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The changing role of the ECB and the EBA in the banking union

Master Thesis

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Abstract

The European answer to the sovereign debt crisis is the banking union. In the banking union, and especially in the SSM, the European Central Bank (ECB) and the European Banking Authority (EBA) will undergo significant changes. This thesis has tried to unravel which powers are dominant in the integration process towards a banking union, and how these political pressures influence the position and powers of the ECB and the EBA. To gain more insight on their institutional setup and the way they have developed over time, the ECB and the EBA will be reviewed and the extent to which they have managed to expand their powers will be analyzed on the basis of Principal-Agent theory. Because of their enormous differences in history, functions, powers and institutional architecture, each institution will be reviewed in its own context.

To find out which are the dominant political pressures in the move towards a banking union, the theories of neo-functionalism and liberal intergovernmentalism provide for contradictory expectations on the dynamics of integration. While neo-governmentalism assumes that integration towards a banking union is merely triggered by spillover effects and the pressure that is exercised by institutions, liberal intergovernmentalism claims that national interests are dominant in the bargaining process. These two theories will be tested against the developments in the banking union so far. The conclusion of this thesis is that –although spillovers are on the basis of integration, and the influence of institutions should not be underestimated- national bargains are still most visible in the outcomes so far. For the ECB, this means that its powers are somewhat limited. Also, delay in bargaining processes and the limitation of funding might bring difficulties for its future functioning. The compromises does, however, leave open some space of maneuver for the ECB. The powers of the EBA have been restricted rather than expanded, even though this would fit well with its task in the creation of a single rulebook. Partly because the EBA is a EU 27 institution, expansion of its powers in the field of supervision would require a large change.

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1 Introduction

As a result of the crisis, financial service regulation and supervision are currently at the center of attention in the European Union. The existing framework was incapable to sufficiently respond to the crisis and the contagion to sovereigns (European Commission, 2012a). With the creation of a banking union, European countries aim to restore credibility of the financial sector and make banking supervision more efficient. This way, future feedback loops between banks and sovereigns should be prevented and bank losses should no longer become public debt (Véron, 2012a, p. 8). In the past decades, there has been an acceleration of the development of financial regulatory and supervisory bodies. Several new bodies were created, and powers have been shifted from the national to the European level, and between European institutions. The current move towards a banking union will again influence the powers and position of these institutions. This thesis will examine which political pressures are dominant in the integration process and how these pressures influence the position of the ECB and the EBA in the banking union.

1.1 Regulatory and supervisory integration in the European Union

Compared to market integration in other areas in the European Union, financial integration has always been a rather sensitive subject and proved to be hard to achieve. It has been incremental, piecemeal and was far from being achieved in the beginning of the 21st century (Quaglia, 2010a, p. 1007). The financial sector is traditionally at the heart of European economies as financial systems were designed in order to support the national economies in the best possible manner. This resulted in a huge variety of systems across Europe (Story & Walter, 1997, p. 150). Opponents of financial integration feared for the loss of autonomy of national governments as integration could hinder their ability to carry out an independent economic agenda and act as a buffer for the national economy (Posner, 2007). It is thus not surprising that Member States are not keen to give up their sovereignty in this field, and integration has only gone so far.

When the financial crisis erupted in 2008, there were severe flaws in the European regulatory and supervisory framework. The system focused on micro-prudential supervision and macro-systemic risks were not properly taken into account. International competition among financial centers encouraged banks to establish their headquarters in the country with the least stringent regulations, so that national governments tried their best to shape attractive regulatory environment. The committees[1] that were set up for cooperation and coordination between European supervisors lacked legal powers to take decisions and enforce them. The 'Larosière Report', that was produced in 2009, partially addressed this problem by replacing them with three supervisory authorities. They gained additional powers to carry out a number of new, specific tasks to improve regulatory and supervisory standards across the European Union (De Larosière Report, 2009).

[1] The so called "level 3 Committees" were set up as coordination organs to strengthen the mutual trust and the equal implementation of measures across national authorities.

As the crisis evolved, another weakness was brought to light; the interconnectedness of sovereigns and banks in the Euro area zone. While the financial market had been functioning at the European level, national authorities were still responsible for supervision-, bailout- and resolution measures. National bailout measures combined with the large amounts of government debt securities that banks hold, caused a mutual dependence between banks and sovereigns. Bank bailouts negatively affected government creditworthiness and a decline in government creditworthiness translated into an immediate negative impact on bank assets (Angeloni, Merler, & Wolff, 2012, p. 23). In the Euro area Summit of the 29th of June 2012, the heads of state and government agreed that 'it is imperative to break the vicious circle between banks and sovereigns'. Herman van Rompuy (president of the European Council) was invited to set out a vision for the future of the Economic and Monetary Union. In close cooperation with Euro-officials, he developed a time-bound report to address the shortcomings in the institutional framework for financial stability. He stated that "Building on a single rulebook, an integrated financial framework should have […] a single European banking supervision, a common deposit insurance and resolution framework" (Rompuy, 2012, p. 4). Since April 2012, the belief that a banking union is an central component of any strategy to prevent the euro area from falling apart has gained remarkable momentum.

1.2 Changes towards a banking union

The three aspects of a banking union seem straightforward, but each of them consists of many elements that need to be agreed on. One of the most sensitive topics is the delegation of powers to European institutions. Member States are not keen to delegate their powers and if they do, they want to make sure that either the new responsible institution reflects their core values, or they remain significantly involved in the decision making process. To secure their interests, countries have varying ideas on the governance structure, amount of powers and their scope, the speed of integration and the order of decisions. Even though the interdependencies between Member States have grown over the past years, integration in the field of financial services is still very sensitive. Not only member states (inside and outside of the euro zone) have interest in the decisions, but the decision-making process is also influenced by European institutions and international interest groups. All these actors have interests at stake that need to be taken into account in the decision making process and will eventually be reflected in the agreements. At the same time, technical institutions are often able to create their own vision and expand their influence on policy outcomes. Their mandate becomes larger than was initially accounted for by their principals. The Principal-Agent theory explains this delegation dilemma. On the one hand, Member States aim to optimize the functionality of the system by delegating tasks and powers to specialized agencies, but on the other, they want to prevent agencies to be able to develop their own interests and autonomy.

Negotiations towards the banking union take place at multiple meetings where actors meet in different compositions. General integration theories argue for a different set of dominant actors in the integration process of which two will be discussed in this thesis. Liberal intergovernmentalism argues that the degree of integration is determined by strategic negotiations between Member States, whose position reflects the aggregate of national coalitions. The final shape of institutions would therefore mainly reflect the preferences of countries with the strongest position in the bargaining process (Moravcik & Schimmelfennig, 2009). Neo-functionalists, on the other hand, argue that integration is triggered by spill-overs. This means that integration spreads from one policy field to the next and as such, integration would be self-sustaining. Furthermore, European institutions and supranational bodies are considered to be crucial actors in the integration process as they should be able to successfully promote integration (Niemann & Schmitter, 2009, p. 49).

1.3 The European Central Bank and the European Banking Authority

The European Central Bank (ECB) and the European Banking Authority (EBA) are the focus of this thesis because of their central position in financial regulation and supervision and their changing position as a result of the banking union. The final institutional architecture has not been reached yet, but an analysis of current changes can give some indication of the future functioning of the banking union. The first step towards a banking union has almost been completed through the creation of the Single Supervisory Mechanism (SSM) that should be functional as of mid-2014. In the SSM, the ECB will have key supervisory tasks and powers over all credit institutions established within the euro area (European Commission, 2013a). The decision to lay down supervisory powers with the ECB is a radical institutional change for both the ECB and the EBA. The ECB, that was previously charged with the single objective of keeping price stability, will be endowed with supervisory responsibilities. On the other hand, the EBA will be moved away from its task to enhance coordination of supervision in the EU banking sector and focus on the development of the single rulebook. The purpose of this thesis is to unravel how these institutional choices were made. Were decisions the result of practical considerations or were they made due to political bargains and tactical choices? Who had a say in these developments, and what will this imply for the future institutional setup of the banking union? The research question of this thesis is the following:

Which political pressures are dominant in the integration process and how do these influence the position and powers of the ECB and the EBA in the banking union?

The focus of this thesis will be on the SSM as it has the most direct influence on the position and powers of the ECB and EBA and because of its advanced stage compared to other components of the banking union. The next component of the banking union, the Single Resolution Mechanism (SRM) will also be discussed. The last component, the Deposit Guarrantee Scheme (DGS) will be left outside the scope of this thesis, as no significant steps on this component have been made at the time of writing this thesis. In the theoretical framework, the fundamental reasons for delegation will be clarified through integration theories. On the basis of these theories, propositions are made on the choices that are currently made in the political process towards a banking union. In the analysis, they will furthermore provide for broad explanation of the pressures that have shaped the ECB and the EBA. The analysis also evaluates how these two institutions have developed over time and if they would be fit as supervisor in the banking union. Turning to the banking union, the interests and positions of relevant actors will be discussed and tested against the integration theories. This way, the forces that influence the EBA and ECB in the new institutional setup will be revealed.

2 Theoretical framework

In the past decades, the financial industry has gone through major changes. The creation of the EU Single Market has started a process of restructuring and scale enlargement that has had fundament impact on the structure of economic and financial markets in Europe. The decision to move towards a European Monetary Union (EMU) in 1992 further fostered integration and accelerated the process. Even though financial markets got increasingly interconnected, integration of financial regulation and supervision remained limited. Powers have shifted to the European level but the final institutional form has not been reached yet. Although it is not the purpose of this thesis to explain banking integration through integration theories, they can provide for very useful insights to evaluate the integration events. By looking at the past, it is possible to gain understandings about the decision-making process and use this knowledge as a tool to predict future developments. This chapter looks at the possible driving forces and mechanisms that have stimulated institutional change. The two most prominent theories are neo-functionalism by Ernst Haas, and liberal intergovernmentalsim by Andrew Moravcsik. These two theories will set out broad hypothesis on the driving forces of the integration towards a banking union. Before these two more contradictory theories are discussed, the principal-agency theory is reviewed. This rational choice theory adds a significant contribution to understanding on how 'supranational actors could obtain a degree of autonomy from national governments, allowing them to make their own input to the policy process' (Bache & George, 2006, p. 25). This

2.1 Principal-Agent theory

Principal-Agent theory is a rational choice theory that was developed in American political science. Rational choice institutionalism focuses on how actors choose the design of institutions to secure mutual gains and how they change or persist over time. The theory puts emphasis on the institutional setup and the constraints this poses on actors. Within rational choice institutionalism, Principal-Agent theory adds a significant contribution by its focus on the difficulties that principals (the national governments) have in checking the activities of their agents (the delegated institutions) and the degree of autonomy that institutions thereby gain from national governments. This allows institutions to 'develop their own preferences and make their own input to the policy process' (Bache & George, 2006, p. 25).

Principal-Agent theory assumes that delegation of powers takes place for functional reasons. The political officials who were originally in charge (principals) must have found it in their interests to delegate tasks and responsibilities to non-majoritarian institutions (the agents), since they are willing to invest time and money in the establishment, training and monitoring of the new institution. These 'transition costs' are accepted because the large future benefits that are expected from the delegations. There can be several reasons why this power transfer is beneficiary for principals; (1) agents can help them by resolving commitment problems as agents can enhance the credibility of made promises; (2) agents can specialize more and gain expertise over technical areas of governance and thereby overcome information asymmetries; (3) agents can enhance efficiency of rulemaking by responding better to details; and (4) agents can take the blame for unpopular measures of their principals (Tacher & Stone Sweet, 2002, pp. 3-4).

Principal-Agent theory does however also warn for a severe risk of delegation; the so called 'agency loss'. An agency loss can appear when agents generate different outcomes than originally intended by its principals. The only way that principals can have real benefit of delegation is by sharing some of their authority and grant them discretion. Once an agency is in place, it has a mandate and starts to build up its own experiences and develop its own interests. Agents are more closely involved in the policy sector than their agents and their preferences might be conflicting with the interests of their principals. The extent to which an agent generates outcomes that differs from the policies preferred by those who have delegated power can be reduced by ex-ante and ex-post controls. At the moment of delegation (the ex-ante moment), the principal can determine how the zone of discretion will be constructed by its institutional setup. This could include the limiting of tasks or the involvement of principals in important decision making procedures. The principal can also limit the zone of discretion ex-post by putting in place tools that can be used to shape (constrain) or adjust (reverse) the outcomes. The principal could then carry out monitoring to check on the outcomes. How much discretion is granted to an agent is dependent on the situation and aim of delegation. (Tacher & Stone Sweet, 2002, p. 5).

