


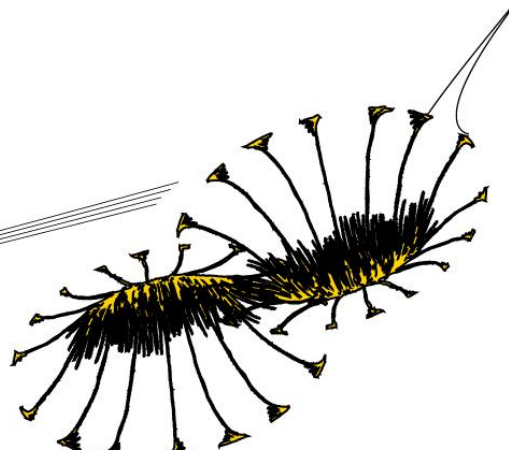


MASTER THESIS



The Final Leg of An Ambitious Project:
Who decides? Resolving Cross-Border Failed
Banks in the European Union

Analysis of the Establishment of the Single Resolution
Mechanism (SRM) through a Neofunctionalist and
Liberal Intergovernmentalist Lens



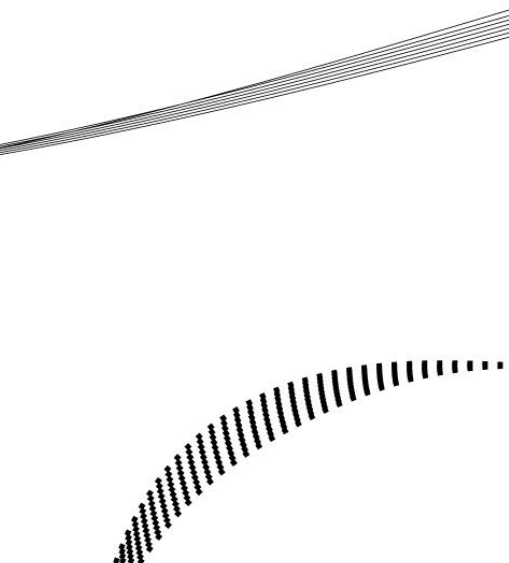
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Date of Graduation: 27 August 2014



Abstract

The present study examines the establishment and integration process of the final element of the ambitious European Banking Union project, i.e. the Single Resolution Mechanism (SRM), through the lens of two European Integration theories: Neofunctionalism (NF) and Liberal intergovernmentalism (LI). The research question to be answered was: *“Why is there such a great gap between demand for and supply of a Single Resolution Mechanism (SRM) with a centralized Resolution Authority and a Single Bank Resolution Fund (SBRF) at EU level and how can Neofunctionalism and Liberal intergovernmentalism explain the establishment of this crucial element of banking Union?”* To answer the research question, a single case study research and a congruence analysis have been carried out in order to see which theory is more successful at explaining the institutional supply of regulation in the field of banking resolution and restructuring at EU level. The qualitative research method of “content analysis” was adopted for data collection and data analysis. Lastly, regarding the main findings of this study, even though NF is successful at supplying part of the SRM, i.e. regulation with bail-in principle among others, the theory most successful at explaining the supply of regulation seems to be LI since the institutional set-up for the SRM was supplied by a process of interstate bargaining in which the most powerful states like Germany and other countries part of the Northern coalition managed to upload their preferences. The integration process was blocked by certain MSs who had a high degree of relative bargaining power based on their power resources, i.e. ability to pay both for their banks and into a common fund, as well as on their intensity of preferences. Supranational actors and other non-state actors did not supply the institutional set-up for the SRM. Power politics is the answer for the research question.

Keywords: European integration theory, Banking Union, Single Resolution Mechanism (SRM), Qualitative Data Analysis, single Resolution Authority, Single Bank Resolution Fund (SBRF), Supranational and National Actors

Acknowledgements

I am particularly grateful to both of my supervisors for assisting me in writing this thesis. First of all, I would like to thank my first supervisor Dr. Shawn Donnelly for his guidance providing me with useful insights into the topic during several discussions. In turn, I would also like to thank Prof. Dr. Karsten Mause who agreed to be my second supervisor and provided me with helpful comments.

Thanks go to Prof. Dr. Kees Aarts for assisting me with the methodological aspects of this thesis. I am grateful for his feedback on the methodology and research design of my thesis.

Last, but certainly not least, I would like to thank my parents and my partner who always supported me during this project.

August 27th, 2014,

Elena Rios Camacho

Table of Contents

1. Introduction	1
1.1 Research Question and Goal of the Thesis.....	3
2. Theoretical & Analytical Framework: European Integration Theory.....	8
2.1 Literature Review.....	8
2.2 Neofunctionalism & Liberal Intergovernmentalism	9
2.2.1 Theory Selection	9
2.2.2 Neofunctionalism (NF)	9
2.2.3 Liberal Intergovernmentalism (LI).....	13
2.2.4 Conclusion.....	18
2.3 Application of NF & LI: The Case of the Single Resolution Mechanism (SRM)	20
2.3.1 Application of Neofunctionalism to the SRM.....	20
2.3.2 Application of Liberal Intergovernmentalism to the SRM.....	22
2.3.3 Conclusion.....	25
3. Research Methodology and Operationalization	26
3.1 Research Design and Methodology.....	26
3.2 Operationalization and Measurement.....	28
3.3 Conclusion.....	29
4. Empirical Analysis: Explaining the Integration Process of the SRM.....	31
4.1 Pre-Crisis Banking Resolution Landscape and <i>De Larosière Report</i>	31
4.2 The Creation of the SRM: Actors' Preferences and Influence.....	32
4.2.1 Commission's Proposals: From the BRRD to the SRM Regulation.....	32
4.2.2 National Actors' Preferences and Interests	35
4.2.3 Supranational Actors' Preferences and Interests.....	40
4.2.4 Final Outcome: The Role of Power in the Negotiations on the SRM	44
4.3 Corroboration of Hypotheses	52
4.3.1 Demand for a SRM at EU level.....	52
4.3.2 Supply of a SRM at EU level	53
4.4 Conclusion.....	56
5. Final Conclusion	58
References.....	60
ANNEX I	71
ANNEX II.....	74

List of Abbreviations

ACPR	Autorité de Contrôle Prudentiel et de Résolution
BaFin	Bundesanstalt für Finanzdienstleistungen
BRRD	Bank Recovery and Resolution Directive
DGF	Deposit Guarantee Fund
EBA	European Banking Authority
EBU	European Banking Union
EC	European Community
ECB	European Central Bank
EDP	Excessive Deficit Procedure
EP	European Parliament
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
FGD	Fondo de Garantía de Depósitos
FGDR	Fonds de Garantie des Dépôts et de Résolution
FSB	Financial Stability Board
IGA	Intergovernmental Agreement
LI	Liberal Intergovernmentalism
MEP	Member of the European Parliament
MS	Member State
NF	Neofunctionalism
NRAs	National Resolution Authorities
SBRF	Single Bank Resolution Fund
SMEs	Small and Medium Enterprises
SRB	Single Resolution Board
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
TFEU	Treaty on the Functioning of the European Union

