

**Breaking the 'vicious circle between banks and sovereigns':
Neofunctionalism and liberal Intergovernmentalism as explanations for the
establishment of the Single Supervisory Mechanism (SSM)**



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Abstract

This thesis tries to explain the integration of micro-supervision of European banks. In the proposal for the Single Supervisory Mechanism (SSM), the ECB will get authority and certain tasks to perform in the supervision of individual credit institutions. The SSM is one component of a Banking Union, which contains the SSM, a resolution framework, and a single rulebook. As this thesis will show, the SSM can't be explained without including the resolution framework in the analysis. I'll test two well known integration theories: neofunctionalism and liberal intergovernmentalism.

Noefunctionalism looks to functional spillovers, and pressures from EU institutions and other international actors, that create a demand on member states for establishing the SSM, which is then also more or less automatically delivered by member states. Liberal intergovernmentalism assumes that the SSM is the result of the interests of domestic actors, which are aggregated to the state level, where member states act upon in interstate negotiations. The conclusion of this thesis is that, although a functional spillover from the single currency is an important explanatory factor, liberal intergovernmentalism appears to be best suited for explaining the SSM. However, although the short-term demand for a complete Banking Union is not 'delivered' by the member states, there are possible explanations for this that would correspond with neofunctionalist assumptions and which cannot be adopted or rejected with much certainty.

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1. Introduction

From 2008 onwards, the weaknesses and instabilities of the European banking sector became apparent as many European banks had to be saved by taxpayers money. In the Netherlands for example, three of the four largest banks have been rescued by state support (ING, ABN Amro and SNS) at the time of writing. The financial crisis has triggered an evaluation and debate on the shortcomings of the current institutional framework for the governance of the banking sector, both on the national and European level. Why didn't the supervisory authorities see this coming? What are the weaknesses in financial regulations? And can supervision, crisis management, and the regulation of the banking sector still be done at the national level, when there is an integrated European market for financial services and a single currency? And more importantly, how can Europe assure that member states and their taxpayers shall not suffer the consequences of a failing banking sector again in the future?

1.1 The banking crisis and the flaws of the current institutional framework

In this thesis I will try to explain the institutional changes regarding the supervision of the European banking sector, and in particular the proposal for a Single Supervisory Mechanism (SSM), which would grant the ECB authority in the micro-supervision of European banks. But first, I'll briefly discuss the problems that are identified with the current institutional structure of supervision. I'll also briefly explain how the SSM is part of the idea for a Banking Union, which has the purpose of breaking the link between 'banks and sovereigns'. In the current institutional structure, supervision of the banking sector is still mainly done by the competent national authorities. Supervisory activities on the European level are based primarily on cooperation and coordination. One problem with this institutional structure is that the powers that national supervisory authorities have, and how well these authorities perform, differ significantly between the member states. Secondly, European regulations for the banking sector can be differently interpreted and implemented by these national authorities. These differences in power and performance of national supervisors, and the differences in the interpretation and implementation of European regulations, could lead to regulatory arbitrage and competition distortion. Financial institutions are encouraged to shift their financial activities to countries with lax supervision (De Larosi re report, 2009). This could undermine financial stability. Another problem is how to handle the supervision of cross-border banks. Is this the responsibility of the host-or home member state of the bank? And how do you deal with conflicts between national supervisors, especially during crisis management? In 2010, based on recommendations of the De Larosi re Report (2009), the so called 'Lamfalussy framework' was already replaced by three agencies with the legal competences to step in on individual credit institutions. The banking agency, the EBA, has the task to create a single rulebook and to intensify coordination and cooperation in supervisory activities. The day-to-day supervision of the banking sector however remained a task of the competent national authorities.

For member states sharing the single currency, it's especially important that the 'link between banks and sovereigns' is broken. Banks that are in need of recapitalization are dependent on the financial support of the state. The state on the other hand, needs (its largest) banks to survive for the functioning of its economy and for the protection of its citizens saving money. In other words, there exists 'a vicious circle between sovereign debt and the banking sector'. The national state could therefore face the risk of falling into a debt crisis in the case it is not able to carry this burden. This could threaten the stability, or even the survival, of the Euro currency. To break this link, a Banking Union is proposed which would have three components: the Single

Supervisory Mechanism (SSM), a resolution framework, and a single rulebook. Under the resolution framework, the ESM would be able to directly recapitalize troubled banks, thereby shifting the liability of risks to the European level.

The idea of the SSM was officially launched by President Van Rompuy (2012), in his plan for the future of the EMU, where he called for a integrated supervision on the European level, whereby 'the European level would be given supervisory authority and pre-emptive intervention powers applicable to all banks.' This single supervisor should then become the ECB. Shortly after, the Euro area summit of the 29th of June stated that the Commission would soon come with proposals for a single supervisory mechanism, and asked the Council to consider those proposals as a matter of great urgency by the end of 2012 (Euro Area Summit, 2012). On the 12th of September 2012, the Commission proposed a new regulation 'conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions' (Commission, 2012a). According to the proposal, the national authorities would have to abide by the supervisory decisions of the ECB. In the Commission's proposal the ECB would have the following tasks: authorizing credit institutions; enforce compliance with capital, leverage and liquidity requirements; supervision of financial conglomerates; and carry out early intervention measures when a bank breaches or risks breaching regulations (Commission, 2012b).

1.2 Main issues in the proposal

However, the proposal is not undisputed. That the proposal touches on a sensitive issue can perhaps be seen by its late timing. It has been 4 years since the start of the financial crisis, and Europe seemed to go for a less radical institutional development by upgrading the 'level 3 Lamfalussy committee's' to three new authorities with legal competences. The idea of granting the ECB authority in micro-supervision was only launched in June 2012. The resolution framework, under which the ESM could directly aid troubled banks, is even more disputed. There's also the question in what chronological order and time-path the different components of the Banking Union should be introduced. National governments, domestic actors, the ECB, non-euro versus euro member states, the Commission and the financial sector itself all have different stakes in the Banking Union proposal. Although the desirability of granting the ECB supervisory powers is now generally accepted, discussion remains on several issues.

First of all, what will remain of the tasks and powers of the national supervisory authorities? Who gets the final authority on which decisions and tasks? And who does the day-to-day supervision? Related to this is the question if the ECB will have the power and task to supervise all European banks or only the ones that are 'system relevant'. A second group of issues is about the relationship of the SSM to EU member states that will not participate in it, and how this relationship affects the single market. The relation between the new SSM and the EBA is especially interesting in this respect. The EBA has the task to create common regulations for the European banking sector, both for member states in and outside the eurozone. The member states outside the SSM might be afraid that member states participating in the SSM will form a block in the EBA, imposing supervisory standards on the rest of the EBA members. So, the voting arrangements in the EBA has become an issue as well. Thirdly, there are discussions relating to the institutional design of the SSM, like how the monetary and supervisory activities of the ECB can be separated, how the ECB should be held accountable, and how the SSM can be legally implemented within the current Treaty.

Finally, as said, the SSM is strongly connected to the other proposed components of the Banking Union, which are the single rulebook and the resolution mechanism that would allow

the ESM to recapitalize the banking sector directly. It is argued that these three components together can break the link between sovereigns and banks and secure the stability of the eurozone. But is this also how the SSM can be explained? Is the SSM the result of a functional spillover from the EMU, a necessary component of a Banking Union that should break the link between banks and states? Is the SSM required for the functioning of the single market for financial services? Another explanation is that the SSM is the result of a 'power play' between Southern-European countries, who are after the European funds of the ESM to recapitalize their banking sector, and Northern-European countries, who are pushed to agree to this but ask influence and control on European banks, in the form of the SSM, in return? These are the questions I will try to answer in this thesis.

1.3 Research question and the goal of this thesis

The purpose of this paper is to explain the integration of micro-supervision to the European level, which is expressed in the proposal for the Single Supervisory Mechanism (SSM). To do this, I will use two integration theories which give competing explanations: neofunctionalism and liberal intergovernmentalism. These two integration theories are used within the theoretical framework of Actor-Centered Institutionalism (ACI). The framework, mainly developed by Scharpf (1997), has the advantage of combining both actor- and structural centered determinants of explaining policy- and institutional outcomes. ACI is helpful to get a picture of who are the relevant players, what they want, and why they want it. ACI helps to understand the politics of institution building, and it provides inside in how neofunctionalism and liberal intergovernmentalism are situated in the structure-agency debate.

My research question is then as follows:

- How can the integration of micro-supervision of the banking sector to the European level, which is expressed in the proposal for the Single Supervisory Mechanism (SSM), be explained?

To demarcate the case, the explanandum will consist of the SSM proposal in general, the way it is going to function in relation to non-SSM members in the EU and the single market, and the most important aspects of the SSM's institutional design. The other components of the Banking Union, especially the resolution framework, will be significantly included in the analysis. As we will see, the SSM is strongly linked to the resolution framework and cannot be explained in isolation of it.

The thesis has a practical approach. Institutional developments in the supervision of the European banking sector are a highly topical issue. Therefore research on the latest developments is still relatively scarce. A lot of the literature so far deals primarily with the question what a future Banking Union should look like to prevent financial instability in the future (CEPR, 2012 & Lannoo, 2012) or merely describes the major discussions and developments going on at the moment (Pisani-Ferry et al, 2012 & Véron, 2012). There is however also literature that tries to explain these institutional developments in financial regulation and supervision. Quaglia (2007) for example uses integration theories to explain institutional developments in financial services regulation and supervision before the start of the 2008 financial crisis. Spendzharova (2012) uses two accounts of institutionalism to explain institutional developments in the period after the 2008 financial crisis. However, Spendzharova (2012) doesn't include the developments regarding the new supervisory role for the ECB yet.

The focus of Spendzharova (2012) is on the upgrading of the 'level 3 Lamfalussy committees' to the new agencies as a result of the De Larosière (2009) report. So, research explaining the latest institutional developments regarding the new supervisory role of the ECB would be a contribution to the existing literature. The main focus of this thesis therefore is on getting a practical understanding of this particular case. But because we also test two competing integration theories, the thesis can also contribute to the theoretical debate about European integration.

The structure of this thesis is as follows. First I will describe the theories used, including the hypotheses that I will test. This is followed by a chapter on the research design and the operationalization of theoretical concepts. The analytical chapter will consist of three parts. First, I describe and analyze the interests and positions of the relevant actors. Secondly, I'll provide a timeline in which I describe the negotiation process and the outcomes so far. In the last analytical part I will test the hypotheses of the two integration theories.

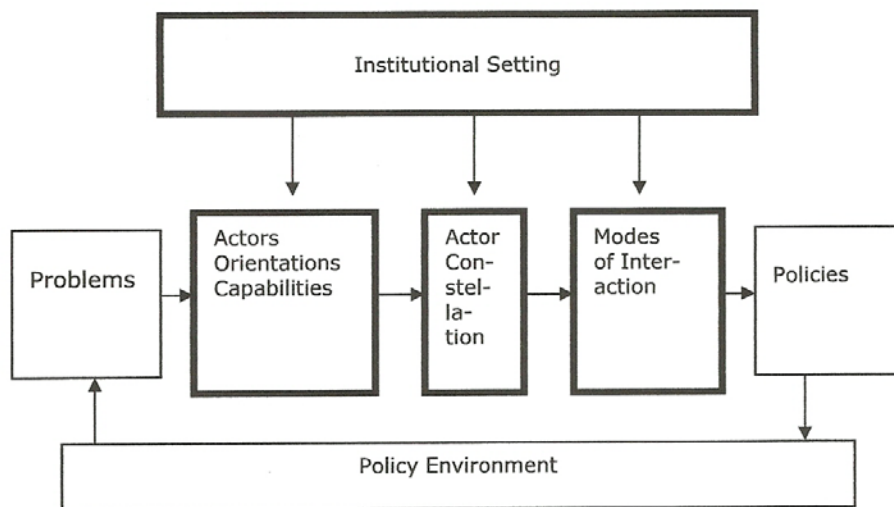
2. Theory

There are three theories that I will use in this thesis. I start with a description of Actor-Centered Institutionalism (ACI). ACI will be used as a theoretical framework, to shed light on what the relevant actors are, what they want, why they want it, and towards what strategic situation this will lead to for the actors involved. The two integration theories that I will test, neofunctionalism and liberal intergovernmentalism, can be applied in this framework and will be structured along the theoretical concepts used in ACI's conceptual model. After describing ACI, I will shortly discuss how the framework relates to the integration theories that I will test.

