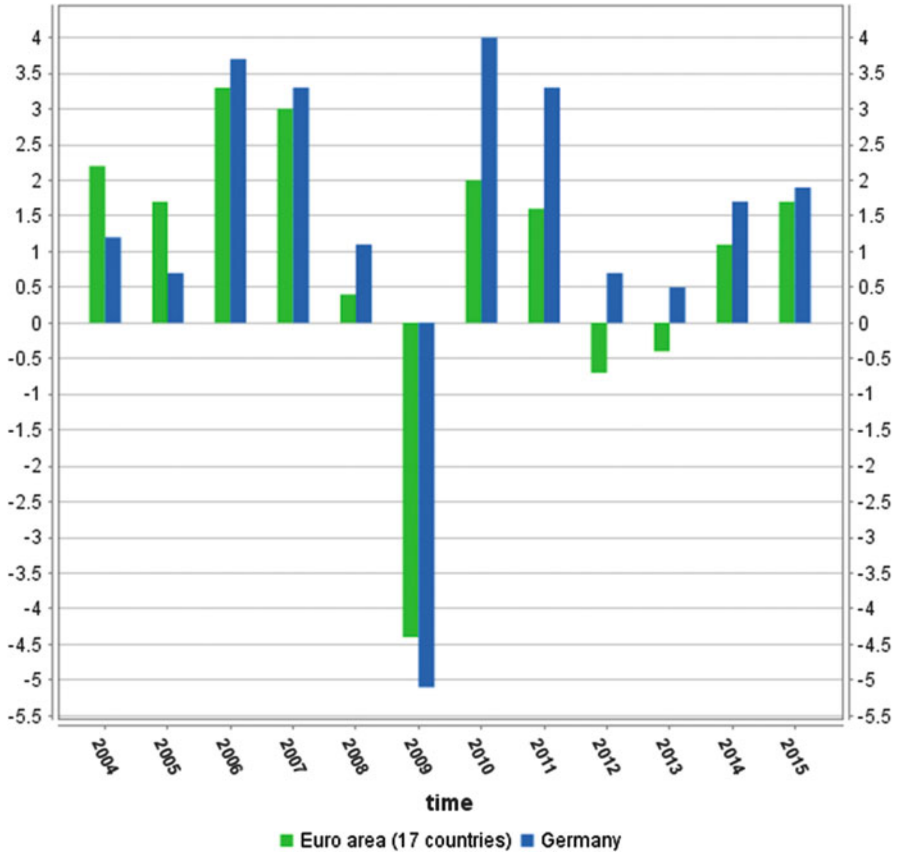

Fig. 1 Real GDP growth rate in Germany and the Eurozone-17 (percentage change on previous year). Source: Eurostat. Available at http://epp.eurostat.ec.europa.eu/tgm/graph.do?tab=graph&plugin=1&pcode=tec00115&language=en&toolbox=data. Accessed 14 January 2014

The success of the German model in adapting to external challenges in spite of a number of substantial inherent institutional constraints in its consensus democracy provided evidence the coordinated model is able to adapt to successfully external challenges without abandoning its fundamental principles (Busch and Goldbach 2011: 293). The orientation of the German economy towards consensual arrangements between the government, employers and trade unions actually turned out to be an asset rather than a disadvantage during the crisis. Germany benefitted from having been under a grand coalition at the time of the onset of the financial crisis. Based on a substantial majority backed by the two major parties CDU/CSU and SPD in the national parliament *(Bundestag)* and the Federal Council (*Bundesrat*), which represents the interests of the Länder, the grand coalition was able to steer the economy through the crisis by adopting consensual solutions with employers and trade unions. This was most important in the area of employment,

where the government temporarily subsidised jobs. In return trade unions agreed to adopt a flexible approach towards the reduction of contractual working hours and wage restraint, while employers refrained from abandoning jobs (Zohlnhöfer 2011: 23). Germany certainly benefitted substantially from having gained an export market for its products within the eurozone, particularly to those countries who subsequently fell into a sovereign debt crisis. Some have blamed Germany for having developed its continuing success as an export giant at the expense of other eurozone countries who would now pay the price for the German economic advantage. The argument is that the combination of the general trend towards domestic wage restriction in Germany since reunification could not be matched by the countries in the Southern periphery of the eurozone, who consequently became uncompetitive. At the same time the low-interest environment the European Central Bank maintained in the eurozone is supposed to have given the German economy an uneven advantage over the economies of Southern Europe, who had supported German exports on the basis of cheap consumer credit (Lapavitsas et al 2012). While this view ignores the fact that Germany's export performance was also substantially boosted by the attractiveness of its products in the emerging markets in Asia during the crisis (Young and Semmler 2011: 19), it cannot be completely dismissed and has added to widespread sentiment of Germany having established a position of economic hegemony in the eurozone.