1. Introduction

“Today’s compromise allows us to complete the architecture of the banking union for the eurozone [...] The Single Resolution Mechanism might not be a perfect construction but it will allow for the timely and effective resolution of a cross border bank in the eurozone thus meeting its principal objective”

Internal Market and Services Commissioner Michel Barnier

(Commission, 2014, p. 1)

This study aims at analyzing the establishment and integration process of the final element of the Banking Union project in the European Union, i.e. the Single Resolution Mechanism (SRM), through the lens of two institutional¹ supply theories: Neofunctionalism (NF) and Liberal intergovernmentalism (LI). Thus, both European integration theories are applied to this case in order to explain how the integration of this element of the European banking union is taking place at EU level. The objective is to conduct a congruence analysis of both theoretical approaches in order to highlight which of their elements are present and can explain certain integration outcomes. Also, since the level of analysis is the EU level, i.e. beyond the nation state, integration theory is appropriate as a subset of international relations theory. I focus on explaining integration and not on analysing European governance structures or outcomes. My initial main assumption is that elements of both theoretical approaches can be found in the case study considered. However, the main objective is to test which one of them is successful at explaining the integration outcomes. Moreover, with regards to the main actors that are analysed, I selected MSs (United Kingdom, France, Germany and Spain), EU institutions like the European Commission and the European Parliament, and other global actors like the European Central Bank (ECB), the International Monetary Fund (IMF), the European Systemic Risk Board (ESRB) and other international expert bodies like the Scientific Advisory Committee of the ESRB.

With regards to the relevance of my research topic above outlined, I will first place this in its context to highlight why it may be of a great interest and relevance to do research. As an introductory note, European policymakers have negotiated measures to complete the single market in financial services since the 1990s. However, whereas the internal market was more developed in areas such as trade, research and transport, the sector of financial services was still lagging behind. Debates about transferring more decision-making and monitoring competences to the EU level emerged in the aftermath of the 2008 global financial crisis (Spendzharova, 2013). In this sense, it is argued that the financial crisis opened a window for reforms in the EU financial architecture that could

¹ There exists no widely-agreed definition for “institutions” in the international relations theory. Mearsheimer defines them as a set of rules that determine how states should cooperate and compete with each other. These are negotiated by states and are normally embodied in organizations with their own personnel and budget (Mearsheimer, 1994-1995).

close the regulatory gap existing between cross-border banks and national bank resolution systems (Kudrna, 2012). The European Commission, international organizations like the IMF, financial industry groups and large cross-border financial institutions support more centralization and the creation of a SRM among other banking union reforms. However, many policy proposals have been confronted with the conflicting views of EU MSs (Spendzharova, 2013). More specifically, the 2008 global financial crisis made visible the limited regulatory integration of national bank resolution regimes (Kudrna, 2012). Therefore, the financial crisis highlighted the need for a European crisis management toolbox for cross-border banks since MSs' resolution regimes differed from each other. For instance, some countries bailed out banks while others tried to ring-fence a bank's assets within their territory (Schoenmaker, 2012). Also, according to Quaglia (2013), the key issue is burden sharing, i.e. the problem of sharing the costs of recapitalizing or winding down troubled cross-border financial institutions, especially in the highly integrated European financial market. The distribution of costs between the home and host countries and across the host jurisdictions in which cross-border financial institutions operate emerges as an important issue to tackle. Lastly, financial supervision, resolution and fiscal power are inextricably linked. Fiscal policy lies at the heart of national sovereignty which can explain the reluctance of certain MSs to create a pan-European resolution authority and fund. Also, the distribution of costs and benefits is likely to be unequal across the MSs. (Quaglia, 2013).

All in all, it is clear that there exists a demand for more centralized regulation in this field at EU level. However, there does not seem to be a "perfect" supply of regulations. The creation of a SRM to complete the banking union is seen as an ambitious project for the EU. However, following the recent events there are initial indications that there exist serious divisions that may threaten a successful agreement. This is puzzling. Why is there an undersupply of regulation in this field even though it is so functionally and politically desired?

Furthermore, in order to test both theoretical approaches, it is interesting to first address how they conceptualize the terms of "demand" and "supply" of regulation before analyzing them in detail in the next section. With regards to NF, Stone Sweet and Sandholtz argue that the role of transnational exchange and functional incentives is central to generating demands for regulation at the European level. And supranational institutions aim at supplying these things² (Rosamond, 2000). They also argue that once EC rules and regulations are in place, the institutionalization process triggered provokes

² According to Giandomenico Majone (1991, 1993, 1994, 1996), the EU can be seen as a "regulatory state". This "may be less of a state in the traditional sense than a web of networks of national and supranational regulatory institutions held together by shared values and objectives, and by a common style of policy-making" (Rosamond, 2000, p. 108). Regulation constitutes one of the functions normally undertaken by states. It is often defined as measures to tackle problems of market failure which reflects the EU's main focus on regulatory harmonization to guarantee the efficient functioning of the single market. Here the Commission constitutes the best actor for the successful execution of regulatory policy-making since it has agenda-setting powers and powers of scrutiny over the implementation of regulatory legislation (Rosamond, 2000).

further integration. This is because the key actors or transactors will always prefer one set of rules rather than twenty-eight, for example (Stone Sweet & Sandholtz, 1997).

On the other hand, LI argues that the stages of “national preference formation” and “interstate bargaining” shape demand and supply functions in the EC which is considered as a regime for international cooperation. Thus, firstly, the potential benefits of policy coordination are identified through a process of domestic preference formation which is perceived by national governments (“demand”). Secondly, “supply” is conceptualized as the outcome of a process of interstate bargaining. The interaction of demand (national preference formation) and supply (interstate negotiations) shape the foreign policy behaviour of states (Moravcsik, 1993).

To conclude, after having reviewed the existing literature dealing with the SRM, it is also interesting and relevant to address it from an institutional building perspective since most of the research material focuses mainly on the *rationales* behind its creation and what it stands for but not on the empirical testing of European integration theories on this case. For instance, several authors like Salines et al. (2012) and Kudrna (2012) focus mainly on the shortcomings of EMU visible in the onset and during the global financial crisis and the pre-crisis banking resolution landscape in the EU. Moreover, authors like Gandrud & Hallerberg (2013) and Veron (2013) analyze the proposals for the Bank Recovery and Resolution Directive (BRRD) and the SRM regulation. According to Gschwend & Schimmelfennig (2007), when defining the research problem the researcher needs to identify untested theories and unexplained observations. Thus, the main objective of the research project is to apply European integration theories to this new case. Also, some of the main background readings that have triggered my research study are Dyson (2010) who highlights the existence of “creditor” states and “debtor” countries and asymmetrical power relations between chronic debtor states and creditor states. He argues that even though institutionally we can speak of a “new Europe”, there are still different strategic interests and an asymmetry of power in agenda-setting and negotiating outcomes in the context of crisis management. Authority remains in the MSs. Schoenmaker (2012) also argues that national interests prevail in cross-border resolution. And Donnelly (2013) underlines the role of power politics in establishing EU financial stability as well as the position of certain MSs like Germany and others from the so-called Northern coalition which insist on institutionally reinforcing national self-help and autonomy.