In this thesis, the Principal-Agent theory is not used to make assumptions on the dynamics of integration, or the actors that are most dominant in the process. It rather provides a framework that can be applied in both neo-functionalism and liberal intergovernmentalism. It explains the process of delegation and resulting zone of discretion that institutions were granted in the financial sector. The discretion that institutions were given influences the way they have been able to develop their interests and expand their powers. As this happens, it also changes the way in which institutions are viewed by stakeholders in the integration process. In the field of financial service regulation, functional demands for delegation to Europe have not directly resulted in installation of powerful institutions. Yet, some of them have managed to expand powers significantly and become more influential than was initially arranged. The Principal-Agent theory is used to find out if how institutions managed to use their zone of discretion, and the change they went through as a result.

2.2 Neo-functionalism

One of the oldest and most complete conceptualizations of the process of integration in the European Union is neo-functionalism. Haas and Lindberg laid down the basics of this theory in the late 1950's and early 1960's. Since then, the theory has been reformulated by many until the early 1970's. Although the theory has been highly criticized and even declared 'obsoleted' by Haas in the 1970's, it provides very useful insights and is well-respected throughout the literature. Neo-functionalism is based on the assumption that actors are rational and self-interested. As a result of their ability to learn from past events, they will change their preferences over time. Political actors are only in place for a short period and are therefore expected to be incapable to engage in long-term purposive behavior and focus on short-term decisions. The decision-making process is therefore assumed to be incremental. This allows institutions, once they are established, to take on a life on their own and benefit from unintended consequences from previous decisions (Niemann & Schmitter, 2009, p. 48). In the decision making process, Haas (1964, p. 66) supports the idea of a positive sum game in which participants of the negotiation process 'seek to attain agreement y means of compromises' that upgrade common interests, thereby supporting the supranational style of decision-making.

The neo-functionalist theory is built on the combination of functionalist mechanisms with federalist goals. Like functionalism, neo-functionalism argues that the task of an organization determines its form, scope and purpose, but aside from that, neo-functionalism attaches considerable importance to the role of political elites and supranational institutions, their influence and autonomy. The driving mechanism for change and integration is encapsulated in the notion of a 'spillover' effect in which integration spreads from one point to the next. It is expected that increasing functional interdependencies between economies should foster integration and make the spillover process automatic (Niemann & Schmitter, 2009, p. 48). Three kinds of spillover effects can be distinguished.

First, "technical spillovers" can be described as the "expansive logic of sector integration whereby the integration of one sector leads to 'technical' pressures pushing states to integrate other sectors" (Haas, 1958, p. 383). Because of the interconnectedness of sectors, the integration of one field would automatically result in integration of other sectors in order to prevent for matching problems or to increase efficiency. As integration would go from one sector into another, integration would spread out through a snowball effect until all possible fields are integrated. It was believed that all sectors are somehow interconnected, and that integration would therefore be automatic. Secondly, "political spillovers" are created through an elite group that promotes further integration and stimulates the integration process. As national elites would go through a learning process, they would come to realize that some problems cannot be addressed at a national level. As a result, their expectations, political activities and sometimes even their loyalties would shift towards European center. This elite group would promote further integration and stimulate the integration process. Aside from the shift of loyalties, increased contact between national groups might lead to a process of socialization that fosters consensus amongst parties and engages them in the integration process. A third spillover effect is the "cultivated spillover" that stems from the group of people that is employed by supranational bodies in the European Union. The process of integration is boosted by upgrading the 'normal' bargaining process to a decision making process in which 'common interests' are emphasized. In these negotiations, Member States agree that they should have a common opinion, to make sure that they do not jeopardize the areas in which consensus prevails. The changed frame and context of the negotiation make governments more willing to make concessions without feeling harassed. Thus, supranational institutions are considered very important actors in the integration process (Niemann & Schmitter, 2009, p. 50).

Neo-functionalism puts emphasis on 'technical pressures' as a primary source of integration and suggests that non-governmental elites provide for the main impetus for integration. The area of financial regulation and supervision is often perceived as 'technical' and received relatively limited public attention. The complexity of governance in this field has increased the dependence on the expertise of experts and the provision of information by the private sector. As experts have unique knowledge, they are able to influence the process of integration in its extent, form and/or speed. Following this reasoning, the following hypothesis are set out;

1. The incentives to move to a banking union came from spillover effects, that Member States had to (automatically) respond to.
2. European institutions will promote integration towards a banking union.
3. Institutions manage to influence the opinions of member states the decision making process effectively and the outcomes of the negotiation process so far mainly reflect their preferences.

2.3 Liberal intergovernmentalism

A very different set of important actors is valued by the theory of 'liberal intergovernmentalism' that was developed in 1993 by Andrew Moravcsik (Moravcik & Schimmelfennig, 2009, p. 67). He believed that the existing theories lacked in their explanation of European integration, and aimed to give better a better and 'all round' explanation. Liberal intergovernmentalism refines the existing interstate bargaining and institutional compliance theory of 'intergovernmental institutionalism', and adds the theory of national preference formation as it is grounded in liberal theories of 'international independence' (Moravcsik, 1993, p. 480). Nation states are placed at the center of the theory, as European integration is understood as "the result of a series of rational choices made by national leaders. These choices respond 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" (Moravcsik, 1998, p. 18). As such, European integration is a result of a series of rational decisions based on national preferences. Liberal intergovernmentalism does not see European integration as an automatic process, but rather looks at isolated events of integration.

Liberal intergovernmetnalism is based on the core assumption that nation states are rational actors. This means that nation states make balanced choices based on utility, aiming to safeguard their interests and taking into account their alternative course of action. However, this does not mean that the influence and importance of institutions is denied. According to liberal intergovernmentalism, institutions are created with a utility objective (following rational choice institutionalism) and seen as a necessary condition to allow a durable international cooperation. They can reduce the transaction costs upon reaching superior outcomes, provide for information on specific issues and reduce the uncertainty of other Member States' future preferences and behavior. Strong European institutions are only created when they aim to resolve problems that cannot be handled by Member States (Moravcik & Schimmelfennig, 2009, p. 67). Institutions are thus considered important for their functionality, but not leading in integration.

In the international context, states are treated as unified actors. This does however not mean that different opinions and positions within states are denied. To determine national preferences in the international context, liberal intergovernmentalism does not assume a set of consistently ordered goals and objectives. It is based on state-society relation, in which shifting pressures from domestic social groups provide for variation in the national point of view (Moravcsik, 1993, p. 480). Policy goals of national governments are constrained by pressures from domestic social groups, whose preferences are aggregated through political institutions. National interests are thus highly important, but are collected through domestic politics. Understanding the domestic political process is a precondition for the analysis of strategic interaction among states. The generated outcome cuts across domestic policies and determines the point of view on which is acted purposively in the international and European context.

When interests is defined domestically, interstate negotiation takes place. The costs and benefits of economic interdependence is seen as the primary determinant of national preferences. Within the international bargaining process, governments and the outcome will largely depend on relative bargaining powers (Moravcik & Schimmelfennig, 2009, pp. 70-71). In this process, strength of states depends on three main variables; the first is the alternative option to pull out of the negotiations. If a country has good unilateral alternatives, it can simply decide to 'opt out' of cooperation and remain with the status quo. A second determinant is the ability to find alternative coalitions. States will always find themselves in a position of negotiation and have to ally with other Member States that have comparable preferences. Thirdly, the potential for compromise and linkage is important. If there are subjects that are not of primary interests, and can be used as a compromised with another country, it increases the chance on cooperation and success (Moravcsik, 1993, pp. 499-500).

In the theory of liberal intergovernmentalists, the most important actors are considered to be Member States and integration will only be achieved if there are considerable (economic) benefits for them. It was therefore not believed that the integration process would spread out to areas of 'high' politics such as national security and defense (Bache & George, 2006, p. 12). Financial regulation and supervision have always been very sensitive fields of integration as the financial sector is at the heart of European economies. Especially the banking sector has played a major role in the buildup of national economies after World War II and governments have always remained connected to this sector (Story & Walter, 1997). Following the theory of liberal intergovernmentalism the following hypothesis are made;

1. National positions are shaped by a variation of domestic interests, and choices of national leaders respond to constraints from domestic pressures. The generated national position cuts across coalitions and is acted on purposively.
2. States dominate the process towards the banking union. Their relative bargaining position shapes the outcome and depend on unilateral alternatives, their ability to shape coalitions and potential for compromise or linkage.
3. European institutions are created with utility objective to serve member states. As integration in financial services highly touches upon the sovereignty of Member States, Member States will rather confer powers on institutions with a more intergovernmental character.

3 Methodology

To find out on which fundamentals the banking union is based and how the new institutional structure will influence future decision making processes, this study makes use of a multiple case study. The banking union is not yet established to its fullest extent and this makes it hard to find variables that can already define the exact consequences of the chosen structure. For these reasons, and because of the complexity of the transition to a banking union, the research method of case study fits very well. Through a case study, it is possible to gain detailed understanding about the case in its context and get better view on the mechanisms that are in place. Another benefit from this method is that it is possible to make use of a variety of methods, which allows the researcher to gather multiple evidence for its findings and create a more complete image of the situation (Yin, 1994, p. 14). In the transition to the banking union, we are dealing with a highly complex political environment and, moreover, fast altering circumstances. In these conditions, a case study is especially useful (Bennett & Elman, 2007, p. 171).

The subject of this research is the changing position of the ECB and the EBA in the light of the banking union. Even though the ECB and the EBA are very different in their history, organization structure and available resources, there are also some aspects that they have in common and that make them interesting to study together. For example, they are both in direct contact with the banking- and financial system and they share the objective to establish a solid financial framework to rebuild trust in the financial sector. Moreover, the move towards a banking union entails changes in the institutional powers of both. Since the crisis erupted in Europe, the ECB and the EBA have been in the centre of attention. They have stood for challenging choices and were often put in situations that they had never faced before, and initially were not equipped for. To answer the research question, a literature study has been conducted. Data mainly consist of policy documents, official communications of European institutions, and proposals (draft) regulations. Furthermore, speeches that are held on the account of the ECB and EBA will be analyzed and news items are integrated. The analytical part of the thesis is built up of two phases.

To answer the research question 'Which political pressures are dominant in the integration process and how do these influence the position and powers of the ECB and the EBA in the banking union?' this thesis exists of two parts. In the first part (chapter 4 & 5) the background of the ECB and the EBA will be reviewed to gain more insight in their institutional setup and the way they have developed over time. Because of their enormous differences in history, functions, powers and institutional architecture, each institution will be reviewed in its own context. The current institutional shape of the ECB and the EBA is to a great extent the result of the bargaining process previously to their establishment, but has also been shaped by their own interpretation of their function and the way they managed to expand their tasks and responsibilities. The extent to which they have managed to expand their tasks and powers will be reviewed on the basis of the Principal-Agent theory. With the move towards a banking union, the purpose and function of both the ECB and the EBA have been put back on the agenda as micro-supervision would be moved to the European level. It will be discussed whether the ECB and EBA would be fit as micro-supervisor and how their other tasks relate to this.

The second part of this thesis will test two integration theories with the integration process towards a banking union. The theories of neo-functionalism and liberal intergovernmentalism provide for contradictory expectations on the dynamics of integration. They have been explained in the theoretical framework, that sets out 6 hypothesis on the In chapter 6, I will look at the preferences of the relevant actors that are involved in the decision making process. The most important actors are Member States (focus will be on the larger and more influential Member States); the European Commission, the European Council, the European Parliament and, last but not least, the ECB and the EBA themselves. This chapter will also review the decisions have been made on the banking union so far and which bargains were made for this. In chapter 7, the hypotheses that have been laid down in the theoretical framework will be tested. It is not the purpose of this thesis to explain the integration towards a banking union through integration theories, but these processes can provide for very useful insights in the integration process and help to answer the main question; 'Which political pressures are dominant in the integration process and how do these influence the position and powers of the ECB and the EBA in the banking union?'

4 The European Central Bank

A major step in European integration was achieved in 1999 when the European Monetary Union (EMU) entered into force. It involved the start of the coordination of economic and fiscal policy, and most importantly, the introduction of a single currency in the European union. With the launch of the euro, the European Central Bank (ECB) gained authority over monetary policy; a policy field that is an important instrument of domestic macroeconomic policy and a crucial symbol of national sovereignty (Puetter, 2011, p. 167). For the integration of economic and monetary policy in the EMU, treaty change was necessary and this would have far reaching political, economic, social and diplomatic implications. The collapse of the communism and the German reunification process after 1989 created the right political environment for countries to reconsider an EMU. As there were significant differences in opinion on the shape and timing of a monetary union, fierce negotiations took place. This chapter will unravel why the EMU was accepted and incorporated in the Maastricht Treaty and what this meant for the institutional setup and later development of the ECB.