2.1 Actor centered institutionalism

Actor centered institutionalism combines both actor- and structural centered perspectives. As Scharpf (1997,p.1) describes it: 'it proceeds from the assumption that social phenomena are to be explained as the outcome of interactions among intentional actors (...) but that these interactions are structured, and the outcomes shaped, by the characteristics of the institutional settings within which they occur'. The interactions between actors are the unit of analysis. Actors are assumed to be rational, to be capable of making purposeful choices among alternative courses of action, and to maximize their own self-interest. Figure 1 shows the conceptual model of ACI:

Figure 1: Conceptual model of ACI



Source: Scharpf (1997,p.44)

Out of the policy environment rises a policy- or institutional problem. In this case the problem is the institutional structure governing the supervision of European banks. Actors have certain orientations towards this problem and certain capabilities to influence the outcome on the issue. Actor orientations refer to the desirability of the status quo, ideas about the causes of a perceived problem, the efficacy and desirability of perceived courses of actions, and the outcomes associated with these (Scharpf, 1997). Basically, actor orientations are about the preferences and perceptions of the actors. Actor capabilities include 'all action resources that allow an actor to influence an outcome in certain respects and to a certain degree' (Scharpf, 1997,p.18).

Dependent on their orientations and capabilities and those of others, actors have several strategies to choose from. And in choosing a strategy, they try to anticipate the choices of others, knowing that they in turn will do the same. An important concept in the theory is the 'actor constellation', which describes the actors involved, their strategy options, the outcomes associated with strategy combinations, and the preferences of the actors over these outcomes (Scharpf, 1997). These 'actor constellations' are static, as they do not describe the actual interactions producing outcomes yet. However, as actors are capable of learning, the actor constellation may change during the process of negotiations. The process of the negotiations is influenced by the mode of interaction. Decisions can be made in the spirit of majority voting, consensus seeking, or by hierarchical decision-making.

The institutional setting is determined by both the existing formal rules and social norms. Violations of these social norms will be sanctioned by loss of reputation, social disapproval or withdrawal of cooperation and rewards (Scharpf, 1997, p.38). As Figure 1 shows, the institutional setting influences how actors form their orientations, what their capabilities are, what strategies they can choose from, and what the mode of interaction is. The institutional structure influences the courses of actions that a set of actors may choose from, but it does not fully determine behavior. Positive and negative incentives attached to the institutional setting will result in an increase or decrease of the payoffs associated with the use of particular strategies (Scharpf, 1997, p.39). Institutional development is path dependent, and the next institutional development is influenced by where you started from (Van Lieshout, 2008). Institutions are hard to reform or abolish, and institutional change will be costly because actors have come to rely on the coordinating function of the institution (Scharpf, 1997, p.41). Ultimately, if actor centered institutionalism shows that the actual outcome was produced by strategy choices that, for all parties involved, were the best that they could do under the circumstances, one has a persuasive explanation (Scharpf, 1997, p.10).

2.2 ACI's relationship towards neofunctionalism and liberal intergovernmentalism

How relates ACI theory towards the two integration theories that I will test? ACI is used as a theoretical framework, on which both neofunctionalism and liberal intergovernmentalism can be applied. All theories assume actors to be rational. However, the two integration theories have different assumptions on the relevance of the theoretical concepts used in the ACI model (see Figure 1), and how the relationships in the ACI model exactly work. The so-called structure-agency debate is of relevance here. ACI was developed to find a middle ground between the extremes of this debate. The extremes were determined by institutionalist theories that paid excessive attention to how the current institutional/structural determines the interests, options and choices of actors, and by the actor-centered theories that neglected these structural and institutional determinants. Liberal intergovernmentalism leans more to the actor-centered side of the dichotomy, where neofunctionalism has more structural determinants in its theory, like that of functional spillovers.

2.3 Neofunctionalism

Neofunctionalism is a theory first developed primarily by Haas and Lindberg in the late 1950s and early 1960s. It tries to explain (European) integration. Haas (1958,p.16) defined integration as:

'the process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations and political activities toward a new centre, whose institutions possess or demand jurisdiction over the pre-existing national states. The end result of a process of political integration is a new political community, superimposed over the pre-existing ones.'

First of all I will discuss some of the assumptions of neofunctionalism. The theory assumes actors to be rational and self-interested. Preferences and interests of actors are not solid, as actors have the capacity to learn. Incremental decision-making is an important aspect of neofunctionalism. Political actors often don't pay much attention to the long-term consequences of their decisions, and 'stumble' from one decision to the next. Adjustments and further steps in integration are often driven by unintended consequences of previous decisions (Niemann & Schmitter,2009). Interstate institutions can take a life of their own after they've been created, and often escape the control of their creators. neofunctionalism reject the assumptions that international cooperation/ negotiations are zero-sum in nature. Cooperation on the European level is more often characterized by positive-sum games, whereby there is a 'cumulative pattern of accommodation in which the participants refrain from unconditionally vetoing proposals and instead seek to attain agreement by means of compromises upgrading common interests' (Haas,1964,p.66). neofunctionalism also assumes that the increasing functional interdependence of economies and their productive sectors, and the process of globalization, tend to foster the integration process (Haas,1958).

'Spillover' is the driving force behind integration. Functional spillovers happens when the integration of one sector leads to 'technical' pressures pushing states to integrate in other sectors. The integration of one sector at the regional level is only practicable in combination with the integration of other sectors, as problems arising from the functional integration of one task can only be solved by integrating yet more tasks (Haas,1958). Haas believed that these spillovers would happen more or less automatically. So, neofunctionalism assumes that the member states orientations are heavily influenced by the current institutional setting, as it creates functional spillovers and therefore serve as strong incentives for member states to support further integration. Contrary to liberal intergovernmentalism, the theory assumes that this 'demand' for integration is almost automatically followed by the 'supply' of integration by the member states.

Besides these functional pressures, support of the political elite and pressures exerted by non-governmental elites lead to 'political spillovers'. Political elites learn that their problems could not be solved at a national level. And gradually, they will shift their expectations, political activities and even their loyalties to a new European centre (Niemann & Schmitter, 2009). Socialization processes between national political elites happen as they have frequent contacts with each other, which stimulates accommodation and concession-making and a shift of their loyalties to the European level. Interest groups also move part of their activities to the European level and therefore focus more of their expectations to the European institutions. A third form of spillover is the cultivated spillover. The Commission is often used as an example for this kind of spillover. The Commission, because of their privileged position of centrality and authority, are able to direct the dynamics of relations among states but also the relations of interest groups

within each state. The Commission's 'cultivation of contacts with national civil servants and interest groups would in time lead to the Commission's progressive informal co-optation of member states national elites to help realize its European objectives' (Niemann & Schmitter, 2009,p.50). So, EU institutions and other international actors have important 'actor capabilities', as they influence, together with other international actors, the orientations of member states in a direction that supports further integration. To conclude The following hypotheses will be tested:

H1: Functional spillovers create incentives/ a demand on member states to introduce the SSM, which is then also more or less automatically supplied by the member states

H2: Supranational actors like the Commission, the EBC, European Parliament and international actors like the European Banking Federation (EBF) and the IMF influence the orientations of member states in directions that support further steps in integration

H3: The institutional structure of the SSM reflects for a great deal the wishes of the EU institutions and other international actors.

2.4 Liberal Intergovernmentalism

Just as neofunctionalism, liberal intergovernmentalism seeks to explain (European) integration. According to the theory, the EU can best be seen as a international regime for policy coordination. According to Moravcsik (1998,p.18), EU integration can best be understood as:

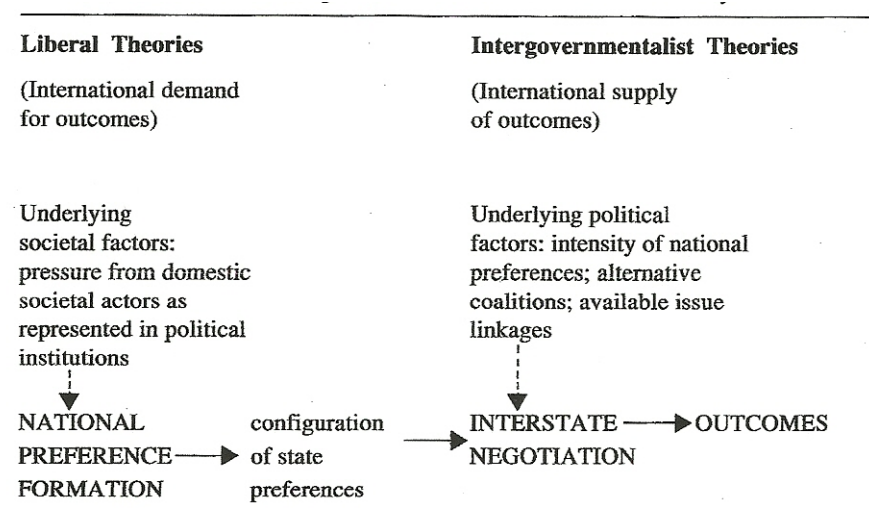
'a series of rational choices made by national leaders. These choices responded to constraints and opportunities stemming from the economic interests of powerful domestic constituents, the relative power of states stemming from asymmetrical interdependence, and the role of institutions in bolstering the credibility of interstate commitments.'

LI combines two types of theory: a liberal theory of national preference formation and a intergovernmental theory analyzing interstate bargaining and institutional creation (Moravcsik,1993). First I discuss some general assumptions of the theory. The most important assumption of LI is that states are the critical actors in furthering or stalling integration. Although the theory assumes interstate institutions not to be insignificant, it doesn't agree with the notion of neofunctionalism that institutions can take a life of their own and become partly out of the control of the states who created them. Institutions only exist as long member states accept their existence and functioning. However, a strong supranational institutional structure doesn't have to be contradictory to LI theory. First of all, supranational institutions increases the efficiency of interstate bargaining and reduces transaction costs. And second, EU institutions give national political leaders more autonomy vis-à-vis domestic societal groups (Moravcsik,1993)

Where neofunctionalism sees integration more as a process, LI looks more to isolated events of integration. According to LI, the assumption that there is an automatic, gradual and incremental process towards further integration is wrong. Integration has proceeded in fits and starts through a series of intergovernmental bargains (Moravcsik, 1993). Integration does not happen in an automatic fashion as a consequence of spillover effects, but are the result of rational choices of states to coordinate their policies. Contrary to neofunctionalism, the theory assumes that member states do not always give in on functional pressures, and the pressures exercised by EU institutions and other international actors, to take a next step in integration. LI theory focuses on the 'supply' of integration, whereby integration is a reaction of the interests of

domestic constituents, who aggregate their preferences to the state level, which results in an interstate negotiation. Motivations for domestic actors' interests in further integration could come from idealistic- security- or economic reasons. Figure 2, which is shown on the next page, is the conceptual model of LI theory. As can be seen in the model, LI is composed of a liberal theory of national preference formation and a intergovernmental theory about interstate bargaining. I will now get into these two theories in more detail.