1.1 Research Question and Goal of the Thesis

After having explained the context of my research topic and its relevance, I have tried to shape the problem above described into a specific, measurable, achievable, relevant and time bound research question.

My research question can be formulated as follows.

“Why is there such a great gap between demand for and supply of a Single Resolution Mechanism (SRM) with a centralized Resolution Authority and a Single Bank Resolution Fund (SBRF) at EU level and how can Neofunctionalism and Liberal intergovernmentalism explain the establishment of this crucial element of banking Union?”

The main underlying question is “Which factors explain the decision-making process regarding the integration of the SRM at EU level?” The independent variables are the explanatory factors of the process of integration (dependent variable). The explanatory factors are extracted from both theories and broadly speaking they refer to the question of “who is controlling the process of integration? Supranational organizations or the MSs?”

Furthermore, the present study aims at answering the following sub-questions.

- How can the SRM be measured?
- How can the development of the Commission’s proposals be explained?
- Which of both theoretical approaches is more successful at explaining the integration process of the SRM at EU level? Why?
- Are the main objectives for the creation of a SRM for banking union achieved? Why?

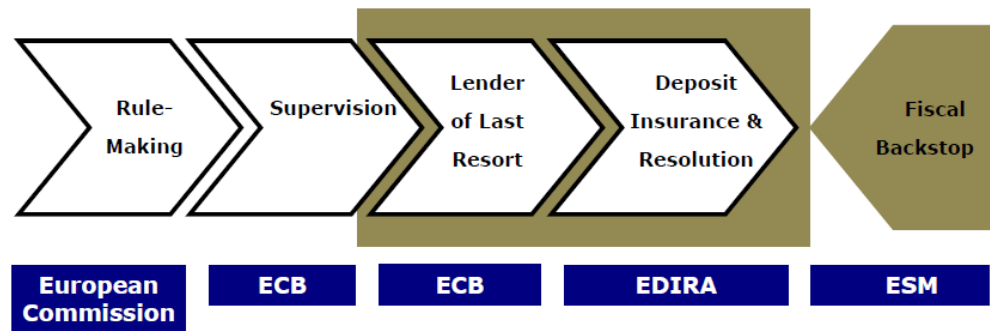
In order to make my research question empirically testable, its main concepts are briefly defined. The concept of “SRM” concerns the establishment of a resolution authority and a resolution fund at EU level. “Bank resolution” refers to specific legal regimes in charge of the orderly restructuring or liquidation of financial institutions (Veron et al., 2013). Resolution has four objectives: 1. guarantee the continuity of essential banking operations; 2. protect depositors, client assets and public funds; 3. reduce risks to financial stability; 4. and prevent the unnecessary destruction of value (Commission, 2012b). Generally a financial institution would be subject to resolution when it has reached a point of distress that makes impossible to recover the bank in time. And winding it up under normal insolvency proceedings would risk financial stability. Because of this systemic risk and the important economic function played by institutions, the normal insolvency procedures may not be adequate in some cases and the absence of effective crisis management tools has too often required the use of public funds to rescue banks³ (European Commission, 2012a). Resolution takes place when the bank is in a situation already close to insolvency. When the financial institution meets

³ In most countries, troubled financial institutions are subject to normal insolvency proceedings. However, as the experience from banking crises shows, insolvency laws are not always appropriate to efficiently resolve banks because they do not take into account the need to avoid disruptions to financial stability. Also, they imply lengthy negotiations in case of reorganization damaging debtors and creditors in terms of delay and costs. Therefore, resolution should obtain similar results to those of normal insolvency proceedings and also it takes into account the Union State aid rules, guarantees financial stability and protects the taxpayer (European Commission, 2012a).

those conditions, the resolution authorities should make use of a resolution toolbox to resolve the situation of the bank. The choice of these tools will depend on the specific circumstances of each case and will be based on the resolution plans for each financial institution (Commission, 2012b). These tools involve powers to: effect private sector acquisitions, i.e. parts of a bank can be sold without the consent of shareholders; transfer business to a temporary structure, also called “bridge bank”, in order to guarantee basic banking functions like having access to deposits; separate clean and toxic assets between “good” and “bad” banks by transferring assets; and bail in creditors. The bail-in tool refers to the fact that it is the creditors or shareholders the ones who rescue the financial institution and pay its debts. This is the procedure to restructure a bank or wind it down in an orderly manner. Moreover, in order to be effective resolution tools require a certain amount of funding. Thus a resolution fund is needed in order to limit the damage on other banks of the financial institution closing. It is important to mention that these measures which are always controversial within a country are new within the EU. They require strong regulatory authority since their role is to intervene in the property rights of firms, creditors and shareholders (Donnelly, 2013b).

Furthermore, the SRM is one of the European institutions conforming the architecture of the European Banking Union⁴ (see figure 1). According to Beck et al. (2013), the European Commission is in charge of rule-making and the ECB constitutes the supervisor and the lender of last resort for the European banking system. In case supervision does not manage to solve the banking problems, the next step is resolution (SRM) of the financial institution. It is well acknowledged that a SRM constitutes an essential supplement of effective supervision (Goyal et al., 2013). Schoenmaker argues for the combination of deposit insurance and resolution and the creation of a European Deposit Insurance and Resolution Authority (EDIRA). Moreover, as it can be observed in figure 1, the final step is the fiscal backstop provided by the European Stability Mechanism (ESM). If there is a need for a fiscal backstop, the SRM would have to function in close cooperation with the ESM. This is the reason why the arrow points backwards.

⁴ According to Quaglia (2013), the banking crisis in Spain reflected the existence of a vicious circle between the sovereign debt crisis and the financial crisis. Therefore, in 2012, the European Council and Euro Area Summit came to an agreement to deepen Economic and Monetary Union (EMU) creating a Banking Union. It was going to be based on four components: a single rule book; more integrated banking supervision/single supervision mechanism; a pan-EU deposit guarantee system and a single resolution mechanism.

