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European Banking Regulation after the Financial Crisis: Franco-German conflict of interest during the negotiations on a Single Resolution Fund

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Abstract

In response to the recent financial crisis, European policymakers put banking regulation in the Eurozone on top of the agenda. In 2016, as part of the newly created European banking union, a mechanism for resolving troubled banks, the Single Resolution Mechanism (SRM), became fully operational for the 19 member states of the euro area. The SRM was established to avoid future involvement of tax payers' money in the resolution of banks. This paper focuses on the negotiations on one of its instruments, the Single Resolution Fund (SRF), a fund of ex-ante contributions of Eurozone banks set up to winding down unviable banks. The SRF proved to be a main conflict issue during the negotiations. Germany and France were pushing for diverging preferences although both countries' banking sectors suffered from the crisis and both governments generally favored a regulatory approach on the European level. I provide an institutionalist explanation for these opposing positions of the two most important Eurozone countries. By drawing on the "Varieties of Capitalism" literature, I explain how the distinct features of these countries' financial and banking systems accounted for their preferences. On the one side, German negotiators sought to preserve the dominant way of bank-based corporate finance by particularly protecting savings and cooperative banks. On the other, the French government was in favor of higher contributions by the banking sector because market-based corporate finance is more prevalent in France. Nevertheless, France aimed at keeping its 'national champions' out as far as possible. This paper has important implications for how to think about preference formation in European financial regulation.

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List of abbreviations

BRRD	Bank Recovery and Resolution Directive
CEO	Chief Executive Officer
CME	Coordinated Market Economy
EC	European Commission
ECB	European Central Bank
EDIS	European Deposit Insurance Scheme
EMU	European Monetary Union
ESM	European Stability Mechanism
GDP	Gross Domestic Product
IMF	International Monetary Fund
IPO	Initial Public Offerings
LME	Liberal Market Economy
NFC	Non-Financial Company
SMEs	Small and Medium Enterprises
SRB	Single Resolution Board
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
VoC	Varieties of Capitalism

1. Introduction

During the recent financial crisis that erupted in 2007, banks across the Eurozone got into difficulties. Large bailouts of banks took place in several countries to avoid failures and further contagion across the financial system. In doing so, taxpayers' money was used to rescue banks which caused an immense increase in governments' debt to GDP ratios and widespread social discontent. The underlying assumption of these actions was a "too-big-too-fail" paradigm. It acknowledged the relative importance of saving systemically relevant banks over the "rules of the game", namely the possibility of a bankruptcy resulting from bad business practices. Consequently, a problem of moral hazard arose as banks could assume that government intervention would always take place in cases of emergency (Deutsche Bundesbank 2014: 32). The banking crisis in Cyprus was handled in a different manner: The adjustment program negotiated between the Cypriot government and the European Commission (EC), International Monetary Fund (IMF) and the European Central Bank (ECB) comprised a writing-off of certain banking accounts of two banks in Cyprus – hence a bail-in of deposits.

These cases do not only illustrate different approaches to deal with banking crises but also the pre-crisis failure to establish a European banking union that lays down common rules within the European Monetary Union (EMU) (Cœuré 2013). Therefore, in the aftermath of the crisis a debate on the introduction of new regulatory measures and the setting of common standards arose (Quaglia 2012). In 2012, the European Council determined the subsequent five components of a European banking union: a single rulebook regarding capital and liquidity directions, a Single Supervisory Mechanism (SSM), a Single Resolution Mechanism (SRM) with a fiscal backstop related to it, termed Single Resolution Fund (SRF), and a European Deposit Insurance Scheme (EDIS) (European Council 2012). While the SSM as well as capital and liquidity obligations for banks have already come into effect, negotiations about the EDIS are still at an early stage and subject to opposing interests. However, this paper focuses on the negotiations concerning the design of the SRM and the SRF in particular.

1.1 The Single Resolution Mechanism

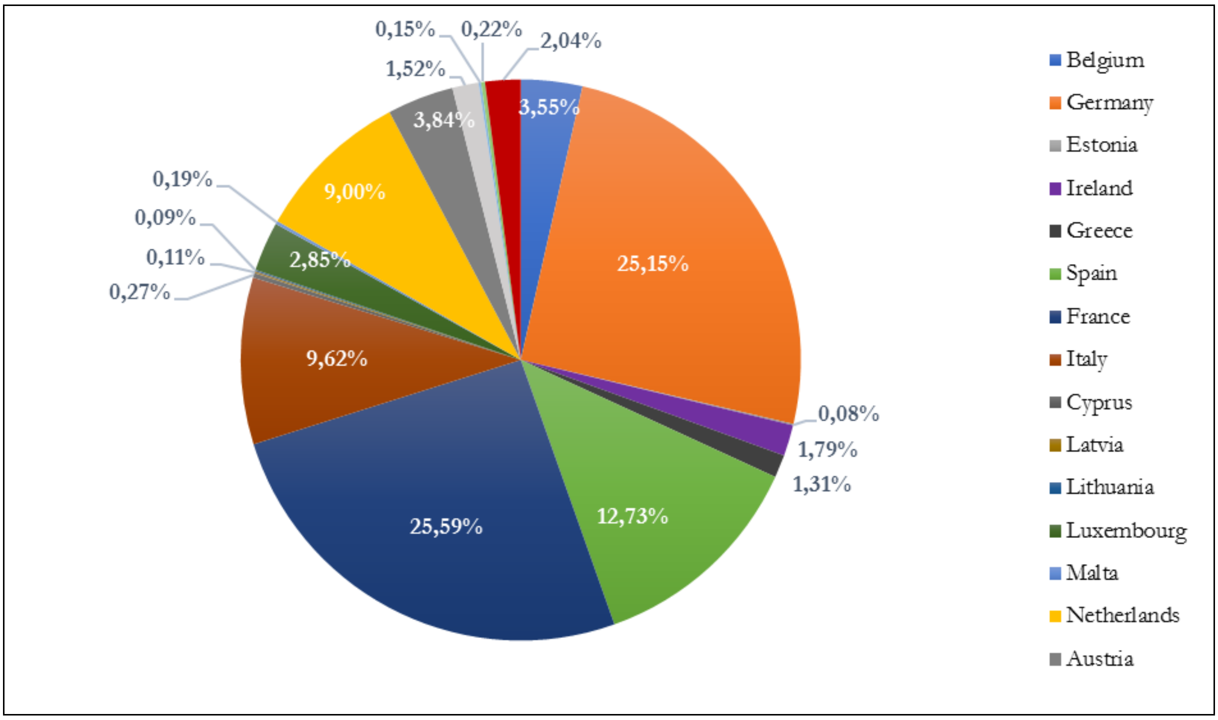
The creation of a SRM was proposed by the European Commission in July 2013 and agreed by the Council of Ministers in December of the same year (Council of Ministers 2013). It sets a common framework for the resolution of cross-border and domestic banks. The mechanism implements the Bank Recovery and Resolution Directive (BRRD) and is composed of a Single Resolution Board (SRB) and a Single Resolution Fund. The SRB consists of representatives from the national authorities, the SSM and the European Commission. It is the decision-making body that is responsible for the effective resolution of nonviable banks. Its goal is to guarantee the minimal involvement of tax payers and the real economy in the process of winding down financial institutions. A clear framework provides the SRB with a set of tools that range from the bailing-in of certain depositors in a narrowly defined order to the usage of means provided by the SRF. The SRF is based on an intergovernmental agreement and will comprise around € 55 billion by the end of 2023. These funds are transferred from a network of national resolution authorities that collect bank levies at the national level (see European Commission 2014; European Commission 2015). This target volume equals 1% of covered deposits of institutions of all participating member states, namely the euro area countries (Single Resolution Board 2015). Although the creation of the SRB and SRF was decided by the end of 2013, negotiations on the distribution of contributions to the SRF among nations and their banks took place in 2014.