Figure 2: Conceptual model of LI theory



Source: Moravcsik (1993,p.482)

First I will look to how the preferences of states are formed according to LI theory. States are seen as unitary and rational actors. Domestic political bargaining, representation, and diplomacy generate a consistent preference function of the state. Shifting pressures from domestic societal groups, whose preferences are aggregated through political institutions, are responsible for variance in the foreign policy goals of national governments (Moravcsik, 1993, p.481). The relationships between society and government is characterized by that of a principal-agent relationship. Societal actors, as agents, delegate powers to the state to further their interests. The primary interest of governments is to maintain themselves in office, which requires the support of a coalition of domestic voters, parties and interest groups (Moravcsik,1993). Societal interests are however sometimes diffuse and not always sharply defined, and this gives governments a range of discretion. When societal groups are divided, governments are less constrained in their actions abroad. When pressure of societal groups is strong and unified, the room for maneuver for the government on the international stage is highly constrained. So, contrary to neofunctionalism, LI assumes no direct and independent influence of non-governmental actors on outcomes at the European level. Non-governmental actors fight their battles domestically, which result in a national preference formation, which then determines the strategic interactions between states and the ultimate outcome of interstate negotiations on the European level.

When the national preferences of the states are determined, the intergovernmental theory about interstate bargaining becomes important. Moravcsik (1993) identifies three determinants of interstate bargaining: unilateral policy alternatives; alternative coalitions; and the potential for compromise and linkage. First, a good unilateral alternative in the case of non-agreement

increases the bargaining power of a state significantly. In that case the state can make a credible threat to walk away and go for the unilateral option if the others are not more willing to give in on its demands. Second, the opportunity to form alternative coalitions, and the threat to exclude other member states from an agreement, strengthens the bargaining power of potential coalition members vis-à-vis those threatened with exclusion (Moravcsik,1993). In the EU, this can take the form of a two-track or multi-speed Europe. Third, when there are several agreements possible which are for all better than the status-quo, the intensity of the preferences on the margin becomes important. Governments with a high intensity of preference on the margin will gain more from the negotiations. When all governments have intense preferences on different issues, issue-linkage can be helpful. For example, State A compromises on a issue on which it has a relatively weak preference intensity and on which state B has a high preference intensity, and state B does the same visa versa on another issue.

H1: The positions of the member states on the SSM proposal and the resolution framework are the result of the aggregation of the interests of domestic actors to the state level.

H2: The relative bargaining power of member states, together with their positions which reflect the interests of domestic actors, explain the creation of the Single Supervisory Mechanism (SSM).

H3: The new institutional design is closest to the preferences of those member states: with the best unilateral alternative; that formed an alternative coalition or threatened to do so; and to those member states that had the most intensity of preferences on the margins.

H4: In the case several member states or all member states had intense preferences on issues on the margin, issue-linkage, when possible, explains the outcomes on those issues on the margin.

H5: When there needs to be unanimity in decision-making, the agreement reflects the lowest common denominator.

3. Research design and operationalization of concepts

3.1 Research design and methodology

The theoretical design of this thesis is characterized by testing two integration theories with competing explanations for the integration of micro-supervision of European banks to the European level. ACI will be the theoretical framework along which the integration theories are structured and tested. I will conduct a single case study research. According to Gerring (2007,p.20), 'a case study may be understood as the intensive study of a single case where the purpose of that study-at least in part- is to shed light on a larger class of cases (a population)'. Case study research has the advantage of shedding more light on the causal mechanisms of a relationship. As it is the goal to get an extensive understanding of our topic, and we have to look at relatively complex conceptual models and relationships, the single case study is the logical option to choose. Gerring (2007) also states that the choice between a case study and a cross-case study with many cases, is one of 'knowing more about less, or less about more. This thesis makes a clear choice for the former. The goal of this thesis is to have a very practical approach. The first purpose of this thesis is practical, that is: to understand the integration of micro-supervision of European banks to the European level, which is expressed in the SSM proposal. So, to get extensive knowledge of this case is an end in itself. But this thesis can also contribute to the theoretical debate on European integration, because it tests two competing theories on a new and important step in the integration process. To answer the research question, I will conduct a literature study and make use of qualitative data. The data that will be analyzed will mostly come from policy documents, texts of European proposals and regulations, newspaper articles, and from interviews, speeches and statements of relevant actors. Also secondary data may be used as supportive evidence from authors that have analyzed for example the current institutional setting or the behavior, interests and preferences of actors.

In the analytical chapter, I'll first look to the preferences of the relevant actors. The actors that are included in the analysis are all the actors that have any interest in the status quo or in the institutional developments regarding the supervision of the European banking sector. The most important actors that are included are: member states of the EU, both non-eurozone and eurozone members; domestic actors; the ECB; the European Parliament; the European Commission; and the European banking sector and its representative, the European Banking Federation(EBF). The IMF is also a relevant actor, as it is extensively involved in lending programs and structural adjustment policies in several member states. Analyzing the pressures from domestic societal groups in all 27 member states, like those of political parties, will give a inconvenient and chaotic picture. Therefore, I will focus on the most important and larger member states of the EU. The member states that I will focus on in the analysis are Germany, France, and the United Kingdom. Together, France and Germany are often able to push for a decision in the eurozone group. The United Kingdom on the other hand is a powerful non-eurozone member state. The preferences, positions and behavior of other member states are also taken into account, but the domestic pressures from societal groups are only analyzed for these three member states.

For testing the hypotheses of liberal intergovernmentalism, I'll first look if member states positions correspond with the interests and positions of domestic actors, and what the distributional consequences of the SSM and the resolution framework are for these domestic actors. For the concept of 'intensity of preferences on the margin', I simply look if member states focus specifically on a issue in their statements, policy documents, interviews, etc. Also newspaper articles about the negotiation process provide an insight on what issues the member

states have an intense preference on. The second thing to do is to measure the bargaining power of the member states. According to LI theory, bargaining power increases when you have a good unilateral alternative in case of non-agreement. So, I will look at which member states have the most benefit under the status quo and/or which actors are most interested in institutional change. I also assume that the size and economic power of the member state increase member states' bargaining power and unilateral policy options. Also, LI theory refers to the threat of exclusion and the formation of alternative coalitions. This could take the form of a 'two-track Europe', whereby a coalition of member states agrees to take a next step in integration, pushing the other member states in a situation of two options: to join or not to join.

For testing the hypotheses of neofunctionalism, I look primarily to the functional arguments for integrating micro-supervision to the European level. The influence of the EMU and the single market for financial services on the need to integrate micro-supervision is investigated. Secondly, the influence of supranational EU institutions like the Commission, European Parliament, ECB, and EBA is investigated. This will also be done for pressures from non-governmental actors like the representative actor of the European banking sector; the European Banking Authority (EBA). For the influence of the EP on the outcome, I focus on the positions of the EP that could find a majority in the parliament and which are adopted and expressed in resolutions and amendments. In the case of the Commission, I will look if it used its central place in the EU, its relations with the member states and other actors, and its agenda-setting powers to steer the negotiation process and the final outcome/agreement. Now I will turn to a conceptualization of the different institutional outcomes that are possible and what is exactly meant by the SSM and the Banking Union.

3.2 The De Larosiere framework, the SSM and the Banking Union

The purpose of this subchapter is to conceptualize the different policy/institutional options that were available to the relevant actors. First of all, I'll define the 'De Larosiere framework', the current institutional design of supervision in Europe. Secondly, I describe what is exactly meant by the Single Supervisory Mechanism (SSM) and a Banking Union and how these two concepts relate to each other. As I will argue later, the possible policy/institutional outcomes can be identified with different explanations for the SSM.

The De Larosiere framework was introduced in 2010. The level 3 Committee's of the old framework were replaced by three new EU agencies with legal competences. The European Banking Authority (EBA), one of the three new agencies, replaced the CEBS. The 4-level structure of the old framework disappeared completely. A separation was made between micro-supervision and macro-supervision. The European Systemic Risk Council (ESRC) was set up to supervise risk factors in the European banking sector on a macro-level. The Council consists of members from the ECB/ESCB General Council, and representatives from the EBA, the Commission and the other two new authorities (EIA & ESA). The ESRC was a response to the criticism of the De Larosiere report (2009) that macro-prudential supervision was too much neglected. The European System of Financial Supervision (ESFS) is now responsible for micro-prudential supervision on the European level, and it consists of the three new authorities; the EBA (banking); EIA (insurance); and ESA (securities). In addition to the competences of the level 3 Committee's (which were primarily based on peer-review), the ESFS agencies have the following competences: legally binding mediation between supervisors; the adoption of binding supervisory standards and binding technical decisions applicable to individual institutions; and the licensing and supervision of EU wide institutions. These EU wide institutions involve mainly

the Credit Rating Agencies (CRA's), who have been discredited after the start of the financial crisis for providing poor judgments on financial products. The additional competences grant the EBA with much more instruments to perform its tasks. The EBA now has the legal competence to make a *binding* decision in the case there is a dispute between national supervisors, where the level 3 Committee could only try to mediate such a dispute. Second, it can adopt *binding* supervisory standards and make *binding* technical decisions for individual institutions in the case national supervisors fail to properly perform their task. This means that the EBA could, at least in theory, overrule national authorities. Such a decision needs a qualified majority in the Supervisory Board to be passed. In conclusion, the De Larosiere framework provides the upgraded version of the level 3 Committee, the EBA, some enforcement powers besides the instrument of peer-review. It is however doubtful if this new framework solves all the problems that were attributed to the Lamfalussy framework. First of all, the question remains if the members of the EBA's Supervisory Board, which are mostly representatives of the member states, are willing to overrule one of its one peers. Together with the condition that such a decision needs a qualified majority, it makes it more likely that this instrument is used as a theoretical possibility that exists on the background, as a final option, to stimulate national authorities to comply. Second, the daily practice of supervising the banking sector still remains the task of the national authorities.

With the Single Supervisory Mechanism (SSM), the institutional design of European micro-supervision will change significantly. Supervision of individual banks will be transferred from the national authorities to the ECB. This could be the case for only the larger 'system relevant' banks, or all European banks. Regarding the division of authority and the day-to-day supervision of the smaller and larger banks, there are thus several options available. The ECB's capabilities are as follows according to the Commission's proposal: authorizing credit institutions; enforce compliance with capital, leverage and liquidity requirements; the supervision of financial conglomerates; and carry out early intervention measures when a bank breaches or risks breaching regulations (Commission, 2012b). So, the ECB can enforce certain rules on individual banks and can even ultimately decide to close them in the case banks do not comply with the rules. The SSM is one of the three components of the Banking Union. The other components of the Banking Union are the resolution framework and the single rulebook. With the resolution framework, rules on when and how European banks should be closed in an orderly fashion, and rules on when European banks should/are allowed to be saved are made on the European level. The actual decision on whether a bank should go into bankruptcy or should be recapitalized is also made on the European level. The funds for the recapitalization of European banks could come from several sources: the European Stability Mechanism (ESM); contributions by the banking sector itself via a financial transaction tax; or from the creditors, shareholders and customers saving money (with more than 100.00 euro) of the troubled bank. This last option is known as a so-called 'bail-in'. Another option is that a certain percentage of the aid that is necessary for recapitalization still comes from the home country of the troubled bank. The source of the funds is an important issue in the negotiations, as it determines where the liability of risks for the European banking sector will lay in the future. Ultimately, The purpose of the resolution framework is to free member states of the burden of that liability. The components of the Banking Union could be introduced in several chronological orders. Is it first necessary to establish effective European control by means of the SSM, before the ESM can start with directly aiding troubled banks? Or is it possible to use the resolution framework as a crisis-management tool in the short-term, in which it works temporary with national supervisors until the SSM is

operational? These different options for building the Banking Union could also have important distributional consequences for the relevant actors.