Figure 1. Financial Supervision and Resolution in a Banking Union

Source: Beck et al. (2013, p. 39)

With regards to its main elements, the SRM at the EU level would have three main elements. According to Schoenmaker (2012), the European Resolution Authority (ERA) constitutes one of the main bodies in the European banking regime as suggested also by Posen and Veron (2009). The main task of the ERA is to resolve cross-border financial corporations operating within the EU. Moreover, the ERA is also envisaged as a single authority with a mandate able to develop resolution and recovery plans, take early intervention measures and carry out the restructuring tools of asset separation, transfer of business and bail-in, bypass shareholders' rights, establish bridge banks and wind up banks (Goyal et al., 2013). Besides this central body, the European Resolution Fund represents an important element of the new banking system since it constitutes the funding of the resolution authority (Schoenmaker, 2012). And lastly, it is important to mention that EU MSs would be asked to transfer resolution powers of their large cross-border banks to the EU level. This can be considered as politically very sensitive (Schoenmaker, 2012).

Furthermore, the goal of the thesis will be to contribute to the scholarly discourse on the relative importance and applicability of the two theories selected in the case of the SRM. The present research can be considered to be relevant when looking at future policy implications in the context of MSs' domestic politics. In this sense, the integration outcomes of the SRM may have a positive or negative impact on MS financial markets and on their economies.

With regards to the theoretical approaches and hypotheses formulated, they can be briefly summarized as follows. In the case of NF, I want to test whether the Commission, the EP and other international actors such as the IMF, ECB or ESRB play a dominant role in the integration process of the SRM. If NF is applicable, I expect that these actors play the key role. Also, regarding mechanisms of integration, I want to test whether functional incentives, i.e. functional reasons/demands for common benefits, play an automatic role and are decisive in the integration process. If this theory is applicable, I expect that this is the case and functional incentives end up in spillovers leading to supranationalization. In the case of LI, I want to test whether the relative bargaining power of MSs (UK, France, Germany and Spain) drives the integration process. If LI is applicable, I expect that the SRM is established as the result of

interstate bargaining where the most powerful states manage to upload their preferences and interests due to their higher degree of relative bargaining power.

With regards to the methodology followed, I will conduct a congruence analysis and a single case study research. Also, I will adopt a qualitative data analysis research method. I will make use of the content analysis technique since the empirical data that will be analyzed comes from official documents of the EU such as proposals for regulations and directives (COM(2012), COM (2013), etc.), press releases and statements; scientific research articles dealing with the case study in question and analyzing the national positions and interests of actors; newspaper and journal articles addressing the research topic (e.g. Financial Times, The Economist, Europolitics, European Voice and EU Observer); other media sources like interviews, speeches or statements of the relevant actors; and Eurostat data on MS public interventions to support financial institutions and financial markets during the financial crisis.

This study is structured as follows. The first section addresses the theoretical and analytical framework of the research study. The main assumptions and theoretical propositions of both theories are explained and their conceptual frameworks are applied to the case study in question in order to generate testable hypotheses. The second section offers a detailed overview of the research design and methodology as well as the operationalization of the main variables. The third section is the backbone of the present study since it constitutes the empirical analysis where the collected data is described and explained discussing whether the hypotheses are accepted or rejected. Lastly, the main conclusions, the answer for my research question and recommendations for further research are gathered in the last section.

2. Theoretical & Analytical Framework: European Integration Theory

“Integration is the process whereby political actors in several, distinct national settings are persuaded to shift their loyalties, expectations and political activities toward a new centre, whose institutions possess or demand jurisdiction over the pre-existing national states”

Ernst Hass

(Wiener & Diez, 2009, p. 2)

“The primary source of integration lies in the interests of the states themselves and the relative power each brings to Brussels”

Andrew Moravcsik

(Rosamond, 2000, p. 136)

The theoretical framework of this research consists of the European Integration theories of NF and LI. Here some of the main literature is briefly outlined and the theory is explained since the more fully a theory is specified, the better it can be tested and the more fully it can explain observations (Gschwend & Schimmelfennig, 2007). According to Gerring (2012, p. 199), “theory must be translatable into specific hypotheses involving individual causal factors and an outcome. In formalizing these elements a general theory is transformed into a causal model”.

2.1 Literature Review

First of all, the following books and scientific research articles have helped me to answer my research question. Two books, “European Integration Theory” by Wiener & Diez (2009) and “Theories of European Integration” by Rosamond (2000) are relevant for getting a first idea about European integration theory. With regards to the first one, the parts of the book which helped me are the chapters dealing with explaining European integration. This part mainly covers the theories of NF and LI. These chapters were highly useful for answering my research question because they outline and explain the main assumptions and concepts of both theories. With regards to the second book, it explains the main assumptions of both theories and their historical development in order to get a better understanding.

Furthermore, the scientific research articles of “Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach” (Moravcsik, 1993) and “Explaining the Treaty of Amsterdam: Interests, Influence, Institutions” (Moravcsik & Nicolaidis, 1999) have helped me to understand the demand and supply functions from a intergovernmentalist approach, the main concepts and variables influencing national preference formation and interstate bargaining to be taken into account when testing the two-phase Liberal Intergovernmentalist analytical framework. “European Integration and Supranational Governance” (Stone Sweet & Sandholtz, 1997) is useful to understand demand and supply from a neofunctionalist perspective.

Lastly, the work of many other authors (Hooghe & Marks, 2008; Peterson, 2001; Pollack, 2001; Verdun, 2002; Quaglia, 2010; Donnelly, 2013b) represents a significant source to get to know the dynamics of both theories in explaining integration.

2.2 Neofunctionalism & Liberal Intergovernmentalism

2.2.1 Theory Selection

First of all, at the heart of NF and LI are the own interests of the actors (international organizations, businesses, banking associations, heads of government) deciding on integration. According to Pollack (2009), the “rational approach” refers to the fact that actors are considered to be strategic utility-maximizers whose preferences are taken as given. However, it is important to mention that NF focuses on structure, whereas LI focuses on agency. Therefore, both theories hold different assumptions about how integration takes place, crucial actors, and integration mechanisms (Verdun, 2002).

Furthermore, these two integration theories were selected for the following reasons. In the first place, my goal is to explain integration processes and not to analyse European governance. These two macro-theories of integration seem to be suitable for this purpose since they are designed to describe, explain and predict European integration as a process (Wiener & Diez, 2009). Secondly, the level of analysis is European. Therefore, the focus is on actors like EU institutions and other international organizations, as well as the MSs. Moreover, NF is a theoretical approach still relevant for explaining integration at EU level. LI works well when there exist clear and intense preferences, positive-sum benefits and problems about credible commitments (Moravcsik & Schimmelfennig, 2009). Lastly, both theories are seen as “competing” theories which can serve to conduct a congruence analysis in order to see which of them is more successful at explaining the integration of the SRM.

Regarding possible weaknesses of both theories, NF has been criticized for underestimating the role of national governments and paying no attention to domestic political processes (Niemann & Schmitter, 2009). It does not take into account the fact that if strong leaders are against: integration comes to a halt. According to rational-choice institutionalism, LI is not able to explain everyday decision-making. It focuses only on intergovernmental decision-making at treaty-amending moments (snapshot view of reality) ignoring the role of supranational actors, unintended consequences and path dependence (Moravcsik & Schimmelfennig, 2009). Also, LI is too rationalist because it ignores values and identities. Besides, LI assumes state interests to be monolithic since it does not explain how national actors are coordinated between levels of governance (Peterson, 2001). Another issue to take into account is that these integration theories formulated in the 1950s and 1960s do not account for factors like the global economy and increasing interdependence (Verdun, 2002).