1.2 Comparative two-country case study

In this paper, I conduct a comparative two-country case study. As the SRF is an intergovernmental agreement between members of the Eurozone, I will focus on Germany and France since they are the two largest countries with their respective banking sectors each accounting for one fourth of the Eurozone's total assets (Figure 1).

Both German and French banks suffered from the recent financial crisis and their governments had to step in at some point to avoid further contagion (Hardie & Howarth 2009). Thus, a common interest to find a joint solution how to deal with a struggling banking system in a monetary union should be assumed. Indeed, in the aftermath of the crisis, both finance ministries were strongly committed to regulating banking in the Eurozone (Moscovici 2013; Schäuble 2013). Nevertheless, negotiations on the SRM revealed that the two countries are pursuing divergent approaches.

Figure 1: Distribution of total assets by domestic banking groups and foreign subsidiaries and branches among the Eurozone by country in 2014



Source: Own calculation based on European Central Bank 2015: 60.

1.3 Research Question and Objectives

For the aforementioned reasons, I will conduct a qualitative analysis, addressing the research question *why German and French authorities favored two different approaches of regulation*. I seek to explain national preferences of governments in the process of negotiating the Single Resolution Fund by drawing on the "Varieties of Capitalism" (VoC) literature. In a first step, the German and French VoC will be derived to build a theoretical framework that allows to formulate hypotheses about the governments' stances during the negotiations. In the following part, these hypotheses will be tested by analyzing the German and French governments' position regarding the funding of the SRF. Hereby, an explanation will be given based on the comparative institutional advantages of the respective national financial and banking systems as well as the ways of corporate finance related to it. As minutes on the negotiations are not published, national positions will be derived from newspaper articles and policy papers. The last section summarizes the paper's findings.

There is already a considerable body of literature that focuses on regulating the EMU after the financial crisis. For instance, several recent accounts analyze the formation and negotiation of national preferences during the construction of the SSM from different angles (e.g. Gren, Howarth & Quaglia 2015; Hennessy 2014; Howarth & Quaglia 2016; Lombardi & Moschella 2016). By contrast, few research has focused on preference formation in the course of negotiating the SRM, and the SRF in particular, due to the topic's actuality. Although Howarth and Quaglia (2014) as well as Epstein and Rhodes (2016) touch upon Franco-German conflicts of interest within the course of creating the SRM, they barely address the issue of funding the SRF. For that reason, this paper contributes to the strand of research proposing a largely institutionalist explanation for German and French national preferences regarding the financing of the SRF.

2. Comparing national models of capitalism

Hall's and Soskice's (2001) "Varieties of Capitalism" is the central account underlying the recent analysis of comparing national models of capitalism. In the tradition of Shonfield (1965), Zysman (1983) and others, the authors distinguish nations by the institutional frameworks they are built upon. As set forth by Hall (2007), diverging institutional settings result from different responses to socio-economic challenges over time (pp. 40-41). Institutions are defined as "a set of rules, formal or informal, that actors generally follow, whether for normative, cognitive, or material reasons" (Hall & Soskice 2001: 9). Rejecting expectations about institutional convergence as a consequence of globalization, the authors insist on varying national trajectories. These different institutional characteristics lead to distinct ways of coordination in five spheres: corporate governance, industrial relations, vocational training and education, inter-firm relations and firm-employee relations. As coordination is largely undertaken by firms, this approach is seen as firm-centered. Bringing together firms and institutional characteristics, the authors deduce that "[i]n any national economy, firms will gravitate toward the mode of coordination for which there is institutional support" (ibid.). In other words, a firm's behavior is shaped by respective comparative institutional advantages and by the enterprise's ambitions to safeguard the comparative advantages it acts within (Hall & Gingerich 2009: 452). As a result of these assumptions, different corporate responses to similar pressures or shocks are predicted across countries (Hall & Soskice 2001: 16).

Besides that, the concept of institutional complementarities is of relevance. The VoC literature points out that firms will force governments to introduce "institutions complementary to those already present in the economy in order to secure the efficiency gains they provide" (Hall & Soskice 2001: 18). Consequently, institutions in one sphere should be complemented by institutions in other spheres that follow the same logic and type of coordination (Amable 2003: 59-61).

Two divergent institutional settings are defined as ideal types by Hall and Soskice: On the one hand, liberal market economies (LMEs) where coordination takes place via market mechanisms. On the other hand, coordinated market economies (CMEs) build on strategic collaboration based upon non-market relationships and interactions focusing at long-term gains (Hall & Soskice 2001: 33). These features cause different outcomes in the same spheres across countries due to the divergent institutional backgrounds and the comparative institutional advantages they are related to.

This dichotomous categorization, exemplified by Great Britain (LME) and Germany (CME) as European ideal types, is challenged by cases where state intervention and mediation plays a major role. In this respect, France reflects a particular model of capitalism that needs to be further defined (see Section 2.2).

In sum, the VoC approach categorizes states according to their domestic institutional frameworks. Out of these settings, different comparative advantages become apparent which are safeguarded and exploited by national actors.