The dominant political role, which Germany established in the EU as a result of its regained economic strength, however needs to be considered from a differentiated angle. In spite of the tendency of German leaders since reunification to be bolder in articulating their country's national interests, none of them has ever shown a desire to act unilaterally. Instead Germany has continued its tradition of multilateral engagement by consulting widely with its partners in Europe. The main difference to the approach of the Bonn Republic lies in the greater openness towards establishing working partnerships outside of the traditional Franco-German partnership. This explains why even under the fundamentally altered conditions, following the profound effects of the global financial crisis in 2008–2009, Germany is neither willing nor able to impose its preferences unilaterally on the rest of the EU. The economic hegemony which Germany established over the rest of the EU, in particular the eurozone, turned out to be as unintentional as its subsequent dominant role in shaping the policy mechanisms in response to the crisis. Merkel initially had neither seen the need to initiate collective support mechanisms for the countries who became embroiled in a structural banking crisis nor did she find it necessary to develop new supranational regulatory initiatives. During the initial period of the crisis in 2008 it seemed that Gordon Brown and Nicholas Sarkozy, who were both convinced of the need to respond to the crisis collectively, had to push Angela Merkel to take action. Supported by her social democratic finance minister Peer Steinbrück, Merkel rejected British and French calls for an EU-wide economic stimulus package and a bailout plan for countries with severe sovereign debt problems (Hall et al. 2008). Merkel came increasingly under fire for her hesitant stance and her failure to take an active leadership role in resolving the crisis. French president Sarkozy publicly criticised her at a joint press conference in

November 2008 when he emphasised that France would be working on solutions to the crisis while 'Germany is thinking about it' (Sarkozy and Merkel 2008).

Merkel eventually was forced to take action as a result of the worsening levels of market confidence which resulted in the downgrading of the credit ratings of the crisis economies Ireland, Greece, Portugal, Spain and to a lesser extent Italy. These developments posed the real risk that they may eventually be forced out of the eurozone with dire consequences for the future of the single currency. Merkel's first step was to work with Sarkozy and the Commission to ensure that the EU's new Single Market strategy would be accompanied by a more effective mechanism to supervise national budgets and ensure macroeconomic stability than this had been the case under the previous open method of coordination. The resulting *Europe 2020* Strategy annual policy cycle of budgetary and macroeconomic supervision (*European Semester*) is only binding for the member states of the eurozone. Member states who currently do not use the euro are part of the cycle and also submit annual Stability and Convergence Programmes in response to the overall reform priorities set by the Commission in its annual growth survey. In practice their participation in the *European Semester* is however monitored on the basis of the open method of coordination. This means that the countries outside the eurozone only receive policy alerts from the Commission and the Council if they are deemed to be at risk of fiscal or macroeconomic instability (European Commission 2010: 25). The wide range of targets set out in the strategy in other areas, such as social cohesion and environmental sustainability, continue to be operated under the loose open method of coordination. Financial penalties of up to 0.1 % of the national GDP can only be issued against countries in the eurozone if they fail to comply with the budgetary limits of the stability and growth pact (three per cent annual deficit limit and less than 60 % gross structural debt in relation to a country's GDP) or the new golden rule of a limit to the structural deficit to 0.5 % of the national GDP at market prices (European Council 2012: Articles 3 and 8). The golden rule was introduced under the *Treaty on Stability, Coordination and Governance* ('Fiscal Compact'), which 25 of the 27 member states signed in March 2012. The treaty came into effect in January 2013. Merkel had intended to incorporate the compact in the EU's treaty structure to make the budgetary golden rule binding for all EU member states. The British prime minister David Cameron vetoed this and the Czech Republic under the leadership eurosceptic president Vaclav Klaus also opted out. As a result the golden rule of the Fiscal Compact is only compulsory for the now 18 eurozone countries but the other signatories, who are considered to be aspiring members, are also expected to voluntarily abide by the rule. The *Europe 2020 Strategy* policy mechanism and the Fiscal Compact are accompanied by the further layer of the 2011 *Euro Plus Pact* in which the Euro-17 countries plus six non-members (Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania) committed themselves to deepen the coordination of their policies in the areas of fiscal responsibility, financial system stability, labour market reform and overall competitiveness beyond the *European Semester* (European Council 2011).