2.2.2 Neofunctionalism (NF)

NF was first formulated in the late 1950s and early 1960s, mainly through the work of Ernst Haas and Leon Lindberg in the context of the establishment of the European Coal and Steel Community (ECSC) and the European Economic Community (EEC)

(Niemann & Schmitter, 2009). Since the beginning, NF understood itself as a “grand” or general theory of integration. Neofunctionalist theorists followed functionalist ideas and tried to explain the departure from the anarchic state system towards supranational institution-building. They put emphasis on societal and market patterns and how they push elites towards supporting supranational institutions in their policy domains. NF focuses on the mechanisms of technocratic decision-making, incremental change and learning processes (Niemann & Schmitter, 2009).

With regards to its main assumptions, the theory looks at integration as a *process* rather than as isolated events as it is the case of intergovernmentalists. NF is considered to be “pluralist” since it assumes that “integration” consists of multiple, diverse and changing actors who can operate across national borders. Also, neofunctionalists argue that actors are rational and self-interested being able to learn and change their preferences. Another basic tenet of NF is that integration is a gradual and self-sustaining process and characterized by positive sum games. Neofunctionalists do not agree with the realist assumption that all games played between actors are zero-sum in nature (Niemann & Schmitter, 2009). According to Rosamond (2000), institutions constitute the setting of these positive sum games since they provide information, transparency and trust.

Furthermore, the main key abstract concepts of this theoretical approach are explained by adopting the dichotomy “actors and mechanisms”. The actors considered to play the crucial role during the integration process as well as the mechanisms driving integration are outlined.

Key Actors

With regards to its main actors, Neofunctionalists see the EC as a “creature of elites” (Niemann & Schmitter, 2009). Haas argues that elites groups become aware of the fact that certain problems relevant for them cannot be solved at the national level. Thus, these groups will push and demand for a transfer of competence to a supranational institution able to tackle them. This leads to the centralization of the issue in question if the problem is important enough and these groups have sufficient political support (Stone Sweet & Sandholtz, 1997). Therefore, governments are seen as reactive playing a marginal role (Stone Sweet & Sandholtz, 1997).

Apart from national and international actors advocating for further integration, it is important to mention that NF considers the existence of a high authority which becomes the main promoter of further integration. It has two main goals: to deepen economic integration in other economic sectors and to increase the institutionalization process upholding its status of authority at the regional level. This high authority, which in the case of the EU can be identified with the Commission, employs strategies to achieve these goals. It acts as a constant advocate of the advantages of integration by highlighting the relationships between sectors (Rosamond, 2000). But it can also act as a political entrepreneur by organizing private-sector groups to promote its policy goals. For example, it is well acknowledged that the Commission often establishes (and

sometimes funds) working groups and committees comprising companies and other non-state actors (Sandholtz & Stone Sweet, 2010).

Mechanisms

The main mechanisms driving integration and implying certain degree of automaticity include the concepts of “spillover” and “path-dependence” (see figure 2). The concept of “spillover” refers to the fact that the integration of one policy field can cause pressures on states which then inevitably have to integrate other sector due to their interdependency and to possible unintended consequences or externalities (Wiener & Diez, 2009; Rosamond, 2000). Also, among the conditions for spillover, it is important to mention that functional pressures have to be seen as compelling, i.e. the issue area has to be salient and interdependent with other strong areas (Niemann & Schmitter, 2009). Moreover, the concept of spillover has three dimensions:

Functional Spillover

It occurs when integration in one policy area is incomplete and undermines the effective functioning of existing policies in other areas, thereby creating pressures and functional demands for deepening and widening policy coordination (Moravcsik, 1993). The issues relate to technical matters (“low politics”) and not to politically sensitive areas of policy-making (“high politics”) (Verdun, 2002).

Political Spillover

The integration process starts when some economic and political *agents* (societal groups, expert bodies or government bureaucracies) consider functionally practical (e.g. high transaction costs) and of substantial interest for them to transfer these issues to the supranational level (Verdun, 2002). In this sense, it is important to mention that NF highlights the autonomous influence of supranational institutions and the role played by organized interests (Niemann & Schmitter, 2009). The theory suggests that interest groups would demand further integration once they are aware of the benefits of existing integration (Niemann & Schmitter, 2009). These actors shift their loyalties towards a new centre by demanding further integration (Wiener & Diez, 2009). They start to promote a self-sustaining process of institution-building. In the case of the EU, these are officials and parliamentarians in Brussels, Luxembourg and Strasbourg (Moravcsik, 1993).

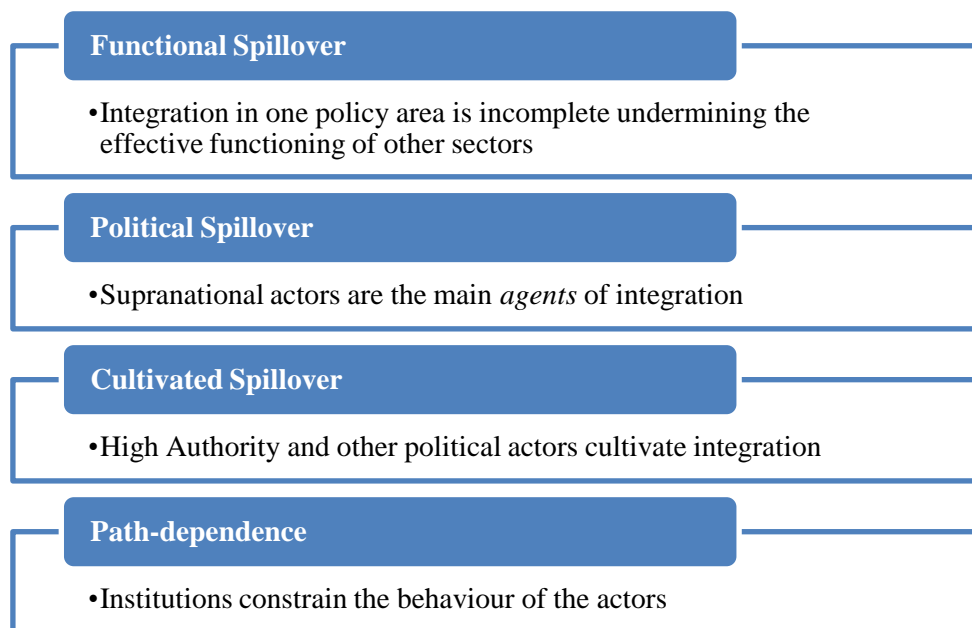
Cultivated Spillover

Especially actors responsible for governance at the supranational level are considered to “cultivate” integration because they may have interests in deeper integration. In the context of the EU this role is mainly played by the Commission (Wiener & Diez, 2009). Moreover, epistemic communities are said to facilitate learning and the promotion of functional incentives and *rationales* fostering integration (Stephenson, 2010). However, the following factors condition its capacity to cultivate spillovers: its ability to establish internal cohesion and shape the agenda by proactively making proposals; its capacity to

cultivate relations with member governments or other actors to guarantee support for its policies; its ability to build consensus while upgrading common interests; and its ability to instrumentalize functional pressures by advocating the advantages of further integration (Niemann & Schmitter, 2009). Another factor that may influence its ability to cultivate integration is the absence of effective interest groups as potential allies. In this situation, the Commission's impact remains very marginal. Commission's influence is most effective when it is backed up by a powerful MS (Niemann & Schmitter, 2009).