4. The interests and positions of the relevant actors

In this chapter I will describe the interests and preferences (orientations) of all the relevant actors involved in the SSM proposal. The orientations towards the resolution framework will also be included, as it is strongly linked to the SSM proposal. I will start with the following member states: the UK, France and Germany. For these countries, I also look to the interests and positions of domestic actors, in what way these are aggregated to the state level, and what level of autonomy and room for maneuver the governments have on the issue of a Banking Union. I also take into account the interests and positions of smaller member states, by looking to which of these three countries they most align and which country coalitions can be identified. The Southern-European member states for example form an important group with similar interests that could have a significant impact on the outcome. This is followed by looking at the relevant EU institutions: the European Parliament (EP); the European Central Bank (ECB); the European Banking Authority (EBA); and the Commission. Lastly, I look to the IMF and the European Banking Federation (EBF).

4.1 Member states

United Kingdom

As a member state that doesn't participate in the euro zone, the UK has different stakes in the proposal for the SSM than for example Germany and France. UK's prime minister, David Cameron, stated clearly: 'we won't take part in a EU Banking Union.... It is not our currency' (The Telegraph, 2012a). The UK however does take part in the single European market for financial services, on which the SSM proposal could have a significant impact. The main task for the UK in the SSM negotiations is thus to 'make sure that Britain's interest, particularly in the single market and the openness and fairness of the single market, are protected' (The Telegraph, 2012a). The UK's positions are also more and more influenced by eurosceptic sentiments in their society and in the parliament. Foreign secretary William Hague, in a press conference with his Polish colleague, commented that 'the government of the UK is clear, as you know, that we will not agree on any further transfer of power or competence from the national level to the EU' (The News, 2012).

A report of the parliamentary EU committee in the House of Lords is useful to determine the UK's interests and positions. The report, published in December 2012, discusses the main issues and the stakes involved for the UK in relation to the Banking Union. This report of the European Union Committee (2012) was called '*European Banking Union: Key issues and challenges*'. One of the concerns put forward in the report is what the consequences of a Banking Union are for its financial sector. The City of London is one of the largest financial centers of the world, and important for the economy of the UK. There are different domestic assessments of the impact of a Banking Union on the position of UK's financial sector. Barclays for example warned that British banks could be subject to deposit flights if the SSM was viewed as a stronger mechanism than the one operating in the UK. Others feared a threat to the provision of cross-border services, which is a fundamental part of the success of the City of London, or the loss of the City of London's role as an entry point to the single market for non-European banks. On the other hand it is argued that similar concerns were expressed at the introduction of the euro, but that no shift of financial activities occurred ever since (EU Committee, 2012). The EU Committee (2012, p.41) however expresses its fear 'that the Government's assurances that the pre-eminence of the UK financial sector will persist may prove misplaced'. Besides its concerns about their

financial sector, the UK has on the other hand also an interest in a eurozone that solves their problems, regains its stability, and that starts to economically grow again.

The UK is however most interested in the new relationship between the SSM and the EBA, and what remains of the powers and tasks of the latter. The UK fears that the SSM members will form a block, imposing regulations and supervisory standards on the other member states in the EBA. The report says in this respect: 'It is in our view inevitable that there will be a convergence towards a single view within the EBA among member states participating in the Banking Union...the EBA's voting arrangements must ensure that it is able to defend the interests of the single market as a whole' (EU Committee, 2012,p.30). The UK government also raised concerns about the new mediation arrangement in the amending regulation for the EBA. Because the ECB cannot be legally bound by a EBA mediation decision, the ECB would be subject to a 'comply or explain' arrangement. In the eyes of the UK this is of course unfair for non-SSM members, as their national supervisors would, contrary to the ECB, still be subject to a binding decision of the EBA. So, it is in the UK's interest that the 'comply or explain' arrangement will be applied to everyone, or that a legal way is found to impose a legally binding mediation decision on the ECB.

Germany

Germany's answer to the euro zone crisis is most of all characterized by a focus on national responsibility. The national debt and the budget deficits of member states need to be reduced and structural reforms in public expenditures need to be made. Secondly, fiscal rules need stronger enforcement on the European level. Germany strongly pushed for the strengthening of the SGP (Bundesbank,2012 & The Independent,2012). It's positions towards the EU reflect predominantly the belief that the 'mutualization of risks' could not go without the 'mutualization of responsibilities'. Germany's interest in introducing a central European supervisory authority was for a large part triggered by the EU summit of June 2012. According to reports of the summit, Angela Merkel was pushed quite hard by the leaders of Italy, Spain, and France, to agree on giving the euro zone's permanent rescue fund, the European Stability Mechanism (ESM), the power to give aid directly to troubled banks (Spiegel,2012a). In practice this would mean that German taxpayers' money, and perhaps the money of German banks, would be used to save banks of countries predominantly located in Southern-Europe. Direct recapitalization of banks by the ESM would thus have mostly negative distributional consequences for German citizens and banks.

Before the summit, the coalition parties FDP and CDU expressed that they were far from enthusiastic about the idea of a Banking Union, with FDP members of the parliament stating that a Banking Union would be 'a new admittedly creative way to tap German solvency' and that 'every eurozone country has to take responsibility for its own banks' (EU Business, 2012). Germany's central bank, the Bundesbank, is also highly skeptical of a Banking Union. The Bundesbank thinks that a Banking Union could result in a 'joint sovereign responsibility to the back door. When the banks in weaker economies find cheaper refinancing cost via the ESM, and would then buy more of their own countries' sovereign bonds, they would pass on cheaper refinancing costs to their governments' (FT,2012a). In the view of the Bundesbank therefore, a Banking Union should only be agreed to if, besides the SSM, also a strong fiscal union is in place and guaranteed. The central bank also doubts if a Banking Union will be legally possible under the current treaty. Looking at Germany's banking sector, it shows many small, non-profit, and regionally managed savings banks, that are directly or indirectly owned by the state. These banks are opposed to a Banking Union, and wrote a letter to Angela Merkel stating that it would be wrong to use the money of their customers saving money to rescue troubled banks abroad

(NOS,2012). The association of the private banks in Germany, the Bundesverband, is more positive. It welcomes the SSM proposal, and want to see it applied to all European banks. De Bundesverband however agrees with the position of the German government that a resolution fund only becomes acceptable when the SSM is in place (BvB,2012). Regarding the political parties, the opposition, led by the SPD and the Green Party, are in favor of the SSM and an European fund that can recapitalize the banking sector. This fund should consist however primarily of contributions by the banking sector itself (Bundestag,2012). According to a opinion poll of PewResearch, about half of the German citizens support bail-outs of other EU countries, and support has slightly grown from 42% in 2010 to 52% in 2013 (Pewresearch,2013). So, this division of German citizens on this issue could provide the German government with some room for maneuver and concession-making on the issue of the possible direct recapitalization of banks by the ESM.

Germany, pushed to accept this mutualization of liability for European banks at the summit in June 2012, insisted that this was only acceptable after an central European supervisor was in place, complemented by a single rulebook (Spiegel,2012a). Bundesbank vice-president Lautenschlager, expresses in a statement what the SSM is all about for Germany: 'Whoever accepts liability also has to have a right to control, especially when it is potentially a question of very large sums as in the case of a banking crisis'(FT,2012). This view is shared by Germany's Minister of Finance, Wolfgang Schauble: 'Solange die Entscheidungszuständigkeit nicht vergemeinschaftet sei, solange könne auch die Haftung nicht vergemeinschaftet werden' (Wallstreet online, 2012). So for Germany, the SSM could be an instrument to get more control on European banks, for which they in turn would accept liability under the resolution framework. This supervisory control on the European level should then also prevents free-riding behavior of member states.

Germany has on two issues an intense preference formation. One of the issues on which it focuses is on keeping the monetary task and the new supervisory task of the ECB strictly separated. Germany is afraid that the ECB is going to use monetary instruments to complement their new supervisory task. Germany therefore insist on creating a separate supervisory body in the ECB, and on keeping the Governing Council of the ECB, who decides on monetary policies, as far away from the decision-making process as possible. Secondly, Germany is strongly against bringing all European banks under the supervision of the ECB. To the press, Wolfgang Schauble stated that 'it would be very difficult to get approval by the German parliament if the deal would leave supervision for all the German banks to European banking supervision'(EUobserver,2012). There are mainly two reasons for this position. First, Germany believes that the ECB is never capable of supervising roughly 6000 banks. Supervising all 6000 banks would indeed require a radical increase of the ECB's bureaucratic capacity. Another reason might be that Germany wants to prevent that their regional savings banks will fall under European supervision. The head of the German regional savings bank association supports the position of the German government, stating that they want a 'supervisory body that is effective, quick and efficient', which can only happen 'if the supervisor is close to the banks and knows their business' (EUobserver,2012). The president of the German private banking association, the Bundesverband, is however strongly in favor of centralizing supervision of all banks to the European level, stating that there should be the same risk factors, the same rules, and the same uniform application of them for all banks, and that it could be unfair if it was to be otherwise (Sueddeutsche,2012). Schauble also came with the suggestion in September 2012 that banks first have to pass an European stress test before they could fall under ECB supervision

(FT,2012b). With the banking sector thus divided on what the scope of supervision should be by the ECB, the government chose the position of the smaller, regionally managed saving banks.

France

France is strongly in favor of the SSM proposal and the creation of a Banking Union in general. France was one of the countries that pushed for the providence of direct recapitalization funds from the ESM to the banking sector on the summit of June 2012 (Spiegel,2012a). The reason for France's support however is quite different from that of Germany. The two countries have significant differential views on how to handle the eurozone crisis. One of these disagreements is on the need and the effectiveness of fiscal austerity programs. Secondly, where Germany stresses the importance of the 'mutualization of responsibilities', France is more supportive on the 'mutualization of risks'. For example, Paris also supports the introduction of Eurobonds.

This support for the 'mutualization of risks' in Europe may well be the result of French (and international) concerns that they might follow the same fate as countries like Greece, Italy, Portugal and Spain (Daily Mail,2012 & Global Post,2013). So far, France escaped the pressures of the financial markets, and interest rates on sovereign bonds are not much higher than those of Germany. Also, France is doing pretty well regarding its national debt, which is higher than 60% but still controllable and below the eurozone's average (Guardian,2012). The question is however if this will continue in the future. France is failing in getting their budget deficit under control, and will significantly exceed the norm of 3 % in 2012 and 2013, although it is expected to be down the 3% in 2014 (Guardian,2013). It's national debt is still rising, economic prospects are negative and there is little international believe that socialist president Hollande will make the necessary structural reforms. The competitiveness of the French economy is also questioned (Telegraph,2013). The French banking sector is judged as relatively healthy, but on the other hand it's also highly dependent on wholesale funding (IMF,2012). Wholesale funding is used by banks as a safety investment and to manage risks, and sovereign bonds are one major component of this wholesale funding. Especially the high exposure of French banks to sovereign bonds of problem countries like Greece is a major concern (Guardian,2011).