The following section provides an in-depth analysis of the German and French variety of capitalism. As this paper applies the theory to European banking regulation, I will mostly focus on the comparative advantages of the respective banking systems and models of corporate finance.

2.1 The German model of bank-based finance and a fragmented banking sector

In order to understand the features of German bank-based finance, elaboration on the composition of the German banking sector is needed before turning to the German model of corporate finance and the financial crisis' impact on it.

2.1.1 Banking sector

The German model of corporate finance was traditionally described as bank-based and characterized by the long-term provision of 'patient capital' to non-financial companies (NFCs) monitored by close ties between banks and NFCs (Deeg 1999; Streeck 1997; Zysman 1983). Until today, private, savings and cooperative banks form a three-pillar decentralized banking system (Hackethal 2004). Although such a composition is not a necessary condition of a bank-based CME, it is an elementary component of the German model. Few big private banks dominate the first pillar: notably, Deutsche Bank and Commerzbank (Bankenverband deutscher Banken 2014). Traditionally, large private banks served as house banks for larger German enterprises and provided long-term loans to the industry. To safeguard long-term profitable investment without giving up their ability to monitor the firms, banks were represented in supervisory boards of firms and acquired industrial holdings (Allen & Gale 2000: 71, 95). From the late 1970s onwards, but especially in the 1990s, the private banking sector abandoned its links to the industrial sector to a large degree and increasingly turned away from conventional banking in favor of investment banking and trading activities (Deeg 1999: 95-99). The shift in commercial banks' activities is therefore, besides the special case of the *Landesbanken*, the central element of German convergence towards a market-based system with increased reliance on trading and investment banking (Hardie & Howarth 2013: 104-105).

On the contrary, the savings and cooperative banks stuck to traditional deposit taking and long-term lending (ibid.: 120). *Sparkassen* as state-owned public savings banks have strong ties to local governments which provide them in part with capital (Deeg & Donnelly 2016: 592). Additionally, *Landesbanken* act as their central banks. *Volks- und Raiffeisenbanken*, on the other hand, are cooperative banks that are self-governed private organizations facilitating a relatively strong position for their clients who, independently of their shareholdings, have one vote in the annual general meetings (Bülbül et al. 2013: 3). Therefore, they can be described as member-owned institutions whose profits should be returned to their members through better conditions and services (*Förderauftrag*; Deeg & Donnelly 2016: 589). Both groups value the *territoriality principle* which aims at limiting competition among them on the regional level (Bülbül et al. 2013: 2; Deeg & Donnelly 2016: 588) and their network structure which enables them to compete with larger private banks (Detzer 2014: 58)[1]. On average, savings and cooperative banks are less involved in risky business practices (Bülbül et al. 2013: 9). Instead, they remain key in supplying small and medium-sized enterprises (SMEs) with long-term loans (Deeg & Donnelly 2016: 585). The *Hausbank* relationship with SMEs is still applicable and goes along with "the strong aversion of SME owners to outside interference and equity" (Deeg 2010: 124).

In addition, Deeg (2005) highlights that the economic significance of each institution and their diverging legitimacies cause a stable distribution of power among the three pillars and avoid domination of one of the groups over the others (pp. 176-177).

[1] By October 2016, there were 408 savings banks with nine *Landesbanken* and DekaBank as central institutions and 986 cooperative banks with their central institution DZ Bank AG (Deutsche Bundesbank Statistiken).

2.1.2 Corporate finance

According to the VoC literature, bank-based corporate finance is a key feature of CMEs. Germany can be seen as one of the role models of economies where banks provide 'patient capital' to NFCs (Hall & Soskice 2001: 22-23). Investors hold large shares in firms and have strategic motivation for ownership instead of desiring short-term profits as is common in LMEs (Vitols 2001: 342). Consequently, the way of financing favors "low-risk investment in capital-intensive, incrementally innovating manufacturing companies" (Vitols 2005: 386). Accordingly, the emergence of a comparatively strong German industry did not occur by accident. Moreover, in Germany, SMEs account for more than half of employment in manufacturing and they prefer easy access to bank loans instead of equity capital (Deeg 2010: 119; Vitols 2005: 394). To build trust between banks and NFCs, in the past, banks held equity stakes in large companies and were represented in supervisory boards (Börsch 2007: 181; Deeg 2005: 175).

Unlike LMEs as the United States but also compared to France, Germany has a relatively weak market capitalization of listed companies (Table 1). Although the stock exchange became more liquid in the 1990s, most German companies stick to their traditional way of financing through bank loans, also due to their intact 'relational networks' (Vitols 2001: 348). If the extent of engagement in market activities of an economy is measured by initial public offerings (IPOs), there was a temporary trend toward increased IPOs from 1997-2000 (Deeg & Perez 2000: 125-127) which then decreased rapidly after the crash of the dot-com bubble from 2000 onwards (Deeg 2010: 125).

Table 1: Market capitalization in Germany, France and the United States in 2015

	Germany	France	United States
Market capitalization of listed domestic companies	51,1 %	86,2 %	139,7 %

Source: Worldbank. Data are end of year % of GDP values.

However, it should not be omitted that the German banking sector and its ties to the NFCs underwent considerable changes in the 1990s and early 2000s. Ties between large firms and banks decreased – also as a result of a corporate income tax law that enabled banks to sell their large industrial shareholdings tax free from 2002 onwards (Deeg 2010: 121). Besides that, attempts by the European Commission to cut ties between local governments and alternative banks in the early 2000s impacted particularly *Landesbanken* that were until then operating in traditional banking activities (Deeg & Donnelly 2016: 599-600).[2] Of course, rising competition from foreign banks also played a role in the shift of private banks and *Landesbanken* towards more market-based banking (Hardie & Howarth 2013).