4.1 National interests of France, Germany and Britain

After the cold war ended, France was a strong driver of the deepening of European structures as the EMU could offer significant political gains. It was seen as an essential promotion of the political unification of Europe, securing peace and prosperity with a more secure framework. It also presented an opportunity to counterbalance the US dollar and gain a stronger position in the international monetary architecture (Dyson & Featherstone, 1999, p. 1). With the collapse of the communism and the reunification of Germany, it was likely that power would be rebalanced to the benefit of Germany. Deepening of EC structures would allow France to retain some influence and control over its powerful neighbour. Overall, Germany was also supportive towards the deepening of the EC. Germany was aware of the fears of its neighbours, and viewed its commitment to integration in Europe as the price they needed to pay to gain acceptance in Europe (Baun, 1995, p. 611). The UK was less positive about further integration of the EC, as it always had a strong commitment to its independence. The move towards a unified monetary policy and the acceptation of the rules on fiscal policy was contradictory to their deeply valued sovereignty. In their perception, the European Union was one of several forums -among e.g. NATO, IMF and G20- rather than a central forums (Dyson & Featherstone, 1999, p. 21).

Even though both France and Germany were supportive towards the deepening of the EC, their perspective of the way in which the EMU should be shaped, differed significantly and so did the relative importance that they attached to issues. In the German view, the monetary union would be a long-term process and the single currency would only evolve as a last step of integration. Their ordo-liberal economic tradition was a key source of reference in the negotiation process. For Germany, economic stability was an important issue that should be backed up with sound domestic policies and binding rules on budgets (Dyson & Featherstone, 1999, p. 277). In this opinion, strongly supported by the British, Danish and Dutch governments, significant convergence between the EC economies would have to be achieved, before a monetary union would be established (Dyson & Featherstone, 1999, p. 29). The French, Italian and Belgium government, on the other hand, favoured a government-led integration in which the process of economic convergence would be follow from the changing market (Hosli, 2011, p. 750). The creation of the new institutional structures was of primary importance and would further stimulate domestic changes towards convergence. Hence, the creation of monetary institutions like the ECB should take place in an early stage. Even though the French government saw the need to match the single monetary policy with some form of supranational economic governance, they generally preferred intergovernmental decision making structures (Howarth, 2007, p. 1062).

There were also strongly differing points of view to the question how this union should be implemented, and what would be the structure of the created institutions. In France, monetary and economic policy have traditionally been strongly dominated by politic and are strongly associated with their sovereignty. Even though they experienced high costs of inflation, their memories of interwar unemployment and their political association with the power of bankers decreased their eagerness for an independent central bank (Dyson & Featherstone, 1999, p. 20). Britain also opposed the idea of a fully independent European central bank. Their national central bank has a strong link with the Parliament and the delegation of monetary policy would therefore touch their constitution tradition and its sense of sovereignty (Hosli, 2011, p. 750). An institutional structure with an independent central bank emphasized technocracy rather than democracy and thus raised fundamental questions about transparency, legitimacy and accountability. Germany however, was strongly in favour of an independent ECB. They had a resolute commitment to price stability, that was seen as economic public good, which should be guaranteed by the state and based on an independent central bank. Conflict of interests would be far less likely in an independent central bank with a good reputation. The institutional model that would be chosen was of significant importance for Germany. In the negotiation process, Germany saw it as its prime responsibility to transfer its ordo-liberal core principals to the European level (Dyson & Featherstone, 1999, p. 20).

4.2 The role of EU institutions

The Commission has always been a strong supporter of the move towards the EMU. Already in 1969, the Commission started to stimulate the debate by writing a memorandum on 'the need for increased economic co-ordination and monetary co-operation' and published a number of documents addressing the shortcomings of economic and monetary co-operation. Many of its ideas ended up in the Werner report (European Commission, 2013b). Traditionally, the Commission has a role of taking initiative in EC proposals, but since the negotiations on the monetary union mainly took place through Intergovernmental Conferences (IGC), experts groups and special committees, the Commission was displaced from its role and only produced one draft treaty (Dyson & Featherstone, 1999, p. 755). Hence, commission influence was mainly carried out through members of the Commission in external meetings or expert groups. One of the main influential expert groups was the Committee for the Study of the Economic and Monetary Union, which was chaired by Jaques Delors (president of the European Commission).

The Committee for the Study of the Economic and Monetary Union started out with the idea to set a 'possible blueprint' for the EU, but during the course of the meetings, it soon became clear that they were interested in creating a feasible blueprint (Verdun, 1999, p. 318). By including all the central bank governors, the Committee gained legitimacy and through the presence of Delors, clear political direction was given to the process. He framed the discussion by asking the question 'how' the EMU should be realized, rather than 'whether' it should be realized (Dyson & Featherstone, 1999, p. 715). It was one of the main priorities of Delors and de Larosière to embrace policy proposals that could be supported in unanimity and would keep the Bundesbank on board. The Bundesbank had however strong opinions on the way a monetary union was achieved, and many of their core values are reflected in the final report. The two most important objectives were, first, to ban political influence from the banking arena and guarantee the independence of the ESCB and ECB, and second, to have price stability as the primary objective. The Bundesbank, that was at that time the de-facto monetary authority to which other banks had to adjust their monetary policy played a large role in the negotiations and managed to anchor many of its principles into the final statutes (Reade & Volz, 2010). To guarantee the independence of monetary policies, it would be transferred to an independent European System of Central Banks (ESCB) and its primary policy objective would be to remain price stability (Delors, 1989, p. 21). The report was presented in April 1989 and strongly supported the implementation of a single currency under the precondition of a good balance between economic and monetary components. The report designed a clear idea of what the end-product of integration in the EMU should look like, but left gaps in on the planning as no deadlines were set (Delors, 1989).

4.3 How was EMU achieved?

Spillover effects from the Single Market act in 1992 had already been present when the negotiations on the EMU started. A single currency would be a great support to the free movement of people, goods, and most importantly, capital. A monetary union had been promoted by the Commission repeatedly. However, until the end of the cold war, there was no strong incentive for states to undertake action. For France, the reunification of Germany created the incentive to push for further integration. The Council asked Delors to draw a report on an Economic and Monetary Union. In the Madrid Council in 1989, the Delors report was accepted as a useful basis for further work towards an EMU. Negotiations took place in different constellations; at the ministerial level, at the level of officials. Alongside these IGC meetings, informal meetings of the ECOFIN functioned as forums for the progress of negotiations. Among the complex collection of bilaterals that surrounded the IGC sessions, a central place was taken on by the Franco-German bilateral. Negotiations took place in official summits, but also in top-secret bilateral meetings of French and German negotiators (Dyson & Featherstone, 1999, p.5). Their relationship presented an inner dynamic to the negotiation processes, often referred to as the 'tandem' (Hosli, 2011, p.752). Typical was that negotiations were largely dominated by political considerations and focussed on the integration towards a single currency, rather than convergence of economies. In the negotiations, two issues played an important role.

For France, a fast move towards the introduction of the single currency was a goal per se, and they pressed for the setting of fixed dates since the beginning of the negotiation process. For Germany, the setting of a final and fixed date merely functioned as a means to keep pressure on the conservative Finance Ministry and the Bundesbank (Dyson & Featherstone, 1999, p. 370). The UK was supportive of the completion of the internal market, but had fundamental questions about the ultimate aims of the EMU. Britain strongly opposed to the creation of the ECB and a fixed date on the introduction of a single currency (Kenen, 1992, p. 459). To avoid a British veto, France proposed three principles to be the basis for the transition to stage three; no veto, no compulsion and no arbitrary exclusion. After intense negotiation the final treaty tried to combine a precise timetable with a set of convergence tests with possibility to opt-out. The UK refused to delegate so many significant powers to the European level and opted out of the EMU.

Negotiations on the institutional setup of the ECB and the ESCB and the related fiscal rules were also very controversial (European Union, 2013). The Commission and the CCBG had expressed their preferences for an independent, newly created institution (Delors, 1989, p.21), but France was still aiming to include government members in the institutional setup and make the government Council accountable to the national parliaments as well as the European parliament. The German and Dutch strongly opposed to this idea. The German Bundesbank was the de-facto monetary authority to which the rest of Europe adapted its monetary policies. As such, German participation to the EMU was of vital importance. As a result of its strong bargaining powers, the governance structure of the ECB was largely determined by German preferences. Germany managed to push through extensive rules that promoted budget reform and debt reduction and according its ordo-liberal principles, the ECB became independent institution. Ties with the governance were however stronger than in the German Bundesbank and Council gained responsibility for agreeing an exchange-rate system and exchange-rate policy.

4.4 ECB's changing powers, explained through Principal-Agent theory

When the EMU was created, the ECB was charged with monetary tasks. This would make the system more effective, as it would allow the ECB to develop expertise and make necessary (unpopular) decisions. Within the EMU, the ECB is the only supra-national institution, meaning that it is independent in its decisions and its policy dominates over all national policy measures. This independence is laid down in the institutional framework, which establishes that; members of the decision-making bodies are not allowed to seek or take instructions from EU institutions or bodies; the ECB has its own budget and its financial arrangements are kept separate from those of the EU; and lays down numerous rules on appointment of officials.

ECB decision making procedures are however not completely detached from national influences. The main decision-making body of the ECB, the Governing Council, exists of six members of the Executive Board and all the governors of the national central banks of the 17 euro area countries. This body adopts guidelines and takes the necessary decisions to ensure the performance of the ECB in the Eurosystem, and moreover, design the monetary policy for the euro area. Also, fundamental decisions related to monetary objectives such as setting key interest rates and the supply of reserves in the Eurosystem fall within their mandate. This means that national central bank governors have significant influence on the course of action of the ECB. The executive board, including the president of the ECB (currently Mario Draghi), are all appointed by the leaders of the euro zone countries. Indirectly, decision-making in the ECB is thus tied to member states and their political preferences. The last and largest decision-making body is the General Council, that comprises all 28 governors of the national central banks in the EU countries. This organ contributes to advisory and coordination work and helps with the preparation of countries that want to join the euro (ECB, 2013a).

The zone of discretion of the ECB has furthermore been restricted by its limited responsibilities and tools. The ECB was made primarily responsible of monetary policy[2] and the ECB was given only two instruments to ensure this. First, the ECB was enabled to adjust short-term interest rates and second, the ECB was given powers to make adjustments in the liquidity management (ECB, 2002a). The ECB was not given any legal authority to use other monetary instruments in case of emergency and its powers only went so far. Economic policies remained at the national level and ECB's monetary policy became part of a macroeconomic governance network[3] in which national policies cooperate with European institutions like the ECB. The ECB was also committed to several ex-post reporting on its activities.

Over the years, the ECB has obtained a strong position in the European policy network by demanding Euro-zone Member States to maintain a strict interpretation and enforcement of the Stability and Growth Pact (Howarth & Loedel, 2004, p. 832). In official policy statements, it has argued in favour of applying the Excessive Deficit Procedure (ECB, 2003), and if necessary, the ECB made precise and public recommendations to Member State governments on how to achieve medium-term goals when budgetary balances were close to exceed the guidelines, or how to achieve sound macroeconomic management in general (Howarth & Loedel, 2004, pp. 832-834). In the wake of the crisis, the ECB has been very responsive in its measures (ECB, 2008a; ECB, 2009a). It reduced its key interest rates rapidly and started to apply a number of non-standard measures. First, the ECB implemented the Enhanced Credit Support[4] policy in 2009. When the sovereign debt crisis struck Europe, the ECB decided to intervene in Government debt markets by the implementation of the Securities Market Programme[5] (ECB, 2009b; ECB, 2010). Through this measure, the ECB started to purchase Greek and Portuguese government bonds in May 2010 and Spanish and Italian bonds after August 2011. As markets had not calmed down in the summer of 2012, the Governing Council of the ECB decided to replace the SMP programme by Outright Monetary Transactions (OMT)[6] in secondary markets (ECB, 2012). With the SMP and the OMT programmes, ECB has been operating on the brink of acceptance under the existing Treaty, which clearly states that the ECB is not allowed to buy government bonds in the primary market[7]. By the purchase of bonds in the secondary market,

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[2] Art. 127 (1) TFEU states that 'The primary objective of the ESCB shall be to maintain price stability'

[3] involving national governments, the European Commission, the ECOFIN and the Euro group

[4] Consisting of a set of five mainly bank-based measures to support the flow of credit beyond the standard interest channel; 1. Unlimited liquidity at fixed rate for euro area banks in all refinancing operations against adequate collateral; 2. The lengthening of the maturity of refinancing operations from three months prior to the crisis to one year; 3. The extension of the list of assets that are accepted as collateral; 4. Liquidity provisions in foreign currencies; 5. Financial market support through purchases of covered bonds.

[5] Under the SMP Eurosystem interventions could be carried out in the euro area public and private debt securities markets to ensure depth and liquidity dysfunctional market segments. To ensure that the SMP did not affect monetary policy stance, the related liquidity provisions are absorbed in specific operations.