All these concerns are shared by the French citizens. A public poll of the Pew research center in March 2013 shows that the French are much more pessimistic about the economic prospects of their country than the Germans are over theirs. 71% of the French respondents worry about their country's national debt, against only 37% of the Germans (PewResearch,2013). Nine out of ten of the French respondents think their economy is doing poorly and only 11% thinks their economy will improve in the next year, making them one of the most pessimistic countries in the EU. However, this had rather a negative effect on the support of French citizens for financial assistance programs to other EU countries. In 2010, 53% supported this, in 2013 this was only 40%. About half of the French respondents are willing to grant more authority to Brussels for solving the crisis (PewResearch,2013). So, the French support for a Banking Union is not explained by the attitudes of French citizens. The poor economic prospects, and pessimistic views of the French, appeared to have caused a decline of solidarity towards other member states. Although not a direct measurement of the opinions of French citizens towards the Banking Union, it gives an indication of their opinion towards the idea of using ESM funds for the direct recapitalizations of banks.

In 2012, the French chose however the leftist candidate Hollande, from the Parti Socialiste, as their president. The ideological motivations of this political party may explain the French support for direct recapitalization of troubled banks by the ESM. The political party of President Hollande, Parti Socialiste, wants 'integration that is based on solidarity' to become the rule in

Europe and the party sees in Europe no confrontation between the north and south, but a confrontation between 'progressives and conservatives' (Parti Socialiste,2012). In a party document, Merkel was even called selfish, 'thinking about nothing else but the deposits of German savers, the trade balance recorded for Berlin and her electoral future' (FT,2013a). Because Hollande's election is a result of many interests of citizens that are aggregated in political parties, and because the French public opinion is divided on the support for bail-outs and on giving Brussels more powers, it could be the case that French support is the result of the positions of the Parti Socialiste rather than it is a expression of strong support of its citizens. Based on the general attitudes of the Parti Socialiste towards integration, it is likely that they are supportive and interested in a resolution fund whereby the ESM plays a central role in the direct recapitalization of banks. The French support for giving the ECB supervisory authority could then perhaps be interpreted as a concession to Germany, to secure German support for the resolution framework, or as a necessary means to an end. This assumption is supported by the country's continued emphasizing and focus on implementing the SSM proposal as soon as possible, exposing that the next step (the ESM plan) is the thing they're really after. France continually stressed the importance of reaching a final agreement by the end of 2012 on the SSM (FT,2012b). Besides that, the supervision and regulation of the French banking sector is judged as having a high quality (IMF,2012). So, ECB supervision will not bring that many drastic changes in the supervisory practice. France wants all European banks to fall under the ECB supervision. The French minister of finance, Pierre Moscovici, stated that ' in the end it must be the ECB that has the responsibility on the whole. Otherwise, there is no real system of banking supervision' (EUobserver,2012). According to Moscovici ' a dual system of supervision could call into question the existence of a single system for some banks' (Reuters,2012).

Country groupings and the orientations of other member states

There are two important country groupings that can be identified in the eurozone. One 'coalition' consist of member states who are largely interested in the direct recapitalization of banks by the ESM in the short-term, who want the SSM to be quickly introduced so that the conditions are met to make this possible, and whereby most member states also would like to see all European banks to fall under the supervision of the ECB. They see the SSM perhaps more as a necessary mean to an end, or as a concession to Germany, for introducing the resolution framework. Countries belonging to this group are Southern-European countries like Spain, Portugal, Italy, Greece and Cyprus. But also France, Ireland and Slovenia belong to this group. With perhaps the exception of France, all these countries are currently dealing with a national debt problem and/or a weak banking sector. The other country grouping involves mainly Germany, the Netherlands and Finland. These countries are not very supportive of an European resolution framework whereby large ESM funds become available for the direct recapitalization of the banking sector. They insist on introducing the SSM first, whereby the SSM gives these countries the ability to get control on European banks, as they would have to accept liability of their risks under the resolution framework. The SSM is an instrument to prevent free-riding behavior, for which these countries might be afraid. Of these country groupings, the group of Southern-European countries is the most important group of member states which is not discussed separately like France, Germany and the UK, but which have nevertheless an important influence on the outcome.

4.2 EU institutions and other international actors

The common position of the European Parliament (EP) in the SSM negotiations can be extracted out of the EP's adopted resolutions, and from the draft legislative amendment the parliament adopted of the Commission proposal of the 12th of September 2012. The EP already suggested the idea of a resolution framework funded on the European level in a resolution adopted in July 2010 on cross-border crisis management (EP,2010). Although not the same as the SSM proposal, the EP also suggested in that resolution that the EBA should become solely responsible for supervising cross-border banks. The majority of the EP is therefore a strong supporter of the SSM proposal and the other components of the Banking Union. The EP's main concern is related to the accountability of the ECB for supervisory decisions. The parliament finds it important that the new Supervisory Board should be accountable for its actions, both to the EP and the national parliaments. In the eyes of the EP, this 'further strengthening of democratic accountability is appropriate given the impact that supervisory measures may have on public finances, credit institutions, their customers and employees, and the markets in the participating member states' (EP, 2012,p.14). The EP suggests several instruments to secure this accountability. For example, members of the Supervisory Board may be heard at the request of the parliaments, and the EP should be able to ask questions, to hold investigations, and to appoint the chair and vice-chair of the Supervisory Board. Secondly, the EP calls for the creation of a Board of Appeal, whereby any natural or legal person, including the national authorities, may appeal against a supervisory decision of the ECB. Thirdly, there must also be the possibility to review the legality of decisions of the Supervisory Board by the Court of Justice, to contest a decision taken by the Board of Appeal or in cases that did not apply for a judgment by the Board of Appeal (EP, 2012). The EP thinks it's not possible for the ECB to supervise all European banks. Mrs. Thyssen, head of the ECON Committee, said that 'it is clear that not all banks should be subject to the same direct supervision by the ECB' (EP,2012). The ECB however should have the power to assume the responsibilities for these credit institutions when necessary.

The Commission acted quick on the recommendations of the Eurotop of June 2012, and came up with the SSM proposal in September of that year. In general, it pushed for a quick implementation of it, and thought the negotiations could be finished by the end of 2012 and to start with the SSM shortly thereafter. The European Central Bank (ECB) itself, strongly supports the idea of the SSM and the Banking Union. Already by the end of May 2012, Draghi stressed the need of using the money from the ESM for the direct recapitalization of banks, stating that 'we have a big pot of money, but if people can't touch it, it's like we don't have it' (WSJ,2012). The central bank asks for 'strong competencies and policy instruments' to perform its tasks.....otherwise, reputational risks could arise that might negatively affect the institution as a whole' (ECB,2012). According to Draghi, Setting up the new supervisor 'for all 6000 banks in the eurozone is crucial to boost market confidence... and would 'paves the way towards severing the link between banks and their respective sovereigns' (EUobserver,2012 & DW,2013). Regarding the scope of supervision, he admitted that supervising al 6000 banks would be impossible, and that the role of national authorities should increase as the size of a bank and its systemic relevance decreases.

The European Banking Federation (EBF) 'has long argued for further supervisory integration in the EU' and 'welcomes the European Commission legislative package proposing a Single Supervisory Mechanism (SSM)' (EBF,2012,p1). Criticism is mostly directed at the institutional design of the SSM in the Commission's proposal. For example, The EBF has its concerns about the lack of legal protection in the Commission proposal for banks against the supervisory

decisions of the ECB. Therefore the EBF calls, just as the European Parliament, for the set-up of a Board of Appeal. In accordance with the position of Germany, the EBF 'finds that the sequencing of the different elements of the Banking Union is key' (EBF,2012). The International Monetary Fund (IMF) also strongly supports the establishment of the SSM and the other components of the Banking Union. In their view, the SSM should ultimately supervise all banks. Secondly, the SSM must be complemented by a resolution framework: 'without common resolution and safety nets and credible backstops, an SSM alone will do little to weaken vicious sovereign-bank links' (IMF,2013). The IMF also stresses that time is of the essence, and that it will be 'important to undertake as soon as possible direct recapitalization of frail domestically systemic banks by the European Stability Mechanism (ESM)' (IMF,2013). To conclude, all EU institutions and international actors analyzed strongly supports the SSM proposal and the Banking Union in general. Some of these actors were already expressing and lobbying for these ideas before it came on the agenda of the important summit in June 2012.

5. The negotiation process and the outcomes so far

In this chapter I provide a timeline of the most important events in the negotiation process, and discuss what has been decided so far. In June 2012, the idea for creating the SSM, together with a resolution mechanism and a single rulebook, was introduced by Van Rompuy, the President of the European Council. In his policy document *'Towards a genuine economic and monetary union'*, he called for a integrated supervision where 'the European level would be given supervisory authority and pre-emptive intervention powers applicable to all banks' (Van Rompuy,2012). Shortly after, on the 29th of June, there was a Euro Area Summit, where the plans of Van Rompuy were supported. The statement published after the summit stated that 'We affirm that it is imperative to break the vicious circle between banks and sovereigns. The Commission will present proposals on the basis of Article 127(6) for a Single Supervisory Mechanism shortly' (Euro Area Summit, 2012). One important agreement that was made during that summit was the chronological order in which the different components of the Banking Union should be introduced: 'When an effective single supervisory mechanism is established, involving the ECB, for banks in the euro area the ESM could, following a regular decision, have the possibility to recapitalize banks directly' (Euro Area Summit,2012). So, the direct recapitalization of banks by the ESM is conditioned on the establishment of the SSM first. The Commission introduced the SSM proposal on the 12th of September 2012, which had the following content. The ECB would be responsible for authorizing credit institutions; enforce compliance with capital, leverage and liquidity requirements; supervision of financial conglomerates; and carry out early intervention measures when a bank breaches or risks breaching regulations (Commission,2012b). The ECB should do this for all European banks, with the national supervisory authorities assisting the ECB in its tasks. So, no distinction was made between larger and smaller banks in the Commission proposal. It was the goal of the Commission to have the SSM proposal adopted both by the member states and the EP by the end of 2012, and to have the SSM operating in the beginning of 2013.

Germany and France however clashed on what the scope of supervision should be, whereby Germany insisted that a distinction should be made between larger and smaller credit institutions, keeping supervision of the latter on the national level. France however was strongly in favor of bringing all banks under the ECB's supervision. Other issues that were discussed were the separation of monetary and supervisory policies in the ECB, the decision-making procedures and the composition of the ECB supervisory board. The time path for introducing the SSM and the resolution framework was also an important issue in the negotiations. Countries like Spain wanted bank bailouts by the ESM already to be possible in 2013, but Germany insists that the SSM must be in place first and be fully operational. Germany also wants to take the appropriate amount of time to design the SSM, with a focus on 'quality, not quantity', with Schauble stating that 'what we don't achieve now, we cannot make up for later on' (Spiegel,2012b). On the 12th of December a summit was planned between the ministers of finance to solve these issues. Hopes on this summit were low, as the positions of Germany and France did not seem to get closer together before the summit. Germany's minister of Finance Wolfgang Schauble made a conciliatory move by suggesting that the supervisory body of the ECB could be domiciled in Paris (EurActiv,2012). As it became clear that the proposed time-path of the Commission could not be achieved, President of the European Council, Van Rompuy, suggested that direct aid by the ESM to troubled banks could already start in the spring of 2013, even though the SSM would not be operational at that time yet. This comment of Van Rompuy resulted in angry reactions at the German ministry of finance (Spiegel,2012b). At the summit,

the member states came to an important agreement on some of the issues. The member states agreed that the ECB is going to supervise roughly 150 banks, but with the ECB having the authority to step in on other smaller banks whenever necessary. The most important issue for non-eurozone member states like the UK, which was the decision-making procedure in the EBA, was solved in their favor. The minister agreed that a double majority of countries both in and outside the eurozone was needed to make decisions. The SSM is planned to start its work in 2014. It was less clear however when the ESM would be able to recapitalize banks directly via the ESM. The summit could all in all be seen as a small victory for Germany and other northern member states, as the SSM would start its operations much later than other member states had hoped for, and much uncertainty remained on when the ESM could start with the direct recapitalization of banks. Also, Germany got largely its way on the scope of supervision, although the ECB still gets the authority to take over the supervision of smaller banks when necessary. After the member states agreed on the most important issues in the SSM proposal on the summit between the ministers of finance in December 2012, negotiations started between the member states and the European Parliament. The member states and the EP came to a final agreement in April 2013. The content of the agreement however has not yet been released at the time of writing.