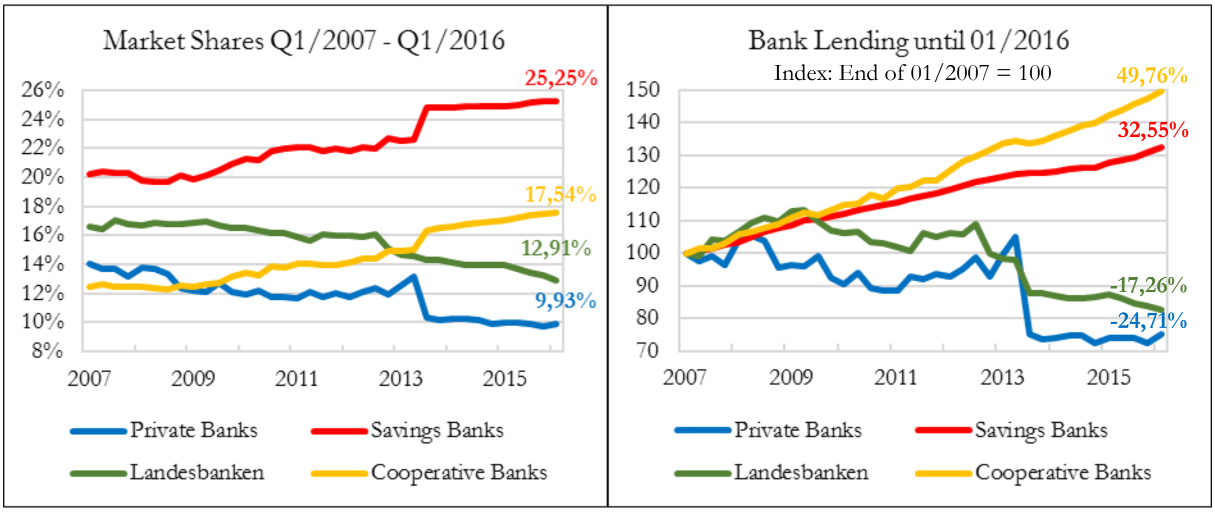
[2] Finally, Germany removed its direct guarantees by the government for public banks by 2005 (Detzer 2014: 59).

2.1.3 German corporate finance and the crisis

Although there was a partial tendency of the German banking sector to converge to the Anglo-Saxon model, I will argue that during the crisis the fragmented and diverse banking sector and traditional banking activities proved to be a stabilizing element of corporate finance and therefore of the economy as a whole.

Despite the huge financial crisis and uncertainty in the markets, neither a domestic credit crunch occurred in Germany (Detzer 2014: 56; Hardie & Howarth 2013: 104) nor did a substitution to elements of marked-based finance take place (Deutsche Bundesbank 2012: 26). Instead, savings and cooperative banks continuously extended their loans to NFCs and self-employed persons throughout the crisis (Figure 2). That way, they filled the gap resulting from private banks and *Landesbanken* who were suffering most during the crisis.

Figure 2: Growth of bank lending to domestic enterprises and self-employed persons



Source: Own calculation based on Deutsche Bundesbank: Kredite an inländische Unternehmen und Selbständige, Wirtschaftsbereiche nach Bankengruppen.

Furthermore, recent developments give rise to the assumption that Germany is at least in part retreating from market-based strategies: Dresdner Bank was integrated into the less market-oriented Commerzbank and the takeover of Postbank by Deutsche Bank stemmed from a refocusing on retail banking (Hardie & Howarth 2013: 124).[3] Furthermore, the announcements of several *Landesbanken* to return to concentrating on their regions and the financing of SMEs instead of engaging in international trading bear witness to this assumption (Bülbül et al. 2013: 10; Hardie & Howarth 2009: 1036).

In sum, for the reasons mentioned above, namely the savings and cooperative banks' important role in corporate finance during the crisis, the absence of a shift to financing via capital markets and post-crisis

[3] Recent accounts of Deutsche Bank to dispose of Postbank (*Wall Street* Journal, 24 April 2015) are less due to the fact that Deutsche Bank wants to shift its policy but due to the environment of low interest rates that undermine the profitability of retail banking.

accounts by private banks and *Landesbanken* to return (to diverging degrees) to their traditional banking activities, the German model can still be described as bank-based. Despite changes in the 1990s and early 2000s, the provision of 'patient capital' as well as comparatively strong ties between firms and banks can still be observed.

In regard to the negotiations about the funding of the SRF, I expect the government to protect savings and cooperative banks from high burden-sharing in order to maintain its model of bank-based corporate finance that proved to be resilient during the recent crisis.

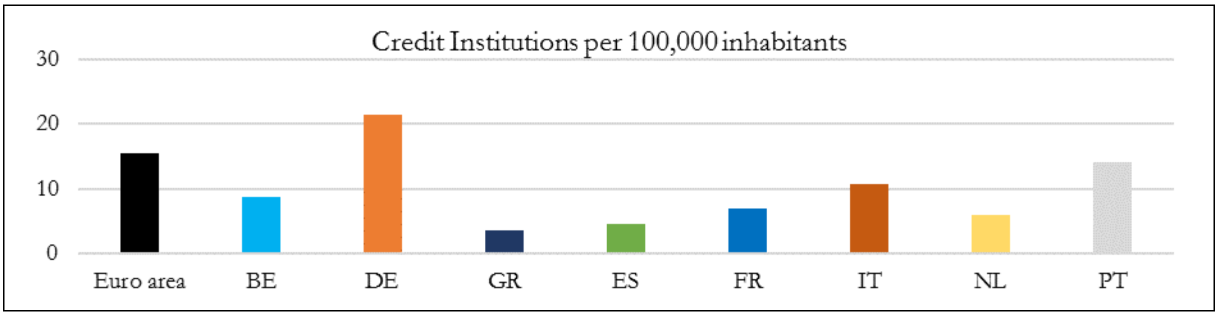
2.2 France's hybrid model attached to a banking sector of 'national champions'

Hall's and Soskice's (2001) categorization is stretched to its limits in the case of France as it focuses on the dichotomy between LMEs and CMEs. Therefore, Schmidt (2002; 2003; 2009) highlights the necessity to introduce a third category that was earlier described as 'statism' by Shonfield (1965) and Katzenstein (1978) or 'state-led' by Zysman (1983). Taking into account rudimentary changes in the French capitalist system since the 1980s, Schmidt defines French coordination mechanisms as rather 'state-enhanced' (Schmidt 2002; 2003). She therefore proposes to introduce an updated third category framed as 'state-influenced' market economies (Schmidt 2009: 521). At the same time, the description of the French financial system as either bank-based or market-based in terms of corporate finance remains ambiguous (Howarth 2013: 370-371). In the following section, first an outline of the French banking sector's distinct characteristics will be put forward. Afterwards, an elaboration on market capitalization is required in order to finally understand corporate finance in France.

2.2.1 Banking sector

Unlike in Germany, the concentration of the French banking system is among the highest in the Eurozone. As figure 3 illustrates, Germany's ratio of credit institutions per inhabitant is higher than the euro area's average while France's ratio is far below.