When it became clear that countries like Ireland and Greece would be unable to consolidate their budget without external support, Merkel also had to give up her

initial strong resistance against providing financial help to crisis countries. The creation of the temporary loan facility, the *European Financial Stability Facility* (*EFSF*) in October 2010 which was followed by the establishment of the permanent *European Stability Mechanism* in 2011, illustrated that Germany as the leading economy in the eurozone could not escape its inevitable role to become the largest creditor and consequently also the dominant force in shaping the accompanying policy framework. It accepted its new role as a hegemon in Europe, albeit very reluctantly and with great hesitation (Paterson 2011: 73). Merkel was under a great deal of domestic pressure not to use German public funds to support the crisis countries. The domestic opposition against introducing a collective responsibility in the EU for budgetary deficits grew substantially. A group of academics, supported by the eurosceptic Bavarian CSU politician Peter Gauweiler, challenged the principle of the EFSF and the loans which were allocated to Ireland (€17.7 billion), Portugal (€26 bn) and eventually Greece (€109 bn) at the German Federal Constitutional Court. The court has since rejected the challenge against both the EFSF and ESM but emphasised that the German federal government would have to request parliamentary approval for each new loan. In its final ruling on the EFSF the court denied the federal government the permission to transfer budgetary powers to EU level bodies (Bundesverfassungsgericht 2011). In its earlier ruling on the Lisbon Treaty in 2009, the Constitutional Court had emphasised that the further transfer of political sovereignty in key policy areas, which affect the economic and social living conditions, would demand a new constitutional settlement in Germany on the basis of a public referendum (Bundesverfassungsgericht 2009). The Constitutional Court has therefore determined the future scope for German European policy which clearly restricts the federal government's ability to agree to a further transfer of powers towards a political union. Bulmer and Paterson argue that recent rulings have turned the Court into a 'co-shaper of German European policy' (Bulmer and Paterson 2013: 1399). Besides between 2009 and 2013 Merkel was governing Germany in a minimum-winning coalition with the FDP, which made any major European policy decision substantially more vulnerable to be blocked by the opposition in the *Bundesrat*. Under Germany's *semi-sovereign* polity the federal government and the regions are effectively trapped in a 'joint decision trap' (Scharpf 2005) which makes consensus on major policy decisions inevitable. It is therefore preferential for any federal government to adopt a consensual approach in its European policy, both by consulting with the opposition on the domestic level and by presenting new initiatives as a multilateral effort with other European partners.

This partly explains why Merkel was reluctant to move centre stage during the crisis and was content to at least publicly present the emerging various policy initiatives in response to the crisis as a joint effort with French president Sarkozy. By the 2010 the public presentation of the new EU and eurozone policy mechanisms hence became part of the close double act which the press widely portrayed as the 'Merkozy' duo (Guérot and Klau 2012). The display of public harmony concealed the fact that it was Merkel who called the shots and was unwilling to follow Sarkozy's proposals for deepening the joint responsibility for

the sovereign debt crisis, such as Eurobonds (Paterson 2012: 247). In substance the unity between Merkel and Sarkozy was limited to their agreement on the fact that under the original design of the eurozone stability and growth pact member states had failed to implement the effective supervision of national budgets. Both therefore concluded that the most effective means of preventing further sovereign debt crises in the eurozone would be the implementation of a debt brake into national constitutions under the Fiscal Compact. In the words of Merkel at their joint press conference on the Fiscal Compact in 2011: 'In the face of non-existing budgetary competence of the European Commission the inherent link of the debt rule with national law is best suited to make it compulsory for all of us' (Merkel and Sarkozy 2011). Merkel's narrow focus on austerity and budgetary supervision however undermined Sarkozy's political standing at home. His opponents accused him of dancing to Merkel's tune and his socialist opponent François Hollande used Sarkozy's closeness to Merkel as a successful political tool against him in the May 2012 French presidential election.

Merkel was unable to put into practice her ambition to introduce the effective coordination and supervision of national budgetary and macroeconomic policies in the whole of the Single Market. The new policy framework is multi-layered and in effect divides the EU into a more closely integrated eurozone core, where member states have strengthened the Commission's supervisory and coordinative powers, a semi-periphery of associated countries (under the Fiscal Compact and Euro Plus Pact) and an outer periphery of countries who opt for loose coordination (currently represented by the UK and the Czech Republic). In its current shape the EU has emerged from the crisis in a state of disunion with multiple groupings rather than united around a collective future policy agenda (Dyson 2012: 181). Moreover Merkel has been widely criticised for narrowing the crisis response to that of an austerity union without a long-term vision and little consideration for the wider social implications of the crisis, such as spiralling unemployment in the crisis countries in the Southern periphery of the eurozone. Zbigniew Brzezinski summed it up as: 'Europe's main problem is that today's European Union is a Europe more of banks than of people, more an economic convenience than an emotional commitment of the European peoples' (Brzezinski 2013).