[6] In OMT, the ECB purchases bonds in secondary markets under explicit conditionality on the part of governments to make necessary efforts to restore sustainability of public finance. The money of the purchase goes to the investor, not the sovereign issuer and transactions are focussed on short-term maturities.

[7] Art. 123 (1) TFEU dictates that 'overdraft facilities or any other type of credit facility with the ECB […] in favor of […] central governments […] shall be prohibited, as shall the purchase directly from them by the ECB or national central banks of debt instruments'.

the ECB caused friction with (the spirit of) the no bail-out clause as it could relieve market pressure and reduce the incentive for governments to consolidate and adjust. Furthermore, interventions under the SMP were directed against direct market turbulence and financial stability, that is only a secondary task of the ECB. Only monetary policy decisions can be made in complete independence. By the application of these measures, the ECB has clearly gone beyond the scope of its original set-up. The constraints that were laid down in its institutional design were bypassed.

Through its strict surveillance and guidance on troubled countries, the ECB also slowly gained importance in the area of supervision (ECB, 2008b). Next to expansion of its Treaty-based advisory role, the ECB engaged in country specific missions together with the IMF and the Commission (the so called 'Troika'), aiming to implement adjustment programmes in countries that did not manage to maintain their national debt within the European guidelines. This practice was institutionalized under the ESM Treaty (ESM Treaty, 2012). In 2011, the supervisory tasks of the ECB were officially expanded as the ECB was put in charge of coordination of the European Systemic Risk Board (ESRB). The ESRB is responsible for the identification and monitoring of macro-supervisory risks in the whole European Union (Regulation establishing ESRB, 2010). With the establishment of the ECB in the ESRB, its macro-supervisory function has been confirmed by Member States.

The powers and position that we know the ECB for today are very different from the ones that it was initially equipped with. After the eruption of the sovereign debt crisis, the ECB has used measures that were based on the absence of strict prohibition rather than accordance with existing articles. The ECB has not only stretched its powers, but also its scope. Although the treaty provides a basis for the support of general economics in the union[8], price stability was viewed as the only acceptable motivation for the ECB to take measures. This view changed when market turmoil persisted and calming the markets became a more important aspect in the decision-making process. In the field of supervision, the ECB has also slowly gained influence. As part of the ESRB, it got involved in macro-supervision and with the SSM, it will also gain powers in micro-prudential supervision. Overall, it can be said that the ECB has optimized its powers and stretched the boundaries of its capabilities actively. Although there has been resistance to some the expansion of powers of the ECB (especially in Germany), the ECB has not been called back on its actions. The originally unintended expansion of ECB powers is partly caused by the indirectness of ex-ante and relatively limited ex-post controls, but also results from the fact that there were little alternative actions to calm markets. The EU lacked a clear and predictable legal framework for an orderly response to calm markets and response to distressed financial institutions.

[8] Art. 127 (6) TFEU states that 'Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievements of the objectives of the Union […]'

4.5 ECB as banking supervisory body

The choice to lay down micro-supervisory powers in the Single Supervisory Mechanism with the ECB arises partly from Article 127 (6)[9] TFEU that implies that the European Central bank could be given specific tasks relating to prudential supervision of financial institutions. The fact that there is a legal basis to confer European bank supervision on the ECB is an advantage that makes it almost logical to choose this body as a supervisor. The ECB is widely viewed as a credible and strong institution and it has been argued that its good reputation could be leveraged into the SSM. Another motive to lay down supervisory tasks with the ECB is its familiarity with the sector. The ECB gained detailed knowledge of banks through its lender of the last resort function and there are multiple connections between monetary policy and supervisory policy (Sibert, 2012, p. 30). The ECB has an interest in a stable financial system and is already involved with macro-prudential supervision and tightly involved with micro-prudential supervision.

There are however also counterarguments to lay down supervisory tasks with the ECB. Supervision is a difficult and complex task and although the ECB has some knowledge of the micro-prudential level, its limited staff and lack of experience are serious obstacles for its ability to carry out tasks. Also, there are severe concerns on the potential conflict of interests between the objectives of monetary policy and the new task of the ECB to protect the stability of the financial system through its new supervisory powers. Depending on the origin of shocks that affect the economy, there can be a trade off between monetary stability and price stability. In specific situations, the objective of financial stability can demand the lowering of interest rates, while this should not be done in the light of price stability (Cukierman, 2009, p. 33). It is therefore of utmost importance that the monetary function and the supervisory function of the ECB remain strictly separated. Another concern in to make the ECB responsible for supervision in the SSM is its lack of accountability. Members of the boards are protected from personal penalties and little information is provided on the procedures, processes actions and interventions of the ECB. To make the ECB a legitimate supervisor in the SSM, these issues would need to be solved (Sibert, 2012, p. 31). Currently, there are high expectations of ECB's Supervisory Board, and if these are not met this could affect the credibility of the whole ECB. To limit this risk, the ECB has been promoting further steps towards a banking union to make sure that a proper backup will be in place when the SSM will come into force.

[9] Art. 127 (6) TFEU The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.

5 The European Banking Authority

Before the crisis erupted in 2008, banking regulation was coordinated by the Committee of European Banking Supervisors (CEBS). Its task was to provide advice to the European Commission on EU legislation in the banking sector, contribute to consistent implementation of EU legislation across the EU, promote convergence of supervisory practice and foster co-operation between supervisors (CEBS, 2004, p. 4). In the absence of legally binding powers, compliance to European agreements rested on the assumption that national authorities would respond to informal means of pear pressure. However, differences in interpretation and differences of power in the competent authorities of Member States resulted in inconsistent implementation of regulations. When the crisis erupted in 2008, the weaknesses of the system became apparent. A High-level group on financial supervision in the EU (also known as the Larosière group) advised to replace supervisory with a new framework, comprising;

- A European Systemic Risk Board (ESRB)[10], responsible for the "macro-prudential oversight of the financial system in order to contribute to the prevention or mitigation of systemic risks" and "contributes to the smooth functioning of the internal marketing" thereby ensuring sustainable contribution of the financial sector to economic growth (Regulation establishing ESRB, 2010).
- A European System of Financial Supervisors (ESFS), comprising of a network of national financial supervisors cooperating with European Supervisory Authorities (ESA's) that take care of micro-supervision by safeguarding the financial soundness of individual institutions and consumer protection. Within this framework, the European Banking Authority (EBA) would take over tasks of the CEBS and gain additional tasks and powers.

Although there was broad consensus on the fact that the existing framework needed to be improved, the details of a new institutional framework and moreover, the amount of powers that would be shifted to the European level were controversial. In this section, the process towards the installation of the European Banking Authority will be discussed.

5.1 National interests of France, Germany and Britain

At the start of the crisis, the UK economy was at the brink of a recession. The British prime minister Gordon Brown stated that further structural supervisory measures were necessary (Guardian, The, 2009a), but the UK did not aim to rule the market trough tougher rules (Loon, 2013, p. 14). Brown argued for quick funding to prevent further slowdown of the economy and to enable businesses to carry on their activities. France was also in favor of funding measures and actively looked for a Europe-wide approach. In France, liberalization of the banking system had been stimulated by the government and banks increasingly engaged in 'market-based banking' activities and retail operations abroad had expanded (Howarth, 2012, p. 369). These activities posed risks on the French financial system. The German economy, on the other hand, weathered through the storm remarkably well. The German government pledged to reduce

[10] the ESRB does not have a legal personality

deficit spending rather than cutting taxes and was not in favor of the creation of a European fund. German Chancellor Angela Merkel blamed the US for their resistance to stricter regulation and finance minister Peer Steinbrück agreed that the key issue was lacking legislation and regulation (Spiegel, 2008; BBC News, 2008b).

Germany is known for its loyalty to ordo-liberal principles based on the idea that the role of the state is to "create an economic and legal framework to enable the market to work efficiently – above all through the maintenance of price stability" (Guardian, 2012). The need for greater centralization of financial regulation and supervision to the EU level was well acknowledged by German politicians (Loon, 2013, p. 3). On the G20 meeting in London in April 2009, Angela Merkel called for encompassing state regulation and in a speech in 2008 she stated that "the robust currency system of the euro has not yet secured sufficient influence of over the rules governing financial markets" as in Europe, "we still have a strongly Anglo-Saxon –dominated system" (FT, 2008). France was also convinced that no financial institution should escape supervision and called for concrete reforms (BBC News, 2008a). In France, a regulation-based economy is preferred over a market-based economy. Sarkozy was hoping to reach fast consensus on the simultaneously raise of bank deposit protection levels, in an effort to restore confidence in the banking sector.

The UK was in favor of reform and increased supervision, but was not willing to cede important decision-making authority to the European level nor to significantly increase regulatory standards. In the British opinion, the financial crisis was rather caused by the failure of individual actors, than the system. Chancellor Darling argued that lack of regulation and supervision had not been the key causes of the difficulties, but that "irresponsible pay practices had made banks take too much risk" (Guardian, The, 2009b). Hence, the UK government found little reason to delegate regulatory or supervisory authority to the European level. The City of London is the financial center of Europe and is seen as an engine of the economy that cannot be bothered with measurements that jeopardize its position in the global arena (Hodson & Quaglia, 2009, p. 948). The UK was concerned that new agencies could require a Member State to bailout a financial institution against its will (Alford, 2010, p. 70).

5.2 The role of EU institutions

Since the beginning of the crisis, the Commission has been flexible to find short-term solutions, by acting less strict on state aid rules and providing guidance to square individual measures with a common framework. Their main aim was, however, to address the problems in the long term by changing regulatory and supervisory provision (Alford, 2010). The Commission installed the Larosière group and supported the strengthening of Committees of supervisors. Internal Market and Services Commissioner McCreevy said that "the financial crisis has demonstrated the need to further strengthen EU supervisory arrangements and has reminded us of the importance of transparency and independence. An essential move in this direction is to reinforce the key bodies in these fields" (European Commission, 2009a). The Commission argued that there was a broad consensus on the need for reform and proposed an accelerated timetable. In its communication of March 2009, the Commission laid down its plans. Supervisory cross-border institutions would be set up as a "lynchpin of the supervisory system", and thus take a central position in the system (European Commission, 2009b).

The European Parliament held the common view that a radical reform of European financial supervision was necessary (EP, 2010a). Before the crisis erupted, the parliament had already highlighted the fact that some activities of stateless financial groups questioned the traditional structure of supervision in 2000, and in 2002 it adopted a resolution that called for a system in which systemic risk would be monitored at EU level. The EP aimed at a radical reform and the Council compromise that emerged from the December 2009 ECOFIN meeting was highly questioned. In December 2009, the four largest political groups in the EP's Economic and Monetary Affairs Committee took the stand that the Council's position was "not workable and much of the substance of the Larosière Report needed to be restored" (EP, 2010b). Most important were the objections against the safeguard clause protecting Member State's fiscal powers, that was considered over-restrictive. The EP brought forward amendments regarding the governance of the ESRB and argued that the president of the ECB should also be the president of the ESRB. Also, the EP proposed a number of improvements that would increase the role of supervision at EU level, including the power of initiative to take stress-tests, representing the EU during international dialogues of supervisors, and binding mediator role for the EBA. Finally, the EP held the opinion that the three authorities should not be spread out over three cities, as proximity would stimulate cooperation (EP, 2010c).

Since its inception, the ECB has strongly encouraged the ongoing efforts of the CEBS to achieve greater convergence in supervisory reporting by banks across the EU (ECB, 2008c). The ECB has supported the strengthening of regulatory and supervisory bodies at the European level as this would increase effectiveness and efficiency and ensure a consistent application. However, in one of his speeches, Trichet (2008c) also commented that the key challenges would lie in the implementation of the new framework. He stated that "the effectiveness of the colleges depend on their ability to facilitate decision-making" and that the "coordination role would be of critical importance to ensure consistency of supervisory actions across colleges" (ECB, 2010d). Furthermore, he stressed the immense importance of the effective information exchange.

5.3 How EBA was achieved

In the years before the crisis, cross-border banking had increased enormously as a result of the Single Market and the single currency. The market was already functioning at the European level, while the European financial system was still largely based on national regulation and supervision. An integrated system would be more efficient and could prevent for regulatory arbitrage and negligent supervision. These functional incentives to move to a more integrated system alone were however not enough to convince political actors for more integration. Attention from the supranational European Parliament on 'stateless' operations that were taking place without proper supervision also did not lead to action. It took until the crisis erupted, that the need to change the system became apparent and Member States. Only then, they gained the motivation and political will to negotiate on supervisory and regulatory integration.