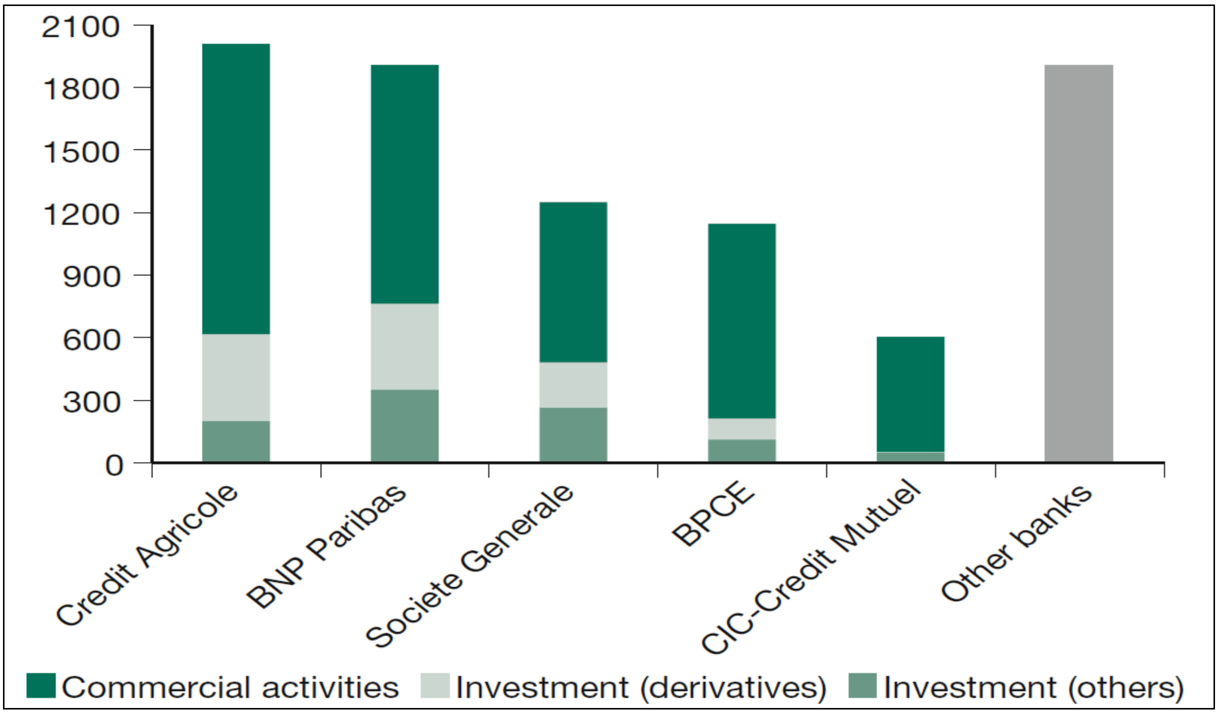
Figure 3: Credit institutions in Eurozone countries with more than 10,000,000 inhabitants in 2016



Source: Own calculation based on ECB: Number of credit institutions (May 2016); Eurostat: Population data (1 January 2016).

This fact is predominantly due to a few large banks that control a vast majority of banking activities in France. Figure 4 demonstrates the size of the five largest French banks in 2012: Together they held 78% of total French banking assets (Creel *et al.* 2014: 65).

Figure 4: Major French banks, end 2012. In terms of banking assets, € billion



Source: Creel *et al.* 2014: 66.

Additionally, four of them (BNP Paribas, Groupe BPCE, Crédit Agricole, Société Générale) are listed in the Financial Stability Board's list of global systemically important banks whereas Deutsche Bank is the only German financial institution (Financial Stability Board 2015). Until 1987, these banking groups and their predecessors were largely state-owned. Privatization and mergers led to a concentrated system of dominant 'national champions' with BNP Paribas and Société Générale as commercial banks, listed on the French stock exchange, CAC-40, and Crédit Agricole, BPCE and Crédit Mutuel as cooperative banks. Nevertheless, the two banking groups largely resemble each other in business activities (Hardie & Howarth 2009: 1021-1022) as well as in management organization (Deeg & Donnelly 2016: 586), in contrast to the differences between commercial and alternative banks in Germany. An important feature of their activities is the strong focus on retail banking domestically as well as internationally on the one hand, paired with the engagement in diverse investment banking activities on the other hand (Howarth 2013: 369).

2.2.2 Corporate finance

The French Post-World War II political system was marked by a dominant state in all economic spheres. Macroeconomic policies "enabled companies to prosper despite a high level of indebtedness by allowing high rates of inflation that governments would periodically counter through aggressive devaluations against the dollar, which in turn would give French firms a temporary competitive advantage" (Schmidt 2002: 184). Besides that, credit allocation was organized by the state through public and semi-public agencies that provided subsidized loans to undercapitalized companies, and especially SMEs (O'Sullivan 2007: 397; Schmidt 2002: 137; Schmidt 2003: 536). These factors explain the initial description of the French way of capitalism as state-led (Zysman 1983: 18).

The failure of this model in the late 1970s and early 1980s after the collapse of Bretton-Woods caused enormous privatizations of state-owned companies in order to partially consolidate national finances. In tandem, the privatization program promoted the expansion of stock as well as debt markets (O'Sullivan 2007: 390, 414). Amable *et al.* (2012) highlight that "privatizations have been instrumental in 'deepening' the financial markets" (p. 1175). Initially, this process did not only serve private sector financing but foremost helped to finance public debt and the sell-off of public enterprises (Juvin 1995: 87; Levy 1999: 261).

However, from the 1990s onwards, French companies increasingly turned towards financial markets (Morin 2000: 39; O'Sullivan 2007: 427). Consequently, French NFCs relied heavily on equity finance by 2000 and much less on bank lending (Howarth 2013: 371). The decrease of bank-based finance was particularly drastic with regard to the largest industries and companies (Hancké 2001: 310; Howarth 2013: 387-388). As a result, banks turned to new forms of market-based banking abroad to compensate for their marginalization in corporate finance (Howarth 2013: 389-390).