3 Destined to Be Alone at the Top?

Germany's leadership in response to the crisis has caused much controversy domestically but even more so across the eurozone and the EU. Germany's new hegemonial role has increasingly been perceived as 'policy dictate' by other EU member states and most of all by the crisis countries (Hübner 2012: 161). The increasing alienation of the United Kingdom from the EU with the realistic possibility of an exit after a public referendum in 2017 and the practical invisibility of the Franco-German partnership since Hollande's election as French president present an unprecedented scenario for the EU. These developments are not exclusively the result of Germany's unintended hegemonial role since the advent of the crisis but

stem from a variety of factors. The perception of an emerging German design of the EU's post-crisis institutional setup is nevertheless troubling for German political elites who are aware that a lasting political settlement can only be found on a multilateral basis. Germany does therefore neither relish its current position nor is it in its long-term strategic interest. The German political elite is likely to aspire to broaden the unavoidable role as a 'hegemonic stabilizer' (Bulmer and Paterson 2013: 1392) it had adopted during the sovereign debt crisis towards that of a leading coordinator of a broadly based multilateral agenda for the future of the EU. This would mark a return to the traditional default German European policy position.

At home the main challenge is to avoid a surge in support for the opponents of Germany as the financial stabilizer in the eurozone. The opponents of Germany's engagement in the now permanent ESM loan facility has in the meantime found a political home in the newly created Eurosceptic party *Alternative für Deutschland* (*ADF*), which calls for a return to national currencies in the eurozone. The ADF polled 4.7 % in the 2013 federal election in Germany and continues to ride high in the polls. Merkel has responded to these developments by adopting a more cautious approach towards proposals to transfer further sovereignty towards the EU level. The awareness of the domestic constitutional hurdles on the path to a potential political union have caused a situation where Germany seems to be divided between the supporters of the classic community method of integration towards deeper harmonisation and those that prefer more effective policy coordination on an intergovernmental basis. The split goes right through the third coalition government which took office in December 2013. Merkel herself seems to have moved away from plans towards a federal political union for the eurozone and is supported in this by parts of the CDU and her Bavarian sister party CSU. In her latest European policy intervention she calls for measures to strengthen the economic and social policy coordination in the EU but rejects the political vision of her finance minister Wolfgang Schäuble, who had proposed a federal union with substantially enhanced powers for the European Commission and the European parliament (Sauga 2013: 36):

> At this stage I do not see any need to transfer further powers to the Commission in Brussels within the next few years (. . .) Economic policy coordination in Europe is far too weakly developed, it has to be strengthened, which is something different than more competencies for Brussels (Merkel 2013).

Externally the main challenge for the third CDU/CSU-SPD grand coalition government, is to re-establish working partnerships with the group of the larger member states in the EU. France will continue to be an indispensable strategic partner for Germany as it shares its fundamental pro-European vocation. In the EU of now 28 member states Germany will however aspire to work towards the establishment of a broader strategic leadership alliance. Here Poland is likely to play a crucial role as a country which can potentially fill the emerging gap in the variable geometry of the group of larger member states which result from the obstructive role the UK has adopted under David Cameron's leadership and the passivity that marks Italy and Spain, who are preoccupied with resolving their economic and social problems. Germany has long-standing close economic and political relations with Poland and

the other Central and Eastern European member states, which stem back to the time of *Ostpolitik* in the 1970s. Opposition to the German austerity approach in response to the crisis has been marginal in the CEE region. In contrast to other EU member states in the Western and Southern part of the Union, the CEE countries are in favour of budgetary rigidity and have a long-standing experience with profound structural domestic economic reforms (Central and Eastern European Development Institute 2014: 7). The Polish government has turned out to be a loyal ally throughout the crisis and called for continuing German leadership when others in the EU criticised it (Sikorski 2011). It has also made no attempts to conceal its leadership ambitions by strengthening its involvement in the Weimar Triangle with Germany and France. Moving to the core eurozone group by adopting the euro has therefore been a major goal of Polish foreign policy in recent years (Schweiger 2013: 36). Poland was the only country who did not plunge into recession at any time during the crisis. It nevertheless recently suffered a setback with regard to its ambition to meet the budgetary criteria for joining the eurozone (Stryjek 2013: 52). As the largest country in the CEE region and the Visegrád 4 group Poland has crucial strategic importance for Germany. Under the third grand coalition Germany is therefore likely to attempt to rejuvenate its traditional partnership with both France and Poland, the latter of which is in the process of overtaking France economically and has also shown greater support for a more integrationist German vision for the future of the EU (Gebert and Guérot 2012). Frank-Walter Steinmeier, who took over the foreign policy brief for the second time in December 2013, advocates for Germany to broaden its vision for the EU beyond austerity and has indicated in this respect that the Weimar triangle would be crucial for Germany to ‘determine strong initiatives for the future of Europe’ (Auswärtiges Amt 2013). The future for Germany’s role in the EU is therefore likely to be positioned in an enhanced strategic leadership axis between Berlin, Paris and Warsaw. The challenge for Germany will be to make sure that both partners are ready to board this train and to set it in on a stable track towards securing a lasting future for the EU and the eurozone.

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