First European response to the crisis was given when the French president Nicolas Sarcozy (at that moment president of the European Council) hosted an emergency meeting in Paris in October 2008. In the mini-summit, the heads of states of the four larger economies (Germany, UK, Italy and France) were present (Telegraph, 2008). A full series of euro summits would follow, primarily aiming to discuss matters of interest to the common euro area in the light of the crisis (Eurozone Portal, 2013). In January 2009, the Commission decided to strengthen the powers of the CEBS to "contribute to ensuring the efficient and consistent functioning of colleges of supervisors" (Commission Decision, 2009) but a full reform of the system needed to be agreed on by all Member States. From the start, meetings of the heads of state, government meetings in the European Council or in bilateral configurations have received most attention and most key issues were resolved there (Puetter, 2011, p. 171). The Eurogroup and the ECOFIN breakfast meetings also became crucial platforms of informal orientation debates at the level of economic ministers as many of the crisis related policy issues did not only concern the euro area, but were relevant to all Member States.

In September, the Commission proposed three regulations and negotiations among the Member States began. Although there was a consensus that the regulatory standards and the supervisory framework needed improvements, the UK had serious reservations on the amount of powers that should flow to the European level. Tight rules could jeopardize the position of its financial markets in the global arena and bailout against its will could become an enormous source of costs. The UK therefore insisted on having a final say regarding the supervision of individual financial firms. Mr. Myners, financial services secretary, stated; "National supervision must be pre-eminent when the cost of failure of an institution lies with the taxpayer" (BBC News, 2009). At the ECOFIN meeting in 2009, the UK blocked the agreement, stating that "we couldn't have a situation where a European supervisor could make an order to an institution in our country which could have fiscal consequences" (Reuters, 2009).

In December 2009, the ECOFIN approved three regulations, but to keep the UK on board, a compromise was made. Compared to the Larosière Report and early communications of the Commission, the proposals that were finally accepted by the Council were heavily reduced and the powers of institutions significantly weakened (European Commission, 2009b). For almost a year, negotiations took place between the Council and the EP, which called for tougher legislation and bigger transfer of powers to the EU supervisory level (EP, 2010c). In September 2010, they reached an agreement in which the financial supervisory system was (to a limited extend) improved and the EP managed to add bite to the EU supervisors (EP, 2010d). In the case of the EBA, it meant that the EBA could issue binding technical standards[11], the continuing role of the EBA in a college of supervisors and the encouragement of common reporting formats (Regulation establishing EBA, 2010). Furthermore, the EBA was empowered to settle disputes among supervisors and has a separate budget (Alford, 2010, p. 72). The new supervisory architecture was put in place in 2011.

5.4 EBA's changing powers, explained through Principal-Agent theory

The EBA was created to ensure effective and consistent prudential regulation and supervision across the European banking sector. To be able to carry out this task better than its predecessor, it was endowed with a legal personality and gained the power to develop draft regulatory technical standards and issue guidelines and recommendations. The EBA is an independent EU authority as it was given administrative and financial autonomy (Regulation establishing EBA, 2010). The first and foremost focus of the EBA is to establish high-quality common regulatory

[11] subject to review by the European Commission

and supervisory standards and practices among EU countries. The EBA contributes to the creation of the European Single Rulebook that aims to provide a single set of harmonised prudential rules for financial institutions throughout the EU and stimulates a uniform implementation hereof. Another main task of the EBA is to assess risks and vulnerabilities in the EU banking sector, mainly by the development of regular risk assessment reports and pan-European stress tests. The EBA is able to collect necessary information concerning financial institutions. Also, the EBA is equipped with resources and powers to facilitate exchange of information and agreement between national supervisory authorities, so that it can act as a mediator when disagreements between competent authorities in cross-border situations occur. Finally, the EBA can take decisions to address situations in which the financial stability is jeopardized (Regulation establishing EBA, 2010). By granting these powers to the EBA, it should be able to help to resolve commitment problems and enhance efficiency of rulemaking.

Although the tasks of the EBA are rather broad, its real powers and decision-making functions are rather limited. Day- to-day supervision has remained a responsibility of national authorities and the endorsement of draft standards and guidelines depends critically on a detailed procedure involving the Commission, the EP and the Council as well as public consultation and Bank Stakeholder groups (Fahey, 2011, pp. 584-585). In consultation with the Commission, the ESRB and ESA's, the EBA can determine the existence of an emergency situation and adopt the decision requiring competent authority to act. However, only in the situation that competent authority does not respond, the EBA is empowered to adopt individual decisions prevailing over previous decisions. Overall, it can be argued that the EBA has a broad responsibilities, but has no sufficient powers to cover for them (Fahey, 2011). It's zone of discretion has thus been restricted enormously.

The European the European Banking Authority has been up and running since 2011, and has tripled its staff from 31 at the start in 2011 to 94 in the end of 2012 (EBA, 2012, p. 39). The first focus of the EBA was to restore confidence in the financial market through a stress test, which was conducted in the first part of 2011. Out of 90 banks that were tested, only 8 failed the test and 16 institutions were categorized as near-fail (EBA, 2011). After a deterioration of the financial environment, several of the banks that passed the test at first, experienced significant challenge (Enria, 2012, p. 4). The EBA was blamed to lack scientific validity, conceptual and methodological clarity and, in particular, effective powers that were needed to deploy stress tests (Langley, 2012, p. 67). As a result, trust in this authority has declined. So far, Member States have not been keen to delegate more authorities to this organ. Disputes between national authorities are most often solved through intergovernmental platforms, so that the EBA's power to make arrangements is not optimized. In the short period that the EBA has been in place, it has been growing and its work has expanded, but the EBA has not managed to enhance its role and was not able to expand its powers.

5.5 EBA as banking supervisory body

Since its establishment, the EBA has been working to ensure consistent prudential regulation and supervision across the European banking sector. Its overall objectives to maintain financial stability in the EU and to safeguard the efficient and orderly functioning of the banking sector, fit well with a potential role as direct supervisor. Its function in the development of a single rule book would also contribute to a good understanding of the rules. Vice-versa, the role of supervisor would give more insights to gaps in the single rulebook. There are however also strong counterarguments to confer micro supervisory powers on the EBA. As micro supervision remained at the national level, the EBA lacks experience at this front. Also, the EBA is a relatively young institution and was given a limited mandate and powers. It is still developing itself as an institution and has not yet built up much credibility. Its limited zone of discretion has constrained the EBA from putting through fast and effectively regulation and coordination of supervision. As EBA's bank test failed to anticipate on the disastrous uncertainty, the credibility of the EBA went down. For a future supervisor, this credibility is of enormous importance as it can be disastrous for the trust in the banking sector and financial stability. If the EBA would take on supervision for the euro area, it would thus have to be granted significant powers to be able to manage this section adequately. Another barrier to put the EBA in charge of supervision in the banking union is that it is a EU27 institution, meaning that it would have to manage supervision only for members of the EMU while decision making for rules in the EU would include all Member States. A separate body section would have to be create to make this construction acceptable. Especially in the eyes of non-euro zone members this is a critical factor.

6 The Banking Union

It has been almost six years since the crisis hit Europe and many institutional weaknesses have been brought to light. Since April 2012, the notion that a banking union is an important and indispensable component of any approach to prevent the euro area from falling apart has gained remarkable momentum. A banking union should break the feedback loop between banks and sovereigns, restore credibility of the financial sector in all countries of the European Union. Ideally, this would preserve tax payers' money and as banks losses no longer become public dept. Herman van Rompuy stated that "Building on the single rulebook, an integrated financial framework should have two central elements: single European banking supervision and a common deposit insurance and resolution framework" (Rompuy, 2012, p. 4). A banking union needs to be implemented step-by-step as it is a huge change on delicate issues.

The first step towards a banking union has been taken through the creation of the Single Supervisory Mechanism (SSM) that should be in place as of mid-2014. Within the SSM, the institutional setup of micro-prudential supervision will be drastically changed and the ECB will take over important tasks from national supervisors. Parallel to the negotiations on the SSM, important decisions were taken regarding a bailout fund through the development of the European Stability Mechanism (ESM). The next step to a banking union is the creation of a Single Resolution Mechanism (SRM), existing of a resolution authority and a resolution fund. This should ensure uniform implementation of rules in case of bank failure. The rules for how EU banks in serious difficulties should be determined in the Bank Recovery and Resolution Directive (BRRD), which is currently under negotiation with the EP. Ultimately, bank failure should be financed through a Single Bank Resolution Fund (SBRF) and a Common Deposit Guarrantee Scheme. This last component of the banking union would imply far reaching changes that touch upon the sovereignty of Member States. The SSM will be the main focus of this chapter because of its advanced stage and because of its direct influence on the changing role of the ECB and the EBA. It is unlikely that a Common Deposit Guarrantee Scheme will be realized in the near future and this component has therefore been mostly left outside the scope of this thesis.

6.1 National interests

Germany

Since the beginning of the crisis, Germany has taken a strong stand against debt-sharing by vetoing the allowance of joint debt issuance and resisting to a joint stimulus. The German chancellor Angela Merkel stated that there would be no Eurobonds[12] "as long as I live" (Spiegel, 2012a) adding in the official government statement that "joint liability can only apply if

[12] Eurobonds is defined as a "joint and several" guarantee by all Member States of the euro zone, implying that if the issuing country cannot service its Eurobond debt , the creditors can demand payment from all other euro zone countries (Gros, 2011)

sufficient controls are ensured"[13] (Bundesregierung, 2012). Germany has put emphasis on national responsibilities. Already before the idea of a banking union was suggested, she pledged for stricter regulation on the European level through the increase of powers of the EBA (Elsevier, 2012). Many agreed with Merkel that Germany throwing money at the problem would not solve the crisis. A member of Merkel's coalition partner FDP stated that a banking union would be "a new, admittedly creative, way to tap German solvency". Merkel's own CDU also had its reservations as German "savers cannot be liable for the deposits of people in other countries" (The Local, 2012). The opposition accused Merkel of trying to introduce joint EU debt by the back door by letting the ECB buy distressed bonds. The center-left SPD argued more in favor of pooling debt and sovereignty, but emphasized that this should only happen when control mechanisms are in place (EUobserver, 2012a). Banks in Germany already signaled opposition to the potential use of their existing deposit guarantee schemes to rescue banks in other countries. The Bundesbank was more in favor of a banking union, and Ms Lautenschläger (vice president of the executive board of the Bundesbank) 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, 2012).

It was not surprising when Merkels acceptance of the ESM on the summit of June 28th and 29th 2012 was received with devastating critics in the German newspapers and in the political arena (EUobserver, 2012b). Merkel underscored that the ESM would only start with the provision of direct assistance after a banking supervisory mechanism would be set up. From that moment, the German motto has been "quality before speed" (EUobserver, 2013a) . Bank bailouts should be accompanied by strict conditions and German finance minister Schaueble stressed that "recapitalization of banks by the ESM […] is unlikely to happen soon". Also, Germany wanted direct banking supervision by the ECB only on the largest banks (EUobserver, 2012d). Instead of a "mammoth" authority that supervises all 6000 banks in the Euro zone, Germany wanted a body that is effective, quick and efficient. Even if the ECB wouldn't supervise all banks in practice, "there shouldn't be too many overlaps" said the head of BaFin, Elke Köning. According to Spiegel (2012c) it is likely that the savings banks lobby group[14] has had an important influence in the German position as well. Merkel had promised to guarantee Germany's savings in 2008 and putting banks under SSM supervision could contradict this promise.

At the of 22nd of September 2013, Merkel won the German elections with a convincing 41,5% of the votes. Election campaigns were dominated by domestic policies, but a large part of the electorate shared the opinion that Merkel had steered Germany through the crisis in a sound way, without running Europe into the ground. The FDP went from 14,6% to 4,8% and could not continue as coalition partner. From Europe, there were hopes that a broad coalition would soften the German stance towards the banking union, but the coalition with the SPD is unlikely to make this happen. For now, Germany is still aiming at slow and gradual financial integration and wants to keep the decision making and funding of resolution at the national level. Schäuble voiced its concerns on the legal base of the SRM, as reforms would require a huge sacrifice of sovereignty (FT, 2013a; FT, 2013b). He argued that 'powers granted to any central authority and

[13] Originally in German; "Gemeinsame Haftung kann erst dann stattfinden, wenn ausreichende Kontrolle gesichert ist."
[14] Sparkassen and credit unions

the capacity of any central industry-financed resolution fund should be limited and well defined', as such, SRM should be able to be 'justified under the current EU treaties' (Schäuble, The Banking Union – another Step towards a tighter-knit Europe, 2013a). Germany proposed a two-step approach towards a Single Resolution Mechanism. In the first phase, the resolution mechanism would be based on a network of national authorities, supported by a national bailout funding. A decentralized approach would be easier to install and would be able to take into account the variety of regulation that is still in place (Schäuble, 2013b). If significant convergence has occurred, a deeper integration could take place. As for future funding of bank failures, Germany is strong supporter of a mandatory bail-in[15] system (Schäuble, 2013a). Merkel's new coalition partner SPD is very insisting to bail-in (Bloomberg, 2013b). This way, the portion that remains to be financed by a bail-out fund can be significantly reduced, as was the case in Cyprus. In this scenario, the ESM would be a last-resort instrument that only has to be used in extreme situations, in combination with appropriate policy conditionality.