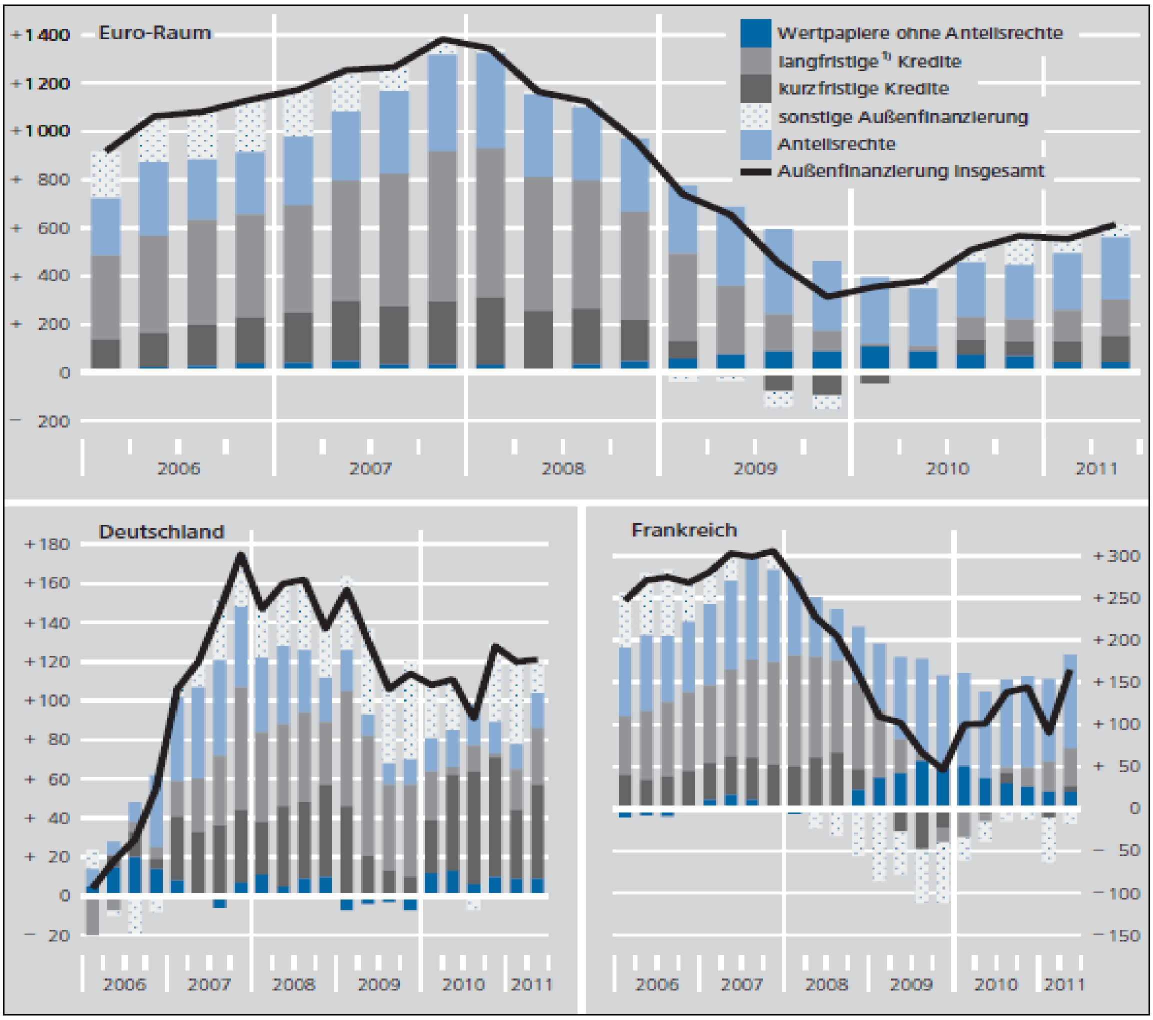
Compared to Germany, where commercial banks and *Landesbanken* also reached out for investment activities, ties between French banks and NFCs have never been as close (Hardie & Howarth 2009: 1020) and suffered even more from firms' increased focus on external sources of funding (Schmidt 2003: 547). Additionally, in contrast to Germany, SMEs were traditionally undersupplied with loans (Amable *et al.* 2012: 1173).

2.2.3 French corporate finance and the crisis

The impact of the recent crisis on the French banking sector and corporate finance, I will argue, was different than in Germany. This is largely due to two main factors.

First of all, resulting from the financial crisis, a negative demand shock depressed credit demand, especially by SMEs. Furthermore, the fact that lending became more dependent on risk assessment exacerbated the situation for new and smaller firms with bad credit ratings (Creel *et al.* 2014: 68). Stronger financial markets and less reliance on a system of relational banking as present in Germany explain the development of NFCs' sources of external finance during the crisis as depicted in Figure 5: From 2008 onwards, the amount of (especially long-term) bank loans in France decreased while the role of shares and securities other than shares remained constant. Consequently, the intermediation rate, i.e. the share of banking loans in total debt of NFCs, deteriorated during the crisis (Deutsche Bundesbank 2012: 26).

Figure 5: NFCs sources of external finance during the crisis, 2006-2011



Source: Deutsche Bundesbank 2012: 25. Numbers in € billion.

Secondly, although the overall impact of the crisis was reduced by the important retail banking divisions of French banks, it is remarkable that commercial and mutual banks suffered alike (Howarth 2013: 374-377) and that difficulties led to an even more concentrated banking sector: Natixis, the investment bank branch of the cooperative bank Banque Populaire and savings bank Caisse d'Epargne, was hugely affected by its investment banking activities which finally led to a merger of the two banks to Groupe BPCE in 2009/10. The merger had a considerable 'state-enhanced' element as it was pursued by then president of France, Nicolas Sarkozy, and his closest advisors (Creel *et al.* 2014: 68; Jabko & Massoc 2012: 578-579). In a less direct manner, but also supported by the government, BNP Paribas took over Dexia's and Fortis' banking operations in Belgium and Luxembourg which made it "the largest bank in the world by assets, recording an increase of 34% in three years" (Howarth 2013: 389). All in all, crisis in France hit commercial and mutual banks to almost similar degrees and led to an even further evolution of 'national champions' dominating the French banking sector.

In conclusion, the French banking sector is characterized by five large banks representing more than three quarters of banking activities compared to a much more fragmented composition of the banking sector in

Germany. Furthermore, differences between commercial and mutual banks are less pronounced in France. Although France cannot be described as an ideal-type market-based economy like the United States, the emergence of well-developed financial markets caused increased corporate finance via equity compared to Germany. The reliance on market-based funding intensified during the recent crisis as well as the concentration of the banking sector. Taking into account the importance of the French state, France is best described as a state-influenced market economy.

As French bank-based corporate finance figures less prominently than in Germany and financial markets are more developed, I expect the French government to be more flexible than the German one concerning higher contributions of banks to the SRF. In regard to the composition of the banking sector, I expect France to support attempts to safeguard large banking groups, i.e. their 'national champions', from picking up the whole bill.