The other mechanism driving the integration process is *Path-dependence*. According to Moravcsik (1993), the dynamic and complexity of "spillover" is likely to trap governments and expose them to unintended consequences triggered by previous commitments. Therefore, institutions can cause unintended consequences making the integration process irreversible (Wiener & Diez, 2009). In this sense, Fritz Scharpf's concept of "joint decision trap" refers to this reality, i.e. the highly irreversible nature of integration. Even though the EC gives MSs the opportunity to solve joint problems, deliberations and outcomes are sub-optimal because the EU institutional system has set up a "decision logic" (Rosamond, 2000). Hence, institutions are likely to constrain and shape the preferences of member governments (Rosamond, 2000). Following Tsebelis's words, "the prevailing institutions (rules of the game) *determine* the behaviour of the actors, which in turn produces political or social outcomes" (Rosamond, 2000, p. 122).

Figure 2. Neofunctionalist Framework of Analysis



Source: Own elaboration according to Wiener & Diez (2009), Sandholtz & Stone Sweet (2010), Moravcsik (1993)

To conclude, NF has the following general theoretical propositions and expectations. First of all, *the integration of particular economic sectors across nations will create functional pressures for the integration of related economic sectors. Functional*

incentives should lead to binding commitments of national governments in order to guarantee economic openness and institutional development to pursue the common interest. This may include the delegation of sovereignty and national competencies to a supranational institution and the mutual commitment of material resources. Therefore, NF expects that incentives/technical reasons to cooperate based on absolute gains and high interdependency (Pareto optimality) make member governments to cooperate and safeguard welfare gains by establishing supranational institutions. The independent variable is the functional pressures and incentives for integration and the dependent variable is the success or not of the integration process. Secondly, *integration takes place because other economic and political actors beyond the nation state shift their loyalties from the national to the supranational level. They seek the most effective way for fulfilling their material interests* (Rosamond, 2000). The independent variable is the transfer of loyalties to the supranational level and the dependent variable is the success or not of integration.

Furthermore, *the Commission's role to cultivate integration is expected to drive integration.* The independent variable is the Commission's capacity to cultivate integration and the dependent variable is the success or not of the integration process. And fourth, *the preferences of MSs' governments are expected to be constrained by previous commitments and thus, integration occurs because actors have to follow a path and are not fully independent to make decisions (path-dependence).* The independent variable is the locked-in status of MSs' governments and the dependent variable is the integration outcome. Moreover, Neofunctionalists expect that deeper economic integration would lead to political integration, thus "politics would follow economics" (Rosamond, 2000, p. 60).

2.2.3 Liberal Intergovernmentalism (LI)

LI builds on the earlier approach of "Intergovernmental institutionalism". It improved the theory of interstate bargaining and institutional choice. Also, it incorporated a theory of national preference formation (Moravcsik, 1993). LI follows up on the core arguments of Realism which argues that states are self-interested actors operating in an anarchic environment formulating their preferences after evaluating their position in the system of states⁵. This involves minimizing risk and maximizing benefits (Rosamond, 2000). LI considers states as rational actors which calculate the utility of alternative courses of action and choose the one that maximizes their utility under the

⁵ According to Hoffmann, nation states constitute the basic units in international politics. He also distinguished between "high" and "low" politics to explain why integration was possible in some technocratic areas while in more controversial ones it was likely to generate conflict. He argued that, in areas where national autonomy is at stake, "nations prefer the certainty, or the self-controlled uncertainty, of national self-reliance, to the uncontrolled uncertainty of the untested blender" (Rosamond, 2000, p. 77). Moreover, Realism holds a pessimistic view on international cooperation since states are worried about power and this leads to conflict and competition. Therefore, even though, they may have common interests, they often do not come to an agreement. And international institutions do not affect international cooperation (Grieco, 1988). Also, according to Waltz, states are worried about maintaining their position in the system by preventing increases in other states' relative capabilities (Grieco, 1988, p. 498).

circumstances⁶ (Moravcsik & Schimmelfennig, 2009). According to Moravcsik (1998), these choices and preferences are determined by constraints and opportunities based on the economic interests of powerful domestic constituents, the relative bargaining power of each state and the role of institutions supporting credible commitments⁷ (Moravcsik & Schimmelfennig, 2009).

Key Actors

With regards to its main actors, national governments represent the key dominant actors in European integration, pursuing national interests, bargaining and institutionalizing integration to remain in control (Moravcsik & Schimmelfennig, 2009). MSs are the “masters of the Treaties” enjoying decision-making power *par excellence* (Wiener & Diez, 2009). Integration is considered a state-led process (Rosamond, 2000). Besides this key actor, institutions play also an important role in integration by facilitating positive-sum bargaining. MS use the institutional environment of supranational organizations such as the Commission and the EP to legitimate decisions and to pursue their preferences (Rosamond, 2000). MSs’ decision-making capacity is said to be enhanced by supranational institutions, and not constrained by them (Wiener & Diez, 2009). According to Moravcsik & Schimmelfennig (2009), the fact that LI puts emphasis on the pooling and delegation of sovereignty indicates that institutions matter. However, they are passive because they do not have a will on their own, but help states by reducing transactions costs and by providing the necessary information so that states know each other’s preferences.

Mechanisms

With regards to its main mechanisms explaining integration, the concepts of “national preference formation”, “interstate bargaining” and “institutional choice” are of key importance since they constitute LI’s conceptual framework (see table 1). According to LI, interstate cooperation has three stages: the formulation of national preferences⁸, the substantive bargaining process, and the creation or adjustment of institutions to secure outcomes (institutional choice) (Wiener & Diez, 2009).

National Preference Formation

In the first stage of the model, national chiefs of government (COGs) aggregate the interests of their domestic constituencies together with their own interests, and formulate national preferences in response to functional policy interdependence. The demand side of integration is embodied in this stage. This is a highly complex process where some dynamics are common across states: “the primary interest of governments is to maintain themselves in office... this requires the support of a coalition of domestic

⁶ According to Mearsheimer (2001), powerful states have the following patterns of behavior: “fear” due to a possible variation in the distribution of power; “self-help” due to the wish to survive; and “power maximization”, i.e. states seek the best way to survive.