It was shortly after this agreement, that Germany suddenly raised its concerns again about the need for a Treaty change. This could delay the introduction of the Banking Union significantly, especially since the UK has told that it would then seize the opportunity to negotiate a new position for the UK in the EU. Schauble said in reference to the SSM and the resolution mechanism that they only want to do it on a clear legal basis, as he doesn't 'want risks in Karlsruhe', referring to the German constitutional court (Bloomberg,2013). Barnier, the Commissioner for the internal market, responded that he thought that it's possible to do this rapidly in the framework of the current treaties. The chairman of the eurogroup, Dijsselbloem, said however that a limited treaty change was inevitable because of the German position. One month later, in May 2013, Schauble suddenly softened its stance again on the need for EU treaty change, saying that the 'Banking Union is a central project, we need institutional changes but we cannot wait for treaty change. We need to work with what we have' (EUobserver,2013). The reason for this may well be a political deal with France. Because it was on a meeting of Merkel and Hollande, just before the European Council meeting of the 22th of May 2013, that France and Germany agreed to weaken the centrality and effectiveness of the resolution framework to make the implementation of the Banking Union legally possible under the current treaty. France and Germany proposed to give national authorities a greater role in resolving troubled banks, and to focus instead on promoting more cooperation through a board of country representatives (WSJ,2013a). This led to comments that France 'sold' the south and that 'the Banking Union is unraveling at a frightened pace' (WSJ,2013 & European Sting,2013). Also, negotiations on determining the rules for the resolution framework in June 2013 seemed to go in a direction that puts the bill of saving a bank at the creditors, shareholders and savers with money above the 100.000 euro, a so-called 'bail-in'. On the long-term, banks themselves should have to contribute to a fund that's used for saving banks, whereby member states are required to set these funds up on the national level. This 'bail-in' method was already applied in Cyprus in March 2013, and eurogroup president Dijsselbloem suggested that this would be a 'template' for future rescue operations. When asked in a interview in the financial times if the method used in Cyprus meant that the possible use of ESM funds for direct recapitalization would become largely irrelevant, Dijsselbloem answered: "I think that's what we should aim at. We should aim at a situation where we will never need to even consider direct recap....If we have even more instruments in

terms of bail-in and how far we can go in bail-in, the need for direct recap will become smaller and smaller'(FT, 2013b). On the Eurogroup summit of June 2013, the member states agreed on a limit of 60 billion euro, of the total 500 billion euro in the ESM fund, to be used for direct recapitalization of banks. Also, the idea of using ESM funds retroactively for past bail-outs is unlikely to happen, with German minister Schauble stating that this would be a 'concession to our Irish friends' (WSJ,2013b).

6. Neofunctionalist and Liberal Intergovernmentalist Explanations

In the theoretical chapter I formulated the hypotheses of neofunctionalism and liberal intergovernmentalism on how they would explain the SSM. Now I have analyzed and determined the independent variables, I can argue more specifically what explanation these two integration theories have for the creation of the Single Supervisory Mechanism (SSM), and if this corresponds with reality. For each theory, I first argue how they would explain the SSM, after which this explanation is compared with its coherence with reality.

6.1 Neofunctionalism

According to neofunctionalism, functional spillovers from the EMU and the single market for financial services create structural incentives for the member states to be supportive of the SSM proposal. Political spillovers, socialization processes and pressures from EU institutions and international actors are supportive of this process. First, a functional spillover from the single market for financial services, and the growth of the number of banks with cross-border activities is a possible explanation for the SSM. For efficiency reasons, and for preventing regulatory arbitrage, lax supervision and financial instability, it would be advantageous to create a single supervisor. This is however unlikely to serve as an explanation. The problems associated with national supervisors and the lack of cooperation and coordination on the European level in a single market were already identified by the De Larosiere report in 2009. After this report, the old supervisory framework was replaced in 2010. The EBA was created to foster supervisory cooperation and to ensure a uniform supervisory practice, having more powers to make binding decisions than its predecessor. That this supervisory framework is already replaced three years after its creation, without much time to prove its performance, suggests that the SSM has little to do with a functional spillover effect from the single market for financial services.

The second (and more important) structural incentive for the SSM would be the combination of a single currency and the existing link between 'banks and sovereigns'. A member state needs its largest banks to survive, both for the functioning of its economy and for the protection of its citizens saving money. The banking sector on the other hand, needs the national state for its recapitalization in the case it needs to be rescued. The nation state and the banking sector are therefore dependent and linked to each other. As 17 member states are also sharing a single currency, it creates the incentive for all eurozone member states to break this link, as a eurozone member state with an unsustainable national debt could endanger the stability or even the continued existence of the euro currency. The liability of the banking sectors' risks must be removed from the state. Therefore, to secure the functioning of the Euro currency, a resolution framework would be needed that is funded out of a European fund, which could be the ESM. As member states trap themselves in institutions, and because these institutions are difficult to change and even more difficult to abolish, it becomes almost impossible for member states to stop with the single currency. Further steps in integration to secure the functioning and survival of the EMU project is then the only way to go for member states. The SSM is then primarily in service of making the resolution framework work. To decide on the European level if a troubled bank should be recapitalized or should go into bankruptcy, you also need an European supervisor who knows the situation of the bank, who can make supervisory decisions on it and who has the power to provide or withdraw licenses to credit institutions, and to enforce regulatory standards. A second argument for this, expressed by the IMF (2013,p.12), is that *'common safety nets and backstops without effective supervision and resolution would break sovereign-bank links, but risk distorting incentives, reinforcing tendencies for regulatory*

forbearance, and shifting losses to the euro-area level. Effective control must accompany, or precede, risk or burden sharing.' The SSM is thus also needed to prevent free-riding behavior.

Besides these functional pressures, neofunctionalism assumes that the EU institutions and other international actors actively pressure member states, and influence their orientations, to support the SSM proposal and the other components of the Banking Union, and that the final SSM proposal will correspond in a great deal with their preferences. And as described in chapter 5, EU institutions like the Commission, the ECB, the EP, and international actors like the IMF and the European Banking Federation (EBF) are indeed all strongly in favor of the SSM proposal and the Banking Union in general, and strongly encourage member states to be quick in establishing it. Second, financial markets could also play a big role in pressuring member states to establish a Banking Union. For instance, at the time of the summit of June 2012, were the intention to establish a Banking Union was pronounced, financial markets were putting high pressure on Spain as there were concerns about the Spanish banking sector.

Non-eurozone member states, like the UK, do not face the same functional pressures as member states with the single currency. The functional spillover from the single market could be an incentive to join the SSM, but are no incentive for taking part in the resolution framework to which the SSM is linked. So in general, functional pressures to integrate micro-supervision to the European level are less for non-eurozone member states, and neofunctionalist assumptions do not contradict with the fact that the UK is probably not going to participate in the SSM. However, the Banking Union could have effects on the functioning of the single market for financial services. When participants in the Banking Union start to develop similar interests, it could possibly lead to a dichotomy in the single market. Banking Union participants could form a block, especially when they are capable of dominating decision-making in the EBA. To prevent this block forming, which could distort the unity of the single market, EBA voting arrangements need to be altered to secure that Banking Union participants need to make coalitions with non-participants to adopt decisions. Therefore, neofunctionalism would predict an amendment on the voting-arrangements in the EBA.

In conclusion, neofunctionalism would predict the creation of the Single Supervisory Mechanism (SSM) complemented by a resolution framework that is financed on the European level. Only with the component of a resolution framework, the link between the state and the banking sector can be broken. Neofunctionalism explains the SSM thus as a step of integration that, in combination with the other components of the Banking Union, is a necessary step to break the link between 'banks and sovereigns', which then again must secure the stable functioning of the Euro currency. And because the sustainability of national debt is currently under severe pressure for some member states, and the European banking sector is still relatively weak, the need for a complete Banking Union is urgent. The 'vicious link between banks and sovereigns' endangers currently, or has already brought into trouble, countries like Slovenia, Spain, Cyprus, Ireland and Portugal. Neofunctionalism would thus expect a complete Banking Union on the short-term. As argued, neofunctionalism also predicts that the EBA voting arrangements are altered to prevent a dichotomy of the single market.

How well do these predictions correspond with reality? As described in the analytical chapter, the member states agreed to introduce the SSM first, followed by the resolution framework only after the SSM is in place. The SSM is planned to start its operations in 2014, and the direct recapitalization by the ESM of troubled banks is placed on the longer-term, and still faces uncertainties surrounding the need of Treaty change, which could delay the introduction even further. Meanwhile, as the eurozone crisis is still going on, a Banking Union would especially be helpful at this particular moment. So, the functional demand for the short-term introduction of a

complete Banking Union is not 'delivered' by the member states. Secondly, the role of the ESM is probably going to be much less than anticipated in June 2012, whereby liability is now first put at shareholders, creditors and investors in a so-called bail-in. Whether this has a more positive or negative effect, or whether it makes no difference for the stability of the eurozone compared with a larger role for the ESM, is something I can't claim with much certainty as I don't have the financial expertise for this kind of judgment.

Relating to the delay, are there possible explanations for this that would correspond, or at least not contradict, with neofunctionalist assumptions? I can think of four possible explanations that I will discuss:

- The chronological order chosen to introduce the different components of the Banking Union are needed to make it work properly
- Pressures from the financial markets have decreased after the Euro summit of June 2012, providing member states more time to pay attention to design a high qualitative institutional structure.
- The problems of the 'link between banks and sovereigns' have become less after June 2012, either by a decrease of national debt or by an improvement of the banking sector's health, which again, give member states more time to pay attention to the quality of the new institutional structure.
- The complex decision-making process of the EU, and the high number of actors with potential veto's, prevent that the functional pressures directly lead to a new step in integration.

The first argument is mostly used by the relevant actors to explain the delay of the establishment of a resolution framework funded by the ESM. For example, the IMF thinks that 'effective control must accompany, or precede, risk or burden sharing.' As have been described, there is a strong argument that the SSM is needed for the proper functioning of the resolution framework. But is it really an absolute necessity to introduce the SSM first, knowing that a resolution framework that would break the link between the banks and sovereigns is especially needed in the short-term? For the short-term, a provisionary arrangement could be made with the national supervisors who provide the necessary information on which the ESM could make its decisions. This was also more or less suggested by Van Rompuy, who stated that the ESM could already begin with providing direct aid to the banking sector in the beginning of 2013, without the SSM being operational yet (Spiegel,2012b). Although the functional argument for the necessity of the SSM is strong and well argued, I found less arguments why this temporary arrangement would be so bad. However, this debate is controversial, and many financial experts with much more knowledge on this subject would disagree with me that such an temporary arrangement would work. So, I leave this issue aside without making a conclusion on it. The liberal intergovernmentalist explanation for the chosen chronological order for introducing the different components is discussed in the next subchapter.