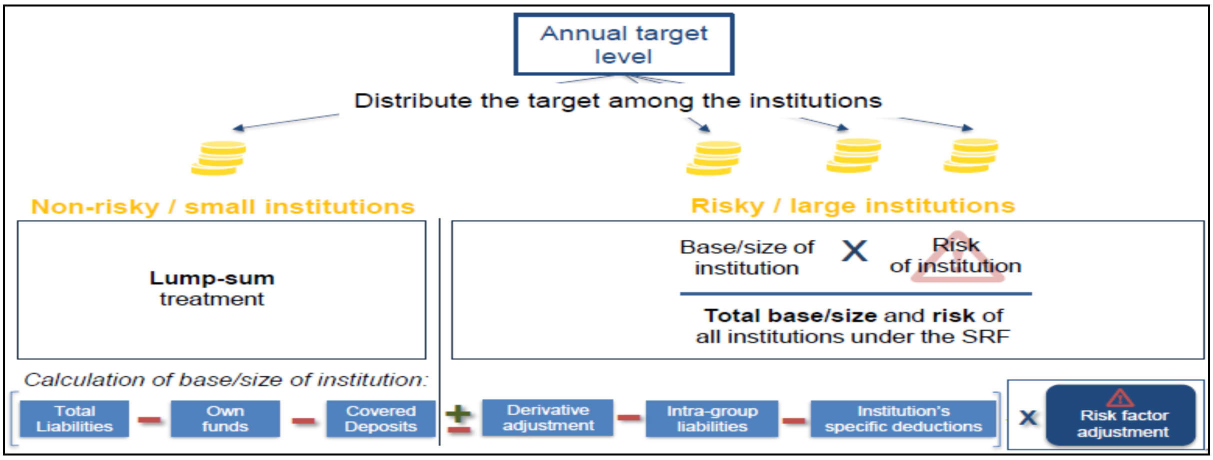
3. Negotiating the Single Resolution Fund

As outlined in the beginning of the previous section, the VoC theory predicts countries to support new regulatory initiatives as long as they do not erode the comparative institutional advantages of their existing model of capitalism. Instead, new regulation should be rather complementary to the prevailing system. In international economic negotiations, theory therefore expects governments to advocate the preservation of the relevant features of their national model (Fioretos 2001: 215; Hall & Soskice 2001: 2, 52).
In this section, I will test this assumption by applying this theory to the preference formation of Germany and France in the course of the negotiations for the funding of the SRF. I will argue that national stances can be largely explained by the goal to protect both their banking sector and model of corporate finance.

Soon after an agreement on the SSM was reached, the ECB pushed forward with the creation of a resolution mechanism. In April 2013, ECB board member Yves Mersch highlighted: "Supervisors cannot give objective verdicts of banks if banks can only be closed in a disorderly way" (*Financial Times*, 29 April 2013). One month later, Benoît Cœuré, another member of the board, added: "[…] if the Single Supervisory Mechanism is to be effective, it needs to be complemented by a Single Resolution Mechanism to deal with nonviable banks. It is thus crucial that the SRM framework is in place once the SSM is operational" (Cœuré 2013). Hence, pressure remained high to reach an agreement as soon as possible.
In the run-up to a compromise, the funding of the SRF as an important tool of the SRM, proved to be a point of particular contention. At first, an agreement on the target level of the fund needed to be reached. The target is distributed among banks across the Eurozone. The precise levies are calculated by a lump-sum for small and non-risky banks while larger and risker banks have to pay additional contributions according to their exact size and involvement in riskier banking activities (Figure 6). Not surprisingly, main conflicts of interests during the negotiation turned out to be the target level of the fund, the question

whether small banks must contribute in the form of a flat fee as well as the extent to which a factor of risk adjustment for institutions due to certain banking activities should be included.

Figure 6: Composition of contributions to the Single Resolution Fund



Source: Single Resolution Board 2015: 12.

3.1 Target level

At the beginning of the negotiations, debates about what happens if a bank needs to be wound down during the period of constructing the SRF took place. Germany insisted on a network-based approach where national authorities would remain in charge of their banks until the SRF becomes fully operational or in case shortfalls of the SRF after its establishment needed to be covered (Schäuble 2013). In the policy agreement by CDU/CSU and SPD, the two parties highlight that in case of emergency – when the bail-in of creditors and the means of the SRF are not sufficient – national authorities remain responsible for the resolution of their banks. If a state is not capable of financing bank resolution, it can apply for conditional loans provided by the ESM (Bundesregierung 2013: 93-94). This scenario would finally compel the taxpayer to take the center stage whereas the German government wants to protect German banks from contributing to foreign bank resolutions. Hence, they aim at burdening German banks as little as possible to ensure the maintenance of their comparative institutional advantage: the ability of financial institutions to provide bank-based loans to the economy.

On the contrary, then French Finance Minister Pierre Moscovici was inclined to a 'unique backstop' providing credit to the SRF if it proves to be insufficient (*Bloomberg*, 10 December 2013). In doing so, France allied with some southern European countries (Howarth & Quaglia 2014: 134; *Wall Street Journal*, 18 December 2013) and the ECB. Cœuré (2013) emphasizes that the backstop needed to be "recouped through ex-post levies on banks" so that its fiscal neutrality and bank's responsibility is guaranteed. Applying theory at that point demonstrates that the French government relies on the fact that its 'national champions' can cover potential additional burdens that needed to be provided as well as the fact that corporate finance can be maintained through substituting to financial markets in case of shortages of credit provision by banks.

3.2 Lump-sum treatment

In order to provide the SRF with € 55 billion, policy-makers had to come to an understanding about how to distribute its costs among banks from different countries to reach the target level.

A point of conflict was the discussion about whether the contributions are limited to large, systemic institutions, as defined in the SSM, because they are more likely to access it than smaller, regionally engaged banks. German finance minister Schäuble demanded to exclude banks with balance sheets[4] of less than € 500 million from contributing to the SRF (*Handelsblatt*, 21 October 2014; *Reuters*, 21 March 2014). This would have kept out a large number of smaller German cooperative and some savings banks from endowing the fund. During negotiations, Schäuble conceded that smaller banks eventually had to pay a lump-sum. In July 2014, he underlined that smaller banks without systemic risk should pay "no or only little contributions" (*Frankfurter Allgemeine Zeitung*, 19 July 2014). Nevertheless, this clearly is an attempt by the German finance ministry to protect *Sparkassen* and *Volks- und Raiffeisenbanken* from sharing too much of the burden. Not surprisingly, the National Association of German Cooperative Banks (BVR) and the National Association of savings banks (DSGV) supported Schäuble's attempts to protect smaller banks (BVR, March 2014; BVR & DSGV, 24 March 2014).