⁷ States seek “credible commitments” because they want to ensure that other states comply with their promises and that their cooperation generates “balanced” gains (Grieco, 1988).

⁸ According to Moravcsik, states may promote further integration in order to safeguard commercial advantages for producers, and economic interests subject to macro-economic preferences (Wiener & Diez, 2009).

voters, parties, interest groups and bureaucracies, whose views are transmitted, directly or indirectly, through domestic institutions and practices of political representation. Through this process emerges the set of national interests or goals that states bring to international negotiations” (Rosamond, 2000, p. 137). This relationship is considered to be one of principal-agent: principals (domestic groups) delegate power to agents (governments) (Moravcsik, 1993). LI sees the state as a unitary actor and argues that national preferences differ among states and within the same state according to issue-specific societal interdependence (Moravcsik & Schimmelfennig, 2009).

With regards to the independent variables influencing national preference formation, one of them is issue-specific interdependency. According to Moravcsik (1993), the primary determinants of national preferences are the *distribution of costs and benefits* of economic interdependence. Therefore, costs and benefits are the main independent variables of national preferences. More specifically, the magnitude, distribution and certainty of expected costs and benefits can be used to predict national preferences (Moravcsik, 1993). Regarding the distribution of benefits, governments tend to have different preferences even though agreements may be mutually beneficial. These different preferences regarding the distribution of benefits lead to conflicts over the terms of cooperation since costs and benefits are often unevenly distributed among states. MSs and domestic groups that face most costs are likely to oppose to integration. Important domestic groups calculate their interests taking into account the expected gains and losses of integration. On the one hand, when the costs and benefits of alternative policies are significant, certain and risky, domestic groups tend to mobilize politically (Moravcsik, 1993). On the other hand, when the costs and benefits of alternative policies are insignificant, diffuse and the risk is low, constraints on the government are looser (Moravcsik, 1993). Another determinant of national preferences is the concept of *vulnerability*. Some governments are more vulnerable to negative externalities and therefore tend to support integration.

Interstate Bargaining

In the second stage, MSs’ national governments take their preferences to the bargaining table in Brussels in order to achieve Pareto-improving solutions and resolve distributional conflicts. In this process, state actors are rational and unitary, i.e. only state actors represent the aggregated preferences of a nation, no other forms of influence from domestic level. Bargaining theory argues that the outcome of interstate negotiations is determined by the *relative bargaining power* of the actors, i.e. power and resources available to the MSs, the size and strength of competing coalition of states and patterns of asymmetric interdependence (Moravcsik & Schimmelfennig, 2009). Relative bargaining power is also determined by *asymmetries in the relative intensity of national preferences* which reflect the costs and benefits of policy coordination to remove negative externalities (Moravcsik, 1993). Therefore, these factors may be determined by the existence of: *unilateral policy alternatives and threats of non-agreement, alternative coalitions and threats of exclusion*, and the *potential for compromise and issue linkage* (Moravcsik, 1993). The first one refers to the fact that

when there is a policy alternative more desirable than cooperation, then the state government will not be willing to reach an agreement. This determinant of bargaining power is based on *asymmetrical interdependence*. State governments that gain less from agreement enjoy greater bargaining leverage (Moravcsik, 1993). Therefore, they are in the position to threaten the others with non-agreement and force them to make concessions. Those who can gain the most economically from agreement compromise the most on the margin for this whereas those who gain the least enjoy more power to impose conditions (Moravcsik & Schimmelfennig, 2009). They are able to manipulate the outcome to their advantage (Moravcsik & Schimmelfennig, 2009). With regards to the determinant of the existence of alternative coalitions and the threat of exclusion, sometimes an alternative coalition is formed strengthening the bargaining power of coalition members vis-à-vis those threatened to be excluded (Moravcsik, 1993).

Lastly, regarding the potential for compromise, side-payments and linkage at the margin, it is important to mention that since a range of agreements preferred to the status quo can be derived from unilateral and coalitional policy alternatives, relative bargaining power will be determined by the *intensity of preference at the margin*. When there is uncertainty about the collapse of negotiations or time pressure, governments most in favour of agreement will make concessions. However, when there is not uncertainty, the final agreement will reflect the relative intensity of preferences at the margin and the feasible set (Moravcsik, 1993). Marginal gains in some areas are more important to some governments than to others. It can be advantageous for governments to exchange concessions thereby adopting a “package deal” with advantages for all (Moravcsik, 1993). It is important to mention that issue linkages are most probable in issues where the preferences of domestic groups are not intense.

Table 1. Liberal Intergovernmentalist Framework of Analysis

<i>Stages of Negotiation</i>	<i>National Preference Formation</i>	<i>Interstate Bargaining</i>	<i>Institutional Choice</i>
Alternative independent variables underlying each stage	What is the source of underlying national preferences? Economic interests or Geopolitical interests?	Given national preferences, what explains the efficiency and distributional outcomes of interstate bargaining? Asymmetrical interdependence or Supranational entrepreneurship?	Given substantive agreement, what explains the transfer of sovereignty to international institutions? Federalist ideology or Centralised technocratic management or More credible commitment?
Observed outcomes at each stage	Underlying national preferences	Agreements on substance	Choice to delegate or pool decision making in international institutions

Source: Moravcsik (2008, p. 160)

Furthermore, Moravcsik adopts the Putnam's idea of two-level games⁹ to explain European integration. Moravcsik's model of a two-level game includes two dimensions: national preference formation and interstate bargaining (see figure 1 in Annex I). In the first one, national preferences arise in the context of the domestic politics of the MS (Rosamond, 2000). In the second dimension, interstate negotiation takes place at the European level. According to Moravcsik (1993), domestic politics constitute an independent variable of national preferences since state governments act in the international arena on the basis of the interests defined domestically. The Council of Ministers is considered as the primary forum for bargaining between governments in the EU context. There national ministers defend their national interests and preferences and negotiate in a particular policy area (Rosamond, 2000).

Institutional Choice

LI considers supranational organizations as tools to improve the efficiency of interstate bargaining. EU institutions act as agents of the MSs and reduce coordination and commitment problems. They increase the power of governments by enhancing the efficiency of interstate bargaining and the autonomy of national leaders in relation to specific social groups of their domestic polity (legitimacy) (Moravcsik, 1993). Moreover, the EC offers the MS the *pooling* of national sovereignty through qualified majority voting (QMV)¹⁰ rules and the *delegation* of sovereign powers to central institutions. The decision to pool or delegate sovereignty to central institutions is the result of a cost-benefit analysis. According to LI, there are three conditions likely to make governments pool or delegate decision-making to a supranational organization.