France

France has always been a strong driver of European integration and views cooperation in the European union as a way out of the crisis. When sovereign credibility went down and the euro came under serious pressure, the French president Sarkozy declared his "absolute determination" to defend it (Bloomberg, 2011). He took the initiative for Euro summit because it feared that the euro would not last very long without one (Eurozone Portal, 2013). Sarkozy backed the idea of Eurobonds and has long argued for European economic governance. French banks are relatively vulnerable to system-wide freezes that came about after 2008. Because of their strong reliance on short-term finance, the French banking system is more dependent on confidence in the financial market. Furthermore, their exposure to countries in the troubled periphery are higher than in northern European countries. French banks have gone through the crisis relatively well, but they did suffered from the write-downs on bonds in the southern periphery (Economist, 2011). France has backed the ESM as the pooling of risks is in line with French beliefs, and moreover convenient for their economy as it would have a positive effect on finance markets.

France is thus in favor of the establishment of a ESM and has been a supporter of the SSM in a banking union. Under Sarkozy's presidency, France argued for Eurobonds and favored the ESM but also accepted the fiscal austerity measures imposed by Germany. Sarkozy, a right wing politician, imposed strict fiscal measures and thought strict rules on the national and European level should be honored. The second round of austerity measures had pressed hard on France, and Sarkozy's inability to address the crisis upset the electorate (France24, 2011). The socialist candidate Hollande won the elections. Hollande stated that he found the ESM treaty too strict and he also aimed to renegotiate the fiscal pact. Hollande argued for the creation of Eurobonds, a financial transaction tax, and wanted to use the European Investment Bank to invest in small business projects (BBC News, 2012). The SSM with the ECB as supervisor was a precondition for the start of direct recapitalization and key to a good functioning of the ESM. Mainly for this reason, France has been supportive towards the SSM and is currently working hard to

[15] A bail-in occurs when investors (creditors) are forced to bear some of the burden in case of a bank failure by having part of the debt written off.

accomplish a full-fledged SSM. Finance minister Moscovici stated that “we want to get there sooner rather than later” (Reuters, 2012). French banks have also expressed their support for stronger European supervision; the FBF[16] stated that it is “essential that all euro zone banks should be submitted to the same supervision” (FBF, 2012), and the president of the Société Générale[17] said that “launching the banking union with urgency is fundamental for restoring faith in the European banking system” (IlSole24Ore, 2013). France has argued for the ECB to have swift supervision over all 6000 banks in the European Union, without exception.

France is determinant to press ahead the timetable on the SSM (Moscovici, 2012)and aims to continue to build a firm framework for the banking union. Hollande stated that the project of a banking union reflects the continuity in France’s intention to have ‘more consistency, more instruments and more regulations’ (French Embassy, 2013). France does not see the necessity of treaty change for the establishment of a SRM and argues that banking union should go as far as possible within the existing treaty framework. Changing the treaty could cause enormous delays for the SRM and should by no means happen for political reasons, but only if it is a legal necessity. The euro area must go further and faster, and France would like to see a social dimension added to the discussion, and have more coordination of social policies run parallel to the development of the banking union. France is in favor of the creation of a single resolution authority, and demands decision making at the central level (FT, 2013b). France supports the possibility to use the ESM as a European backstop within the banking union that can be used to recapitalize banks directly, and keeps has been defending this throughout the negotiations (EUobserver, 2013b).

UK

As the UK is not part of the euro zone, their position towards the SSM and the banking union is taken from a different perspective. From the beginning, the UK has made clear that it does not want to take part in any of the elements of a banking union. Cameron firmly stated that this would “raise far reaching questions of national sovereignty” (Cameron, 2012) and that “Britain is not in the euro, so we won’t be part of that integration” (Independent, 2012). The move towards a banking union does, however, have serious implications for the strategic position of the EU and could affect the Single financial market that is of great influence on the UK. In the SSM negotiations, it is key for Britain that its interests are protected – especially in respect to the Single Market. Critical voices in the House of Lords (EU Committee, 2012) warn that cross border services could suffer from an SSM and London’s success as an entry point to the EU could be jeopardized (EU Committee, 2012, p. 40). Another concern is related to deposits that might be moved to countries in the SSM if this proves to be a better system. The precise impact of the SSM and the banking union are hard to predict, but “a degree of marginalisation will be inevitable” (EU Committee, 2012).

The SSM will not only have impact on the financial market in the UK, but will also change the UK position in the EBA, that represents all 27 EU Member States. There is the risk that non-euro countries are outvoted in decisions that concern the regulation of banking and finance as a whole. For the UK, it is essential that there will be no discrimination against non-euro zone

[16] Frderation Bancaire Francaise

[17] One of the largest banks in France

members and that voting modalities in the EBA are changed to the benefit of non-euro zone Member States. The mediation role of the EBA is also at risk. The EBA could become an overarching umbrella without teeth, which is no match against powerful bodies such as the ECB and the Bank of England. The (EU Committee, 2012) expresses its concern that "the sheer weight of influence that the ECB would exercise would make parity of treatment difficult to achieve in practice" and states that "it is important to maintain the distinction between the EBA's role in setting rules across the EU and the ECB's role in supervising within the SSM".

Even though the UK surely won't take part in the banking union, it does not per se have a negative attitude towards the proposals. There is broad consensus that the single market has brought "appreciable economic benefits" and the UK is keen to see European markets calm down. If measures in the banking union stabilise the single currency and calm financial markets, the UK would highly benefit from this. The leading association for the banking and financial services sector in the UK has welcomed banking union proposals, as it is believed that it is in the UK's interests if there is a stable and consistent supervisory regime in the Euro area (BBA, 2012). However, to give this calming effect, the link between banks and sovereigns needs to be decisively broken. The EU Committee (2012) regrets the delay and opposition that has been voiced against further steps towards the SRM and DGS. Cameron has however also made clear that he sees further integration as a chance to loosen its relationship with the EU and the British position would be renegotiated (EUobserver, 2012e). In the parliament, Cameron therefore declared that he will surely fight for its position in a changing European Union. In the case of a treaty change, the UK will most certainly take its chance to renegotiate its position.

6.2 The role of EU institutions

The Commission has aimed for a decisive and comprehensive response to the crisis, in order to restore the confidence in the euro area and in whole the European Union. Already in 2011, Barosso stated that the "reactive and piecemeal" approach to the crisis had not worked and there was a need to get "ahead of the curve" (European Commission, 2011). When the euro zone agreed in its meeting of June 2012 to move towards a SSM, the Commission presented its proposals only three months later. The proposed legislation would give the ECB ultimate supervision on all euro area banks as "we have seen non-systemic banks popping up and posing systemic risks" in previous years (EUobserver, 2012f). The Commission put forward a phased but ambitious timeframe, aiming to have SSM in place by January 2013, have all banks of major systemic importance under supervision of the ECB by July 2013 and complete the process by Januari 2014. Barosso stated that rapid political agreement was "crucially important" (Bloomberg, 2012) and called the Council and the EP to adopt the proposals by the end of that year. The proposals that the Commission tabled for the SRM in July 2013were equally ambitious. The Commission suggested a strong central-decision body comprised of representatives from the ECB, the Commission and relevant national authority in a bank failure. This body would have the expertise to be able to deal with failing banks in a more systemic and efficient way than individual national authorities. Also, a Bank Resolution Fund would pool significant resources from bank contributions in order to protect taxpayers and provide for a level playing field across participating Member States. The Commission pressed for a timely implementation to back up the SSM and enhance the credibility of the SRM (European Commission, 2013c).

The EP supports the idea of a single supervisor and has called for direct supervision over financial institutions by a European body on various occasions. In 2010, the Parliament adopted a resolution in which it aimed to create a crisis management framework. The EBA would gain supervisory tasks regarding cross-border banks and ultimately, resolution would be taking place in the EBA or a separated body (EP, 2010). Although the proposed legislation did not follow these recommendations and moves supervisory powers away from the EBA and to the ECB, the EP is largely in favor of the SSM. To avoid conflict of interests within the ECB, the EP has backed strict separation between monetary and supervisory tasks. The Committee on Economic and Monetary Affairs put its focus on the scope of supervision and the link with banks outside the euro area, the roles of the ECB and the EBA and, last but not least, democratic control and legitimacy of the newly established system (EP, 2012). Amendments increase the amount and quality of the reporting standards to the EP and to Member States and the EP has pushed for a say in the hiring and firing of the chair and vice-chair of the ECB Governing Council Regarding the scope of supervision, the EP is concerned that quality of supervision could suffer from a too broad reach of ECB supervision and has argued for a focus on credit institutions of systemic importance (EP, 2012b; EP, 2012c). At the time of writing, negotiations between the Council and the EP on the BRRD are ongoing and the EP is going through the first reading of the proposal and a common position has not been reached (EP, 2013).

The ECB is strongly in favour of the SSM that brings supervisory powers to its mandate. Already in 2009, Trichet (at that time president of the ECB)held the opinion that it would be a "natural extension of the mandate [...] to contribute to financial stability" (ECB, 2009c) . Smaghi (member of the Executive Board) argued that "strengthening the role of the ECB in the field of supervision has some important advantages which, outweigh the disadvantages" (ECB, 2009d). The ECB generally holds the opinion that euro zone states need to give up sovereignty to fix the flaws in the euro system should. In his press conference of 6 December 2012, Draghi stated that the ECB should be in a position to carry out supervision in a "decisive, firm, complete and strong fashion without any reputational risks" (Draghi, 2012). As such, all 6000 banks in the euro zone should fall under this supervision. Secondly, the new tasks will not be mixed with the monetary policy tasks. Draghi expressed to be "confident that the SSM will make a significant contribution to safeguarding financial stability in the monetary union" and that "it will support the conduct of monetary policy" (ECB, 2013b). Within the ECB, there is little doubt that monetary and supervisory tasks would be compatible with each other. The ECB has welcomed the proposal for the SRM as this should provide for strong backup for the SSM. ECB officials are concerned that if resolution remains tight to the national level, their unwillingness to take action after the ECB has declared a bank insolvent will undermine the system. The ECB called the developments of the Bank Resolution and Recovery Directive of paramount importance and insisted that a resolution authority and fund will be set up by the time it starts supervising the largest banks in the euro zone. Officials of the ECB have repeatedly expressed their concerns on national involvement in resolution and has been actively championing for decision-making at the central level. In October this year, the ECB has already started a risk assessment in preparation to its supervisory function. This test is not only an important step in the preparation towards the Single Supervisory Mechanism, but also creates the need for a well arranged resolution mechanism.

6.3 The Single Supervisory Mechanism

In the summer of 2011, a heated discussion took place on the mutualisation of debt through the issuance of Eurobonds[18]. This was a very sensitive subject as it would not just be a technical solution for borrowing, but would also imply political integration, joint political accountability and determine the way decisions are made in the euro zone (Véron, 2011). The idea of a banking union came from Herman van Rompuy (2012) who stated that "Building on a single rulebook, an integrated financial framework should have […] a single European banking supervision, a common deposit insurance and resolution framework". In the euro top on the 29th of June 2012, Member States supported his ideas and expressed their intention to break the 'vicious cycle between banks and sovereigns' (Rompuy, 2012). In this meeting, the effective establishment of the SSM was specified as a precondition for the transfer for support of banks. The linkage of these two aspects caused rigidity and delay to the creation of the crisis framework (Véron, 2012b, p. 11).

The discussion on the mutualisation of risks and responsibilities took place through a series of euro tops, in which two dominant coalitions could be distinguished. One group has been primarily interested in recapitalisation through the ESM and aims for fast introduction of SSM to allow this. Tighter rules and supervision by the ECB are viewed as the means to an end. SSM should allow for further move into a banking union and be thus be accomplished in a complete way. This opinion was shared by countries in the south of Europe such as Italy, Spain, Portugal, Greece and Cyprus, but also by France - especially under the leadership of Hollande. The second country grouping consists of Germany, Finland and the Netherlands, which even released a joint statement on the issue (Finnish Ministry of Finance, 2012). They have held the opinion that budgetary discipline at the national level remained key and the ESM could only play a 'supplementary role' to ensure financial stability. In their view, recapitalisation through an ESM can only start to take place after the SSM is in place As the SSM should prevent banks from free-riding, the quality of SSM is considered more important than the speed of establishment.