On the contrary, French officials categorically advocated against exceptions for smaller banks to safeguard dominant French banks (*Reuters*, 21 March 2014). A deal excluding small banks would have meant relatively higher contributions for large banks as the target level was fixed in advance and needed to be reached anyway. The French finance ministry bore the SSM deal in mind which places French banks that hold 89,1% of total bank assets in France compared to only 68,9% of bank assets in Germany under supervision since it only oversees 'system-relevant' Eurozone banks (Howarth & Quaglia 2016: 444, 447). Besides, because of the interdependency of the European banking system, a failure of a large banks could also considerably hit smaller banks. On this basis, it can be referred to the shared interest of all banks in a stable banking system.

3.3 Risk factor adjustment

A further controversial subject during the negotiations was the risk factor adjustment. As banks with riskier business practices[5] are more likely to be resolved, those banks were requested to contribute relatively more in advance.

On this point, the German finance ministry engaged in favor of a strong weighted risk factor related to risky banking practices (*Frankfurter Allgemeine Zeitung*, 19 July 2014). Consequently, banks with stronger involvement in trading and investment activities would be obliged to pay comparatively more than those with a lower risk profile. The German demand once again can be explained by its interest to guarantee the

[4] The amount refers to the size of the bank's balance sheet less own funds and deposits covered by national deposit insurance schemes (Single Resolution Board 2015).

[5] Detailed information on weight of different risk pillars and indicators are provided by the Single Resolution Board (2015: 14).

continuity of corporate finance through savings and cooperative banks that act on a regional level pursuing conservative activities that also proved to be resistant in times of crisis. If the post-crisis commitments by private banks and *Landesbanken* to retreat in part from investment banking can be taken seriously, a higher risk factor would also be in line with their banking practices.

However, France defended its large banks from contributing too much due to their involvement in investment banking that is occurring throughout all major banking groups (Figure 4; Howarth 2013: 369). Particularly in coalition with Spain whose banks also have a weak capital base and an augmented risk profile, France supported to minimize the factor of risk adjustment (*Frankfurter Allgemeine Zeitung*, 19 July 2014). This can be interpreted as an initiative to protect their 'national champions' in whose evolvement the state itself was engaged. One argument in favor of the French position was advanced by Jean-Laurent Bonnafé, the director and chief executive of BNP Paribas, in an interview with *Le Figaro* (31 October 2014). He states that the French banking sector proved to be one of the most solid in the ECB's stress tests and should therefore not be considered as unreliable and obliged to increasingly contribute to the SRF.

3.4 Tax deductibility

Finally, one of the most contested issues was on tax deductibility of bank levies.

Germany vehemently opposed the idea of allowing banks to deduct their contributions to the SRF from their payment of taxes as it is also prohibited for the payments to the *Restrukturierungsfonds*, the German national resolution fund (*Zeit Online*, 21 May 2014). Statements of the German Ministry of Finance stress this position, explaining that "a key objective of the banking union is to minimize the taxpayer's costs regarding the resolution of banks" (*Les Echos*, 2 October 2014, translation by author). Hereby, the government also opposed joint statements of the German banking sector demanding tax deductibility (Deutsche Kreditwirtschaft 2014: 22-23).

On the contrary, France deemed the contributions as deductible and was not willing to change this regulatory approach. As a response, German Christian Democratic politicians accused the French government of "sponsoring the banks" although the French state has "sufficient budgetary problems" to be solved (*Les Echos*, 2 October 2014, translation by author).

At this point, theory cannot explain national stances on taxation because this issue is not of explicit importance to the VoC approach. The attempt to account for national preferences referring to the banking sectors fails: As hypothesized above, I expect the German government to protect banks more rigorously than the French side. Here, this is not the case. Instead, other explanatory variables need to be considered.

German reluctance to allow tax deductibility may be due to ordo-liberal thinking that insists on a rule-based functioning of the economy accompanied by moral and ethical values (Bonefeld 2012). In this context, a certain degree of burden sharing by banks for costs resulting from risky business practices fits in this pattern of thinking. Several recent accounts emphasize the importance of ordo-liberal ideas for German crisis management (Matthijs 2016; Schäfer 2016).

In regard to France, close ties between government officials and CEOs are often highlighted in the literature. These elite networks result from a highly meritocratic education system with *grandes écoles* as leading universities from which future top state officials are selected that later often moves on into top positions in banks and large firms (Creel *et al.* 2014: 69; Hancké 2001: 313; Schmidt 2002: 124-125, 184-185, 195-196). The informal elite system therefore may hold as an explanation for tax concessions to large banks that would not be charged unduly by the non-deductibility of levies.

4. Conclusion

According to common belief, international economic developments during the last decades have caused convergence of financial models among states. Nevertheless, this paper argues that bargaining positions of states can in fact be explained by the distinctiveness of their national institutional settings. Taking the negotiations on the Single Resolution Fund as as empirical case study, I demonstrated that German and French governments sought to reach an agreement that protects the comparative institutional advantages of their financial systems and models of corporate finance. This explanatory variable accounted for respective national stances on the target level of the SRF, lump-sum treatment and risk factor adjustment. German negotiators aimed at protecting its banking sector and particularly savings and cooperative banks as they are a key provider of loans to NFCs and therefore an important factor for the entire economy. The French negotiating position took its 'national champions' in the banking sector into account advocating for small banks paying a lump-sum and the reduction of the risk factor calculation. The attempt to reach a higher target level implies acceptance of higher bank levies in general which is due to the fact that reliance on and substitution to financial markets as alternative source of corporate finance is more significant in France.

Only with regard to the tax deductibility issue the application of theory did not offer conclusive results. Although there is no room for further elaboration on this puzzle, ordo-liberal thinking and crisis management in Germany as well as the importance of elite networks in France were proposed as potential explanatory variables in this context.

Of course, this paper poses several follow-up questions. As I only analyzed the reasons for the preference formation in both countries, research on why whose preferences prevailed in the course of negotiating the SRF would complement this paper's analysis. Besides, this case study on the SRF is not capable of determining the validity of the VoC theory and comparative institutional advantages related to the broader issue of European banking regulation. Hence, the theory needs to be applied to other aspects of regulation in order to determine its significance for regulatory initiatives on banking in Europe.

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