Relating to the pressures from the financial markets, they have indeed been much lower since Draghi made a strong commitment to the euro, stating that the ECB would do 'everything in its power' to preserve it, in a speech at the end of July 2012 (Telegraph,2012b). The problems associated with the link between banks and sovereigns however is still continuing to be significant, as can be seen with countries like Cyprus and Slovenia. So, the situation is somewhat less pressing as in June 2012, when the decision for establishing a Banking Union was made, but the problems with the 'link of banks and sovereigns were still there. It cannot be said with much certainty if the decrease of pressures from the financial markets provided the relevant actors

with more time for designing a Banking Union. The last possible explanation for the delay that corresponds with neofunctionalist assumptions is that the complex decision-making procedure of the EU, and the high number of relevant actors with a veto slows the translation of functional pressures into new steps of integration. Indeed, with a high number of member states, who all have their particular wishes regarding a Banking Union, and with the needed majority in the European Parliament, coming to a final agreement could take more time than is desirable in relation to the short-term demand for a Banking Union. However, looking at the actual decision-making process, it is especially Germany, which has an interest in delaying the direct recapitalization of troubled banks by the ESM, who causes the slowdown of the decision-making process, while France and countries in Southern-Europe press for quick decision-making. All in all, some of the possible neofunctionalist explanations for the delay are stronger than others, but ultimately no strong and scientific conclusion can be made about either of them. Of the four possible explanations, the clear decrease of financial market pressure is the strongest and most likely factor that could have caused the delay.

However, even if the delay of the introduction of a complete Banking Union cannot be explained by the four possibilities I just discussed, it wouldn't necessarily mean that the unintended consequences of the EMU, and the resulting functional spillovers, do not contribute to explaining the establishment of the SSM. Without the single currency it would have been much more unlikely that the SSM was placed on the agenda, and that a country like Germany would accept the liability of risks for Southern-European banks. Also, it is probably not a coincidence that member states agreed on establishing a Banking Union at a time when the problem of 'the link between banks and sovereigns' was putting a heavy burden on Spain. Were neofunctionalism could be wrong however, is that these functional spillovers, which create a demand for further integration, are always and automatically met by member states' support.

Secondly, I think it's wrong to see the concept of functional spillovers as a variable with two possible measurements (it is there or not). It is more a variable with several gradations. For example, would the single currency collapse without a Banking Union or would it just be more unstable? The latter situation is probably more likely. Perhaps it is the case that for domestic actors, the stability of the euro is just one of the things they take into consideration in forming their orientations towards the SSM proposal and the other components of the Banking Union. And that this consideration isn't always the decisive factor in determining their position. This possibility is tested in liberal intergovernmentalism, the theory I will discuss in the following subchapter. Basically, this goes about a fundamental question on which the two integration theories have different answers: to what level is the existence of the single currency a constraint on the policy options the relevant actors can choose from? Neofunctionalism assumes that this constraint is high, and that the policy options that help to secure the stability of the single currency are the only one to choose from. Liberal intergovernmentalism however thinks that this constraint is much lower, and that policy options that could endanger the stability of the single currency, or even its survival, are still on the table when other interests of domestic actors outweigh the interest in the stability and survival of the single currency.

For now we can say that the first two hypotheses are not accepted, but they also cannot be rejected with much certainty:

H1: Functional spillovers create incentives/ a demand on member states to introduce the SSM, which is then also more or less automatically supplied by the member states

H2: Supranational actors like the Commission, the ECB, European Parliament and international actors like the European Banking Federation (EBF) and the IMF influence the orientations of member states in directions that support further steps in integration

Because the future institutional design of the SSM was for a large part still unknown at the time of writing, the third hypothesis cannot be sufficiently tested. What is already known, is that the ECB is not going to supervise all European banks directly, and that it will focus on the banks which are 'system relevant'. This contradicts the original proposal of the Commission, and the positions on this issue of the ECB, the European Banking Federation (EBF), and the IMF. An important institutional issue, that of the accountability of the ECB's supervisory decisions, is an important demand of issues like the European Parliament and the EBF, and will be a good indicator if the wishes of these actors are taken into account. But for now, the third hypothesis couldn't be tested sufficiently.

H3: The institutional structure of the SSM for a great deal reflects the wishes of the EU institutions and other international actors.

6.2 Liberal Intergovernmentalism

With Liberal Intergovernmentalism, we have to look at interstate negotiations, the bargaining power of member states, the distributional benefits of cooperation for domestic actors, and how preferences and positions of member states are formed on a national level. LI theory assumes that the member states' support for the SSM is triggered by the interests of domestic actors, who have aggregated their preference for it to the state level. Member states are in control, are not constrained by the current institutional setting, and pressures from EU institutions or other international actors are negligible. As I want to argue, LI theory would explain the SSM as a trade-off deal between Germany, backed by some other northern countries, and the Southern-European member states, who are backed by France. This trade-off deal involves the acceptance of liability for the risks of European banks in return for supervisory control on these banks. How LI theory comes, as I want to argue, to this conclusion is the following.

First, I look what LI theory has to say about the national level. As to the strong Southern-European support for a Banking Union, this can probably be explained by the distributional gains they can get out of a resolution fund that's financed by the ESM. These countries suffer currently the most in the eurozone crisis and have a high level of economic, financial and fiscal problems. Available funds out of the ESM to recapitalize their banking sector directly would be very beneficial in these circumstances, as the problem of 'the link between banks and sovereigns' is the largest in these countries. French support for a Banking Union is somewhat more difficult to explain. There are concerns that France might go down the same path as these Southern-European member states, and the French are also one of the most pessimistic countries on how they see their country's future (PewResearch,2013). But this has rather caused a decline in support of German citizens for financial rescue operations on the European level (40% in 2013). French support is then probably the result of the ideological motivations of the leftist government of Hollande, which has a great deal of autonomy and room for maneuver on the issue (with French citizens divided on the issue), whereby the Parti Socialiste calls for 'integration that is based on solidarity'. This motivation may be combined with genuine concerns in the government that the link between their banking sector and the state will become a problem for France itself in the near future. For Germany, and countries like the Netherlands and Finland, a resolution framework that's financed out of the ESM would have primarily

negative distributional consequences, and is therefore not in their interest. A resolution framework would probably mean that predominantly their taxpayers, and perhaps also their banks in the case of a financial transaction tax, would have to pay for the rescue of Southern-European banks. Looking at the actual positions of domestic actors in Germany, we indeed saw in chapter 4 that: MP's of the German coalition parties were skeptical about a Banking Union before the Euro summit of June 2012; the Bundesbank expressed hard criticism on the idea; and that the association for the smaller regional banks of Germany also expressed its aversion against a Banking Union. German opposition against bringing all European banks under the ECB's supervision can be explained by the opposition of these smaller, regional saving banks to be part of a Banking Union.

On the other hand, domestic actors in Germany will weigh the disadvantages of a Banking Union against their interest in maintaining a stable single currency. However, the current institutional framework appears to be more beneficial for a country like Germany to do this. When the state has the liability of the risks of their banking sector, and when the state must borrow the ESM funds for their banks recapitalization, Germany is much more able to let that particular state contribute as much as possible itself, complemented with the austerity programs necessary for that contribution, and to force them into restructuring their banking sector. This was clearly seen in the case of Cyprus, a country that was forced primarily by Germany to restructure its financial sector dramatically, having significant economic consequences for the country. When the ESM directly lends to the banking sector itself, the member states' own contributions are not maximized, resulting in a higher contribution from German taxpayers and perhaps German banks. Of course, the disadvantages of a resolution framework for Germany could be somewhat decreased by pressing for: strict conditions under which the ESM may directly aid the banking sector; contributions by creditors, shareholders and large savers of the bank; and a contribution that still has to be made by the member state itself. In general, when Germany is pushed to accept a resolution framework, it should be interested in keeping the contributions of the ESM and that of German banks as small as possible. Looking at the opinions of German citizens, we see that the German public is divided on its support for European rescue operations, although the support grew from 42% in 2010 to 52% in 2013 (PewResearch,2013). So, although many German domestic actors appear to be not that enthusiastic about a Banking Union, the absence of strong opposition from German citizens to European rescue operations perhaps provide the German government with some room for maneuver to make concessions.

To conclude, there appear to be primarily two 'coalitions' of member states with opposing interests in relation to a resolution framework. The SSM could then be explained as the result of a trade-off deal, whereby the coalition around Germany is pushed by the coalition of France and the Southern-European countries to accept direct funding by the ESM to the banking sector, and whereby the 'German coalition' asks the SSM in return. The SSM is then the result of a German demand for control in return of accepting liability for the risks of European banks. This argument is supported by several German statements, including that of Germany's minister of finance, Wolfgang Schäuble, who stated that: 'Solange die Entscheidungszuständigkeit nicht vergemeinschaftet sei, solange könne auch die Haftung nicht vergemeinschaftet werden' (Wallstreet online, 2012), and by the vice-chair of the Bundesbank, who stated that 'whoever accepts liability also has to have a right to control, especially when it is potentially a question of very large sums as in the case of a banking crisis' (FT,2012a). Dutch prime-minister Rutte, summarizing what would be the case if a resolution framework was implemented without the SSM, stated that it 'would mean that we have to tell Dutch taxpayers that they should stand surety for Southern-European banks without knowing what mess there exists in those banks'

(Rutte,2012). By asking for the integration of the control and practice of supervision to the European level, the coalition around Germany also wants to prevent free-riding behavior of other member states, as the incentive to strengthen supervision and regulation may weaken as the liability of the risks is transferred to the European level.

What is the role of the UK and the other non-eurozone members in this? As these countries are not going to participate in the SSM and the resolution framework, their interest in it arises mainly from the consequences it would have for the single market for financial services, and for their position in the regulation of the European banking sector in the EBA. It would not be in their interest when Banking Union participants form a block with similar interests, which is capable of dominating decision-making in the EBA. On the other hand, non-eurozone countries do have an interest in the return of stability in the eurozone. If a Banking Union is supportive of that, it also contributes to the interests of non-eurozone member states. For the UK, the consequences for the City of London are also important, but these are unknown and controversial and are therefore no reason to expect strong opposition towards the Banking Union. Therefore, the support for a Banking Union of these countries, in which they will not participate themselves, together with the voiced concerns relating to the EBA, do not contradict LI theory's predictions.

To conclude, the first hypotheses of LI is not rejected:

H1: The positions of the member states on the SSM proposal and the resolution framework is the result of the aggregation of the interests of domestic actors to the state level.

However, it should also be said that it's difficult to prove the hypothesis with hard scientific certainty. The aggregation of domestic interests to the state level, the room for maneuver for the government, and how the government itself really thinks about a Banking Union are complex things that are difficult to measure. Because of space limitations, and the lack of sources that really give a profound insight of the decision-making processes, this thesis can only provide a good impression of these things. These impressions however do correspond with the first hypothesis, so H1 is not rejected. But to adopt the hypothesis with certainty is probably a step too far.