Before the euro summit on the 29th of June, Merkel had taken a tough stance, but the problem was pressing and European partners (especially Italy) put high pressure on Merkel. The fact that Germany was now open to possible recapitalization through the ESM was a breaking point. It was decided that ESM would only take place *after* the establishment of the SSM and the Commission was asked to come forward with proposals for a SSM. Quickly after, the Commission presented a proposal conferring strong powers on the ECB for supervision of all banks in the euro area "regardless of their business model or size" (European Commission, 2013c), and another proposal aligning existing regulation on the EBA to the new set-up for banking supervision in the euro area. Important issues in the country negotiations were the timeframe, the decision making procedures and last but not least, the scope of bank supervision of the ECB. A Franco-German rift on the scope of supervision caused enormous delay. In the Council agreement that was reached in on December 13th 2012, a compromise was made in which the ECB supervision would be directed at approximately 150 larger banks, and could -

[18] Eurobonds is defined as a "joint and several" guarantee by all Member States of the euro zone, implying that if the issuing country cannot service its Eurobond debt , the creditors can demand payment from all other euro zone countries (Gros, 2011)

only if necessary- interfere with smaller banks. Germany managed to postpone the entry into force of the SSM until 2014 and it was agreed that the ESM could ‘possibly’ start with the direct recapitalization of banks after that. Concerns of non-euro countries (especially England) on their voting rights in the EBA and the level playing field between banks inside and outside the SSM were taken into account (EUobserver, 2012g). An agreement between the council and the parliament was reached on the 19th of March. The EP managed to ensure separation between the monetary and supervisory policies and improved the transparency and accountability of the governance structure within the ECB. Final regulations were accepted by the Council on 15th of October 2013.

In the SSM, the ECB will take over important tasks from national supervisors as it will become the competent authority for licensing and authorizing credit institutions conduct supervision related to financial conglomerates; ensure compliance with minimal capital requirements, provisions on leverage and liquidity and capital buffers; and be able to take intervention measures when regulatory capital requirements are breached (Regulation 1024, 2013). Within the ECB, a Supervisory Board will be created, consisting of a chairperson, a vice-chairperson, four ECB representatives and one representative of the national competent authority of each participating country. The ECB’s supervisory powers would become fully operational from November 2014. The ECB will then become responsible for banks that have accepted bailouts and the carry out direct supervision of the approximately 130 largest banks. To prepare itself for its task in the SSM and in the light of the development of the SRM, the ECB has started to conduct an assessment of the banking sector in order to foster transparency, repair and build confidence. The assessment consists of a supervisory risk assessment, an asset quality review and a stress-test on the resilience of banks. This step is taken in the perspective of next steps towards resolution (ECB, 2013d).

The consolidation of the supervisory framework under the authority of the ECB affects the functioning of the EBA in several ways. First, the voting preferences of euro-zone countries are more likely to correspond, and as these countries make up the majority in the EBA they could easily press through their opinion. Voting modalities for the Board of Supervisors was therefore amended to the benefit of non-euro countries in regulation No 1022 (2013). This regulation also sets out a mandate to promote best supervisory practices in the internal market through a supervisory handbook. The handbook should not take the form of legally binding acts or restrict judgment-led supervision, but should be a significant element of the convergence of supervisory practices in the EU. It is likely that the focus of the EBA will shift more to the harmonization of rules through the design of the single rulebook. Monitoring and assessment of market developments and the identification of potential risks and vulnerabilities in the bank sector will remain its task, but the ECB already started a risk assessment test for the euro area. The EBA will not only work with the national supervisory agencies, but will also have to interact a lot with the ECB. The EBA is a relatively young and small institution, while the ECB has more powers and experience.

The SSM was set as a precondition for the ESM to start with the direct recapitalization of banks, as the “ESM could, following a regular decision, have the possibility to recapitalize banks directly which would rely on appropriate conditionality, including compliance with state aid rules”

(Regulation 1024, 2013). As such, commitments towards the direct recapitalization through the ESM have barely been made. It has been agreed that the main features of the instrument should be operational once an effective SSM is established, but no exact timeframe has been set out. The instrument will however not be finished before the Bank Resolution and Recovery Directive has been agreed on by the parliament (Eurozone Portal, 2013).

6.3 The Single Resolution Mechanism and Deposit Guarantee Scheme

Even before the SSM had officially been adopted by the Council, Germany put up a barrier against a fast route to a banking union, by insisting that a revision of EU treaties is necessary to establish of a resolution authority and –fund. This message seriously crossed the European Commission that would table a proposal for a SRM few months later. The call for treaty change raised Britains hopes on new negotiations, which made clear that 'British backing for treaty change would come at a price' (FT, 2013a). In May, Schäuble stated that Germany would assess upcoming Commission proposals with 'open mind', but also pointed at the benefits of limited treaty change and stated that the EU does not have 'coercive means to enforce decisions' (Schäuble, 2013b). In a bilateral meeting on the 30th of May, Hollande and Merkel laid down a detailed vision on issues in the euro zone in a report (Bundesregierung, 2013). Most significantly, the report affirmed the intention to establish the SRM on the basis of current treaties by giving national bank authorities a prominent role in the single resolution board. This implied a far looser configuration of a resolution authority than was originally intended. The Commission tabled its proposal on the 10th of July, that gives the final say on bank closure to itself. Ever since, there has been controversy on the decision making procedure. Germany rejects this arrangement, while France is in favor of the Commission plans (Bloomberg, 2013a).

In the mean time, negotiations on the Bank Resolution and Recovery Directive were held. The directive sets out rules to resolve failing financial institutions and thus determines rules on who will pay in case of a bank failure. The debate on resolution and recovery rules has been ongoing for three years, but the case of Cyprus renewed attention on the subject and put it on top of the agenda. The bail-in method that was used in the case of Cyprus has been a template for resolving the crisis (Reuters, 2013). Mandatory bail-in is included in the proposals and the Council position, meaning that unsecured depositors with deposits over the guaranteed €100.000 will be forced to bear the costs of restructuring first. Next to this measure, the sale of part of a business, establishment of a bridge institution and asset separation are likely to become the main resolution measures (Council, 2013). This would drastically reduce the need for direct recapitalization and European funding after bank failure. At the time of writing of this thesis the Bank Resolution and Recovery Directive is in firs reading of the parliament.

The proposed resolution fund should be based on ex-ante contributions from the financial sector and function as a private backstop. The target size is 1% of banks' covered deposits, which would be around €55 billion. This resolution fund could possibly be backed up by the ESM, that has much more capacity. However, there are different opinions on this. Germany is leading a group of countries that want to avoid the creation of such a fund being backed up by the ESM. Most countries are aware that the failure of a small number of banks would wipe out their national funding, while it would do small damage to a euro wide fund. As such, a single euro zone fund is especially attractive for smaller member states (EUobserver, 2013b). France supports the possibility to use ESM as a backstop within the banking union. The question whether or not the ESM will eventually function as a backstop thus still remains the question and as the Bank Resolution and Recovery Directive is not agreed on, the moment of direct recapitalization by the ESM has also not been set. The last component of the banking union, the Common Deposit Guarrantee Scheme, is not likely to be implemented in the near future. This would have far reaching consequences for burden sharing in the euro zone and is thus a very sensitive political subject.

7 Integration theories in the banking union

In the theoretical framework, the driving forces and mechanism of integration in the European union have been explained through two main contradictory theories. On the basis of these two integration theories, propositions have been made on the current developments in the banking union. In this chapter, propositions will be tested against ongoing developments in the banking union so far. As the negotiations from the SSM have been completed, the focus will be on this aspect of the banking union. Negotiations on the SRM and bail-out through the ESM will also be taken into account. At the time of writing, the negotiations on the Deposit Guarantee Scheme have not resulted in significantly outcomes that can be tested against the hypothesis and will therefore mostly be left outside the scope.

7.1 Neo functionalism

Neo-functionalism assumes that incentives for integration are created through spillover effects which put pressure on states to integrate. In the theoretical framework this leaded to the presumption that;

1. The incentives to move to a banking union came from spillover effects, that Member States had to 'automatically' respond to.

In the case of the banking union, a spillover effect can be found in the disparity between the highly Europeanized financial system and the national functioning ex-ante supervision and ex-post safety net in case of bank failure. Without a banking union, banks and sovereigns are mutually dependent; sovereigns have interests in the survival of their (most important) banks and banks often hold many government bonds. A doom-loop can take place in which the devaluation of banks and sovereigns continue to negatively influence each other: bailout of banks by national government has negative effect on the value of sovereign bonds, that are often owned by banks. Because of the shared currency, the downgrading of government bonds can have significant consequences for the financial stability in the whole euro area. As such, a spillover effect to the move towards a banking union can indeed be identified. However, this 'spillover' effect was in place long before the crisis and even though European institutions asked for attention on this subject, no action was taken. It took until the sovereign debt crisis that states got increasingly concerned about this spillover effect. Without this second intensive (the sovereign debt crisis), it is unlikely that action would have been taken. It seems that spillover effects are only responded to when problems showed up and (potentially) threatened Member States individually.

An 'automatic' response to would mean that action reflects functional demands. In the case of the banking union, that would be the need to break the link between banks and national sovereigns. This would mean a (quick) move to European funding to ensure bank debt does not automatically become sovereign debt; European resolution to ensure equal application of rules in case of bank failure and; European supervision to prevent troubles and enable early warning. In order to make this system work efficiently, the measures would be implemented together, or at least, shortly after each other. In the current integration process initiatives towards all three components have encountered much opposition. An agreement has been reached on the least contested component (SSM) of the banking union. Only slow progress is made on the SRM, which touches more severely on sovereignty. Member states have very different opinions on the governance structure that should be put in place and are reluctant to give up powers. Proposals on the DGS have been put in deep freeze and it is unlikely that agreement on this subject will be reached soon. As the markets have calmed down in the course of 2013, it was agreed that euro tops would only be held twice a year. The sovereign-debt crisis has thus had a major effect on the pace of decision making. Now that there is less emergency, slowing down of the integration process is already visible. Spillover effects alone have not been enough to convince Member States to integrate. An automatic response cannot be fully identified as there has been much controversy over the integration process. However, fact that all states have agreed to move to a banking union and the three proposed aspects does indicate a certain consciousness of functional demands.

The second and third hypothesis to test neo-functionalism in the banking union are somewhat related as they state that :

2. European institutions will promote integration towards a banking union.
3. Institutions manage to influence the opinions of member states of the decision making process actively and effectively and therefore, the outcomes of the negotiation process so far mainly reflect their preferences.

In the European Union, decision making processes are complicated and involve many actors. In the banking union, the Commission, as well as EP and the ECB have favored more integration in the financial sector. Before the idea of a banking union was introduced by Herman van Rompuy, the Commission as well as the EP and the ECB were in favor of more supervision at the European level. The ECB has acted responsively to the crisis and managed to expand its powers unofficially. Already in 2009, a Commission decision was issued, putting more tasks on the CEBS. Barroso stated that a “reactive and piecemeal” approach to the crisis had not worked and there was a “need to get ahead of the curve”. The EP also promoted direct supervision over financial institutions already before the move towards a banking union was made. In 2010, the EP adopted a resolution to give the EBA supervisory tasks. Although institutions have largely favored integration in the financial sector, they have not been able to activate Member States to the extent that action was taken. Reaction was triggered by the crisis, rather than institutions.

In the negotiation process, the Commission has aimed for a decisive and comprehensive response to the crisis . When the European Council stated its support on the start of a banking union, the Commission responded quick with the issuance of proposals on the SSM. The proposal conferred supervisory powers of all banks in the euro zone to ECB, and pressed for quick adoption. In the negotiation process in the council, no significant commitments were made on the ESM and the scope of ECB supervision was limited. The EP has mostly been concerned with the democratic control and accountability in the governance structure and managed to make some improvements at this front. Before the Commission issued a proposal for the SRM, Germany already took the initiative to state its opinion and a ‘negotiation’ meeting with France took place. It is difficult to say to which extent this influenced the proposal, but it indicates that Germany has kept the Commission on a short leash. In this case the German initiative rather influenced the Commission's proposal than the other way around. Commissions' proposal for SRM has suggested that final decision for resolution would lie at the European level, but objection to this was made in an early stage. Throughout the negotiations on the SSM and SRM, the ECB has expressed itself explicitly and repeatedly in favor of the creation of decisive, firm and complete transfer of powers. The ECB has even confronted Germany with its opinion several times, trying to convince them of the need for a fully equipped banking union. The ECB has profiled itself as an independent technical institution, but in the run-up to the banking union, it has exercised an enormous amount of political pressure. Overall, it can be said that European institutions have actively promoted the quick and simultaneous establishment of the components of the banking union. They argued for broad scope of the banking union, complete transfer of powers and a simultaneous implementation of backstop funds. Although pressures from institutions have not gone without response, institutions were not able to convince Member States to move to a banking union and overall outcomes of the banking union so far do not merely reflect their preferences.

7.2 Liberal intergovernmentalism

Liberal intergovernmentalism assumes that interstate bargaining determines the integration process and argues that countries' position originate from the total of domestic preferences. To see if this is the case in the banking union three hypotheses are tested.

1. National positions are shaped by a variation of domestic interests, and choices of national leaders respond to constraints from domestic pressures. The generated national position cuts across coalitions and is acted on purposively.

Member States have varying preferences concerning the shape and pace of a banking union. Following liberal intergovernmental assumptions, they are not a set of consistently ordered goals, but they are constrained by pressures from social groups in the domestic sphere. For this reason, the outcome would have broad support inside nations, so that country positions do not change entirely each time there are elections or the situation in the European Union changes. In the banking union, two broad coalitions can be identified. Finland, the Netherlands and Germany are supporting the banking union to the extent that it should bring along financial stability. However, they have objections when it comes to the sharing of liabilities and giving up sovereignty. Germany has taken the toughest stance on the objection to accept liabilities without consequences. This point of view was supported throughout the political arena, and shared by the Bundesbank. Germany has been one of the countries that has had a relatively small downturn in the crisis and easing funding through ESM or using ESM money would be very much against its interests. The many critics that Merkel got after acceptance of the move towards a banking union on the 29th of June 2012 show the constrains that are in place to 'control' the choices that are made in the international sphere. Merkel's earlier commitment to guarantee savings to also constrained her in the SSM as the savings banks would not easily accept this. Merkel therefore pressed to reduce the scope of the SSM. There has been a variation of opinions on the amount and severity of conditions that should be established. Merkel, a center-right politician, has generally opted for a more strict interpretation. The new coalition partner of the CDU/CSU is the SPD, a center-left party. The SPD is generally more in favor of the pooling of debt, but also wants to let the sector pay for its own problems.

The southern countries have generally suffered the most from the crisis and a fully fledged banking union could provide for a solid backstop fund and stabilization of their financial markets. It is not surprising that they generally support the move towards a banking system. For France, that weathered through the crisis relatively well, ESM funding is not necessary. Their economic dependence on short-term financing and their connectedness with financial markets in the periphery have increased their eagerness to more solid financial framework. To accurately improve the system, the banking union would have to be achieved in a complete way. In the French political arena, the banking union is generally favored. Before Hollande came in place, Sarkozy already expressed its support to risk-sharing in the euro area and favored the introduction of euro bonds. The transition of powers within France has firmly changed the dynamics on the European agenda as Hollande has expressed himself against the German way of handling a euro crisis. It is striking that the overall opinion of France (in favor of debt-sharing and a banking union) has not changed when power was transferred from the right-wing Sarkozy to the socialist Hollande.

From each of the 'coalitions' in the banking union, the most dominant state has been discussed. Within each country, a variation of opinions on the banking union can be distinguished. However, all preferences are generally shaped along the line of their (economic) interests. It is difficult to generalize from just two examples, but based on the cases of Germany and France the hypothesis cannot be rejected. Political leaders have responded to pressures from inside the countries, and after the elections, their view on Europe only changed within a range of options that runs along the line of their (economic) interests.

2. States dominate the process towards the banking union. Their relative bargaining position shapes the outcome and depends on unilateral alternatives, their ability to shape coalitions and potential for compromise or linkage.

The two 'coalitions' that have been distinguished are unequal in size. The southern coalition consists of France, Italy, Spain, Greece Portugal and Cyprus, whereas the northern group is merely comprised of Germany, Finland and the Netherlands. In economic strength, there are also a significant difference between the two groupings. The countries in the northern coalition and France still have relatively strong economies and sovereign debt has not come under stress. In all other countries, sovereign debt has been under severe stress due to the collapse of financial institutions, and their economy has suffered from this greatly. Following liberal intergovernmentalist assumptions, the northern countries have better unilateral alternatives than the southern countries and should be able to use their strong bargaining position to their benefit. Because of their minority position, it is however difficult change alliances and change coalitions. A banking union would strengthen the financial stability in the whole euro zone and it is now merely the organization, scope, conditions and limits that are under negotiation. Looking at the negotiations in the SSM the structure of compromise and linkage can be identified. The southern coalition has had its priority on funding while northern countries aimed mostly to put regulation and supervision in place to prevent recurrence of a crisis. In the bargaining process, both coalitions gained wins and losses. For the southern countries, the commitment enable ESM to directly recapitalize banks was one of the largest achievements. Also, they managed to put all banks under ultimate supervision of the ECB and commit northern countries to move on to the next steps of a banking union. For the northern coalition, the order of establishment of the aspects of a banking union (first supervision and bank-test, then recapitalization), the reduction of scope of ECB supervision on smaller banks, the limiting of funding of the ESM through bail-in measure are the main gaining points of the northern countries. Overall, it can be said that the northern countries have pushed through relatively strict conditions and especially Germany has taken a strong stand and has significant influence on the final shape of the SSM. In SRM, bail-in is used as a template and significantly reduces the likelihood of full use of ESM funding. As such, the initial engagement to sharing of liability has been brought to a minimum. It is however difficult to say whether the northern coalition has also gained most out of the negotiations as this is a matter of valuation.

3. European institutions are created with utility objective to serve Member States. As integration in financial services touches upon the sovereignty of Member States, they will keep institutions on a short leash and reverse powers if necessary. Member States will only confer powers if necessary and to their interests.

Following this assumption, the financial regulatory institutions EBA and ECB have gained powers for functional reasons. Their amount of powers is balanced against their functionality, and as soon as the balance gets skewed, it is expected that Member States will intervene and make sure that the equilibrium gets recovered. In the wake of the crisis, both the EBA and the ECB stood for challenges that they had never faced before. The ECB has taken the lead by the expanding its supervisory measures and by the introduction of monetary measures that were on the brink of acceptance of the treaty. Following liberal intergovernmentalist assumptions, Member States would not accept this amount of 'free-riding' of its institutions. It would be likely that Member States would call the ECB to account and keep the ECB on a short leash. Even though there have been calls (especially from Germany) to take action and limit the ECB's freedom to act, the ECB has not been called to justice. Instead, its expanding powers were confirmed by the transfer of supervisory powers in the SSM. The fact that the ECB has taken up initiative when this was needed has most certainly played parts in this decision. The powers and information sources of the EBA, a fairly young institution, have showed insufficient to conduct good coordination of supervision and produce a reliable stress-test. At first sight, it would maybe be assumed that it would be granted more powers and cooperation from Member States to ensure the good functioning of the institution. In the SSM however, the powers of the EBA are rather weakened than strengthened. EBA will have to coordinate the development of the single supervisory book with the ECB and the ECB has indicated to start undertaking stress-tests as part of its supervisory tasks. Even though the ECB has gone beyond its intended powers, Member States prefer this strong and credible institution to carry out supervision. In this case, the expansion of powers of the ECB has worked in its benefit.

8 Conclusion

The European answer to the sovereign debt crisis is the move towards a banking union. A banking union should restore credibility in the financial sector and prevent for future feedback loops between banks and sovereigns. The first step towards this banking union is the establishment of a Single Supervisory Mechanism and the establishment of direct bank recapitalization through the ESM. The next step is the Single Resolution Mechanism, which is still under negotiation at the time of writing this thesis. The last component, the Deposit Guarantee Scheme, is currently still far from being achieved and has been left outside the scope of this thesis. All components of a banking union seem straightforward, but details can make large difference on the impact of the system, especially when it is under stress. One important decision aspect is the amount of powers that will be conferred on European financial surveillance institutions. The delegation of decision making powers to institutions such as the ECB and the EBA are very sensitive as they can touch on the sovereignty of Member States. This thesis has tried to unravel which are the dominant political pressures in the integration process towards a banking union and how they influence the powers and position of the ECB and EBA in the banking union.

To find out which are the dominant political pressures in the negotiation process towards a banking union, two theories have been tested. The first theory, the theory neo-functionalism, assumes that the incentives to move to a banking union came from spillover effects that Member States had to (more or less) automatically respond to. Furthermore it was expected that European institutions are in favour of more integration and they would successfully influence the decision making process. As a result, the outcomes of the negotiation process so far would largely reflect their preferences for a banking union. Although spillover effects are the underlying reasons for which a banking union is needed, this has not triggered Member States to come in action; it was rather the crisis that caused this effect. An automatic response could also not be identified as this would mean a fast and efficient implementation of the banking union, while delegating enough powers to institutions. There has been much controversy on each of the aspects of a banking union and Member States are far from keen to give institutions sufficient powers. It has been shown that European institutions favoured the move towards a banking union and that they have brought up the subject of supervision and regulation quite a few times. However, this has not activated Member States to move to a more integrated system, and the preferences of institutions are reflected in the outcomes so far only to a limited extent. Even so, pressures from institutions have not gone without response. The move towards a banking union is made and the setup of the banking union follows the Commission's proposal on broad lines.

The second theory that has been tested is liberal intergovernmentalism, that puts more emphasis on the interests of states. According to this theory, national positions are shaped by a variation of domestic pressures. The generated national position is widely supported and cuts across coalitions. In the international context, states are expected to be rational and act on their goals purposively and balance decisions against their interests. Following liberal intergovernmental assumptions, the outcome of the banking union so far is determined by the relative bargaining position of Member States, and their ability to make compromises. It was found that the national position was broadly supported across the country and was shaped along the line of economic national interests. Pressures from social groups in the domestic sphere have become apparent especially in the case of Germany. In France, the large political change after elections changed the French attitude, but its underlying preferences remained equivalent.

In the negotiation process, the larger coalition of southern countries, pledged for fast move to a banking union and the adoption of a European bailout fund with a solid backstop. A smaller coalition of northern European countries have however put emphasis on national responsibilities and has aimed to adopt a regulatory and supervisory framework before (minimal) European funding would be in place. In the current outcome compromise and linkage deals can be found; the southern coalition has committed the whole Euro area to funding measures and eventually, direct recapitalisation by the ESM. Also, it was ensured that all banks fall under the final supervision of the ECB so that the SSM forms a good basis for further steps in the banking union. The northern country grouping has however put restraints and delay on sharing of liabilities through the order in which aspects of the banking union are put in place. Also, it is likely that the amount of funding will be significantly reduced by the application of bail-in. In liberal intergovernmental theory, it is furthermore argued that institutions are kept on a short leash and powers will be reversed if they go beyond original intentions or touch upon the sovereignty of Member States. In the wake of the crisis, the ECB has acted decisively and expanded its measures in monetary policy. The ECB has operatedon the brink of acceptance under the current treaty and has become actively involved in the political discussion on the establishment of a banking union. Through the appointment of the ECB as supervisor in the SSM, its new powers have however been confirmed rather than disciplined.

Although functional spillovers are on the basis of the need for integration, a crisis was needed to convince countries to move towards a banking union. Institutional pressures have given pressures in the bargaining process, but overall, liberal intergovernmental pressures seem dominant in the decision making process to a banking union. Important decisions such as the order in which aspects are installed, the pace of the decision making process, the amount of powers that is conferred on institutions and the amount of money that is made available in bailout and backstop funds is still largely dominated by the interests of states and their relative bargaining positions. For the ECB, this means that their direct supervisory powers have been limited to the largest 130 credit institutions. The large differences in the opinion of countries in the bargaining process also mean that the consolidation of the SRM takes longer. The northern coalition is still aiming to restrict the funding arrangements through a resolution fund and the ESM and this can cause delay and can even be blocked. This is unfavorable for the ECB, as it can cause difficulties and limitations in their operations as single supervisor. For the EBA, the decisions in the banking union cause a redirection of its activities in the coordination of supervision as they are no longer the only coordinating institution in the EU. The EBA will have to interact and harmonize its actions with the ECB. The EBA was given a mandate to set out best supervisory practices in a supervisory handbook, but enforcement powers were not given.

It has however also been showed that, depending on ex-ante and ex-post constraints, institutions are able to expand their powers. In the wake of the crisis, the ECB has acted on the brink of acceptance under the existing treaty and has maneuvered itself in a position in which it would be extremely hard to call back powers. In the light of the crisis, action was needed and the ECB could exercise measures that would calm the markets. The current negotiation process has resulted in somewhat incomplete transfer of powers to the ECB, but this leaves open some space of maneuver for the ECB. It is not unlikely that the ECB will again use this space and exercise its powers to the fullest extent (or beyond). In the current process towards a SRM, the ECB has taken on a swift approach by the announcement of a supervisory risk assessment, even before the BRRD has been adopted. The EBA is less likely to be able to expand its powers. With the move towards a banking union, its supervisory powers have been restricted rather than expanded, even though this would fit well with its task in the creation of a single rulebook. The EBA is a fairly small and inexperienced institution with limited powers. Partly because the EBA is a EU 27 institution, large change would have to take place for the EBA to gain more powers in the field of supervision.

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