Besides that member states have to take account of their domestic interests, they also have to deal with the relative bargaining power of themselves and other member states. So, Germany may have had some room for maneuver to accept the direct recapitalization of banks by the ESM, but if it has enough bargaining power, perhaps there's no need to make concessions at all. Thus the question is if France, together with the Southern-European member states, are even capable of pressuring such a large member state as Germany to accept that the ESM can directly aid troubled banks. To answer this question, a picture of the bargaining power of both coalitions is needed. According to LI theory, a good unilateral alternative in the case of non-agreement increases the bargaining power significantly (Moravcsik, 1993). It is clear that the coalition around Germany has the best alternative for non-agreement, which is the status quo. The Southern-European member states are most interested and eager for the resolution framework. Also, Germany is the largest country of the EU and has by far the most economic power of the European countries. So, why would they accept direct financial aid of the ESM to the banking sector when it's not in the interest of their domestic actors? The primary reason I can think of is that Germany, and its domestic actors, have an interest in the stability, or at least the survival, of the single currency. A collapse of the Euro would probably have severe negative consequences for Germany as well, and this could give France and Southern-Europe possibilities to push

Germany in the direction of a complete Banking Union. For example, Germany needs these countries' cooperation on fiscal issues, austerity programs, and the restructuring of their economies. Thereby, Germany would stand almost solely alone when it would block a Banking Union, which is not a comfortable position. Also because of Germany's history, it is keen on maintaining the Franco-German tandem and fears a position of isolation. Therefore, Germany can, despite its power, still be pushed in a situation where it is pressured enough to accept direct aid by the ESM.

However, that does not take away the fact that Germany is still able to condition the direct funding of banks by the ESM upon the establishment of a single European supervisor. There are two explanatory arguments that correspond with the assumptions of LI theory for the fact that the member states agreed to first introduce the SSM, followed by the resolution mechanism. First, Germany doesn't want to risk to introduce the resolution framework first, to find thereafter unwilling Southern-European partners for establishing the SSM. The chronological order can thus be seen as a German demand to first have a credible commitment to the SSM by other (southern) member states, before they accept the mutual liability for the risks of European banks. Secondly, Germany also secures with this chronological order that the resolution framework is only implemented on the long-term, expecting that the weak European banks are more recovered from the eurozone crisis by then. Besides the delay of establishing the Banking Union, and the chosen chronological order to introduce the different components, the final shape of the Banking Union could even come closer to German interests if it succeeds in weakening the amount of ESM money that becomes available for the direct recapitalization of troubled banks. Besides the funds of the ESM, a so-called 'bail-in' can be applied, whereby creditors, shareholders and large savers contribute to the saving of the bank first. This is also what appears to be the outcome following the negotiations on the resolution framework in June 2013.

So despite the fact that such a powerful state as Germany is still pushed to accept direct funding of the ESM to troubled banks against its interests, LI theory can explain this by: the fact that it got control on European banks in return through the SSM; direct funding by the ESM is delayed because of the chronological order that's chosen to introduce the different components of the Banking Union; and by the fact that the funds of the ESM used for direct aid to European banks are brought to a minimum. Secondly, the German government had probably some room for concession making on the issue. But still, to explain why a Banking Union is interesting, or at least acceptable, for the German government and its domestic actors, their interest in maintaining the stability and existence of the single currency must be taken into account. There is hardly any reason to find why a country like Germany would accept the liability of risks for European banks if it did not share a single currency with other European countries. This doesn't have to be contrary to the hypotheses of LI theory however. LI simply assumes that domestic actors will weigh the benefits and the disadvantages of the single currency, and when the disadvantages of keeping the Euro stable and intact become too great, it will step out of the single currency. Neofunctionalism does not see this as a possibility.

All that can be said from German behavior, is that it seems to suggest that they are willing to accept the disadvantages of a Banking Union to keep the Euro intact, but that they try to keep these disadvantages to a minimum, even though this sometimes means that possible policy options that would be better for the stability of the eurozone are neglected. This can be seen by its emphasis on taking time to build a qualitative Banking Union, demanding that the SSM is introduced before the resolution framework, its shifting positions on the need for treaty change, and by trying to keep the amount of ESM funds for rescue operations to a minimum by putting the emphasis on so-called bail-in's. As discussed however, neofunctionalism could find possible

explanations for the delay and the chosen chronological order of introducing the different components. Some of them are more stronger than others, but neither of these explanations can be rejected or adopted with much certainty. However, the clear difference in behavior of member states, which correspond with their different interests towards the SSM and the resolution framework, seem to suggest that liberal intergovernmentalism has more explanatory power than the neofunctionalist assumption that the single currency is putting such a forcing demand on member states that it constrains member states' policy options to the point that it can only chose to adopt a Banking Union as soon as possible.

Finally, LI theory would assume that member states outside of the eurozone have very little bargaining power to influence the negotiations on the SSM and the other Banking Union components. As they will not participate in it, it becomes quite easy for the eurozone members to exclude them from participating in the negotiations. Together with other non-eurozone countries however, the UK has a relatively strong power position to negotiate for a change of the voting-structures in the EBA. This is also what has been decided in December 2012, despite the protests of France and Germany that this would hamper decision-making in the EBA.

To conclude, the second hypotheses is also not rejected:

H2: The relative bargaining power of member states, together with their positions which reflect the interests of domestic actors, explain the creation of the Single Supervisory Mechanism

However, just as with H1, it must be noted that determining the bargaining power of member states, and how this affected the negotiations and the outcome, is difficult to determine with much precision. The painted picture of the relative bargaining power of member states is an impression. Also, the way decisions are being made in the Council is often by unanimity, and formal decision-making rules and social norms of accommodation could alter the bargaining positions of member states. Regarding the hypotheses H3, H4 and H5, which make predictions on the institutional design and the outcomes on issues on the margin, they cannot be sufficiently tested because much of the institutional design is still unknown at the time of writing. On the issue of the scope of supervision, the member states agreed on adopting the middle ground: not all European banks will fall under the direct supervision of the ECB, but the ECB has the authority to step in on smaller banks when necessary. I will now turn to the conclusion of this thesis.

7. Conclusion

In this thesis I tried to explain the integration of micro-supervision of European banks, which is expressed in the proposal for the Single Supervisory Mechanism (SSM). The explanandum includes the SSM in general, how it relates to the single market and non-eurozone member states, and its institutional design. The SSM is one of the three components of a Banking Union, and it turned out that it therefore can't be explained in isolation of those other components. Especially the resolution framework, and the possibility of the ESM to directly recapitalize troubled banks, has proven to be an important explanatory factor. I tested two integration theories that have different explanations for the SSM: neofunctionalism and liberal intergovernmentalism. Actor-centered-institutionalism was used additionally as a theoretical framework. Neofunctionalism assumes that functional spillovers, and pressures from international actors and EU institutions, are the incentives for member states to take further steps in integration, and that these 'calls/demands' for further steps in integration are more or less automatically answered by member states. Liberal intergovernmentalism on the other hand, assumes that integration, or the absence of it, can be explained by the interests of domestic actors, and how these interests are aggregated to the state level. Member states then engage, with the interests of domestic actors in mind, in interstate negotiations whereby the bargaining power of member states will have a great influence on the outcome. Both theories predict the establishment of the SSM, but have different explanations for it. Neofunctionalism explains the SSM as a part of the solution to break the damaging link between banks and sovereigns, which is needed to secure the stability of the single currency. The SSM is primarily needed for the proper functioning of this resolution framework. LI theory assumes that the SSM is a means for getting control on European banks, which is demanded by a coalition of member states, with Germany as its most important member, in return for accepting the liability of risks for these European banks under a resolution framework funded by the ESM. Southern-European member states push for this resolution framework because they would probably benefit from the direct recapitalization of banks by the ESM. Secondly, neofunctionalism expects that a complete Banking Union is introduced on the short-term, while liberal intergovernmentalism leaves much more room for outcomes whereby the resolution framework is introduced on the longer-term, and whereby the role of the ESM in the direct recapitalization of banks is brought to a minimum.

Looking at the actual outcome, we see that the demand for a short-term introduction of a complete Banking Union is not met by the member states. Member states have chosen to introduce the SSM first, starting its operations in 2014, and a resolution framework only after the SSM is already in place, an outcome which is on first sight contrary to neofunctionalist predictions, because the demand for a Banking Union is currently at his peak as the eurozone crisis is still going on. Liberal intergovernmentalism could explain this delay with two reasons: Germany demands a credible commitment to the SSM from other member states before it accepts the liability of risks for European banks; and the chronological order and the resulting delay makes sure that the ESM can only start to directly recapitalize troubled banks when the peak of the eurozone crisis is over, probably saving German taxpayers' money. Also, negotiations in July 2013 on establishing the rules for a resolution framework seemed to go in a direction whereby the role of the ESM was brought to a minimum, and a so-called bail-in would become common-practice. This is a shift compared with the original plans that were spoken out at the Euro summit in June 2012. Whether this is a worse or better option for securing the stability of the eurozone is debatable, but it seems to suggest that it has more to do with German domestic interests than that this option is chosen because it better serves the stability of the eurozone.

Relating to the fact that the short-term demand for a complete Banking Union is not delivered by member states, I discussed four possible explanations for this that would not contradict with neofunctionalist predictions; it is a functional necessity to have the SSM operational before starting with the resolution framework; pressures from the financial markets have decreased, and/or the problem of the 'link between banks and sovereigns' have become less significant; or the complex decision-making process in the EU delays the quick implementation of the Banking Union. Neither of these explanations could be rejected or accepted with much certainty. Some were more convincing than others, although the clear decrease of pressures from the financial markets, which are a result of the ECB's statements and policies after June 2012, is probably the most convincing one.

Finally, I argued that even though when it would be the case that these possible neofunctionalist explanations for the delay would be false, a functional spillover from the single currency is still likely to be an important factor for explaining the SSM. Without the single currency, there would be hardly any reason to think of why Germany, and some other northern countries, would agree to accept the liability of risks for troubled banks in Southern-Europe. So there is no doubt that the Euro is an explanatory factor for the SSM and the other components of the Banking Union. As I have argued in chapter 6, this doesn't have to be contrary to the assumptions of liberal intergovernmentalism. For some member states, like those in Southern-Europe, the functional demand for a Banking Union corresponds with their domestic interests. For other member states, like Germany, the functional demand for a Banking Union could be against its domestic interests, but after weighting the interest in maintaining the stability of the Euro and the costs of a Banking Union necessary to secure this, it is still more beneficial to keep the single currency than to stop with it. The question in what way the institutional setting of the single currency constrains the policy options available for member states can be related back to the structure-agency debate discussed in the chapter about actor-centered institutionalism, whereby neofunctionalism and liberal intergovernmentalism think differently about how the institutional setting influences the orientations and capabilities of actors, and what strategies they can choose from.

Ultimately, the behavior and positions of member states doesn't seem to suggest that the functional demand for a Banking Union is pushing member states into similar behavior that supports the establishment of a Banking Union in the short-term. Rather, the behavior and positions of member states correspond with their different interests in the SSM and in a resolution framework that's financed out of the ESM. German behavior is not supportive of a quick implementation of this resolution framework, while primarily Southern-European countries, including France, opt for a quick implementation of a complete Banking Union whereby the ESM has the role that was foreseen at the time of the Euro summit in June 2012. The final conclusion is then that liberal intergovernmentalism seems to be best suited to explain the SSM, and that it thus should be seen as the result of a trade-off deal whereby Germany, and some other countries, demand control on European banks for which they in return would accept the liability of their risks under the resolution framework funded by the ESM. However, the neofunctionalist explanation still can't be disproved with much scientific certainty.

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