First of all, the *potential benefits from cooperation*: the less attractive the status quo and the greater the expected benefits from policy coordination, the greater the incentive to pool or delegate. Secondly, the *level of uncertainty of pooled or delegated decisions*: bargaining under unanimity may be preferred over QMV or delegation in cases where agreements are certain in order to block policies. And lastly, the *level of political risk* for governments with intense preferences: governments may pool or delegate sovereignty only in cases where there is little probability of biased decisions against their own national interests (Moravcsik, 1993). Moreover, according to Donnelly (2013b), states establish credible commitments and institutions on the basis of power politics. This has two consequences: stronger countries can upload their interests at the expense of other national preferences thereby using institutions to constraint and impose their interests on others less powerful states.

To conclude, this theory has the following general theoretical propositions and expectations. First, *integration happens through interstate bargaining among the MSs*

⁹ According to Putnam, national executives play games in two arenas more or less simultaneously: domestic and international. In the domestic arena, power-seeking office holders want to build coalitions of support among domestic groups. In the international arena, they bargain to enhance their position domestically by meeting the demands of the most important domestic voters (Rosamond, 2000).

¹⁰ According Moravcsik (1993), QMV makes the decision-making process more dependent on the votes of the other governments and on the agenda-setting power of the Commission.

rather than through the centralized authority of the EU institutions. Second, regarding national preference formation, where domestic policy instruments remain effective, governments will aim at maintaining them; but where governments have no cost-effective domestic means of achieving domestic targets, they will turn to policy coordination/integration (Moravcsik, 1993). Policy coordination is likely to be sought by smaller governments that have little control and high economic interdependence. The independent variable is “issue-specific interdependence” (effective/ineffective domestic tools to deal with policy externalities) and the dependent variable is national preferences (policy coordination or not).

Furthermore, *the outcomes reflect the relative bargaining power of states. This depends on asymmetrical interdependence: the more attractive a government's unilateral policy alternative, the less intense its preference for agreement and the greater its bargaining power. However, governments with unattractive unilateral policy alternatives will benefit more from policy coordination even and thus, will have less bargaining power* (Moravcsik, 1993). Therefore, *the greater the potential benefits a government has from cooperation, the more is willing to cooperate and the less risk of non-agreement is willing to assume and therefore, the weaker its bargaining leverage* (Moravcsik, 1993). The independent variable is “relative bargaining power” which is understood in terms of “asymmetrical interdependence” based on the determinants previously outlined. The dependent variable is the outcome of interstate negotiation (Moravcsik, 2008). And lastly, *states choose to pool or delegate sovereignty to international institutions to enhance credible commitments* (Moravcsik, & Nicolaidis, 1999). The independent variable is the “need for credible commitments” and the dependent variable is “institutional choices to pool or delegate sovereignty” (Moravcsik & Nicolaidis, 1999).

2.2.4 Conclusion

As table 2 shows, both theories have different key actors and integration mechanisms. They also provide a different explanation for the process of integration. One of the main differences between them is that NF views supranational institutions and non-state actors as the dominant actors in shaping outcomes, whereas LI argues that supranational organizations are passive institutions being the state governments the key actors (Moravcsik, 1993). LI argues that states can act as *gate-keepers* if certain policy reforms proposed by EC do not match their preferences. Haas's neofunctionalist argument refers to the fact that elites groups become aware that certain problems relevant for them cannot be solved at the national level. These will demand for a transfer of competence to a supranational institution better able to tackle them. This leads to the centralization of the issue in question if the problem is important enough and these groups have sufficient political support (Stone Sweet & Sandholtz, 1997). Governments are seen as reactive playing a marginal role (Stone Sweet & Sandholtz, 1997). However, according to LI, national governments represent the key dominant actors in European integration, pursuing national interests, bargaining and institutionalizing integration to remain in control (Moravcsik & Schimmelfennig, 2009). Integration is considered a state-led process (Rosamond, 2000).

Table 2. Main Assumptions of Neofunctionalism and Liberal Intergovernmentalism

Theoretical Approach	Key Actors	Mechanisms	Explanatory Approach
Neofunctionalism	<ul style="list-style-type: none"> • Supranational actors as <i>agents of integration</i> 	<ul style="list-style-type: none"> • Automaticity: Functional Spillover, Political Spillover, Cultivated Spillover • Path-dependence 	<ul style="list-style-type: none"> • Supranational actors lead the integration process • Result of a process where elites shift loyalties to a new centre
Liberal Intergovernmentalism	<ul style="list-style-type: none"> • States as <i>gate-keepers</i> 	<ul style="list-style-type: none"> • National preference formation • Interstate bargaining • Institutional choice 	<ul style="list-style-type: none"> • Integration is a state-led process • Result of interstate bargaining

Source: Own elaboration according to Verdun (2002)

Furthermore, NF argues that the main mechanisms driving integration are the concepts of “spillover” and “path-dependence”. “Spillover” refers to the fact that the integration in one economic sector creates pressures for further economic integration within and beyond that sector and it increases the authoritative capacity at EU level (Rosamond, 2000). Regarding “path-dependence”, according to Moravcsik (1993), the dynamic and complexity of spillover is likely to trap governments and expose them to unintended consequences triggered by previous commitments. Thus, institutions can cause unintended consequences making the integration process irreversible. On the other hand, LI argues that interstate cooperation has three stages: the formulation of national preferences, the substantive bargaining process, and the creation or adjustment of institutions to secure outcomes (institutional choice) (Wiener & Diez, 2009). And lastly, their main hypotheses are summarized in table 3.

Table 3. Main Hypotheses of Neofunctionalism and Liberal Intergovernmentalism

Neofunctionalism	Liberal Intergovernmentalism
H1: Functional spillovers create incentives and demands on nation states to integrate other sectors due to interdependence between national economies.	H1: Nation states as actors calculate the utility of alternative courses of action and choose the one that maximizes their utility.
H2: Integration occurs because other economic and political actors beyond the nation state shift their loyalties from the national to the supranational level.	H2: The relative bargaining power of nation states, together with their positions which reflect the interests of domestic actors, explain integration outcomes.
H3: The High Authority is expected to be in control of the process of integration.	H3: Integration happens through interstate bargaining rather than through a centralized authority.
H4: The preferences of nation states are expected to be constrained by previous institutional commitments.	H4: States choose to pool or delegate sovereignty to international institutions to enhance credible commitments.

Source: Own elaboration according to Verdun (2002), Rosamond (2000), Stone Sweet & Sandholtz (1997), Moravcsik (1993), Moravcsik & Nicolaidis (1999)

2.3 Application of NF & LI: The Case of the Single Resolution Mechanism (SRM)

2.3.1 Application of Neofunctionalism to the SRM

In the first place, I will conceptualize “functional spillover” as functional incentives to cooperate or arguments in favour of the creation of a SRM at EU level. These can be also conceptualized as the *rationales* behind its establishment. It is well acknowledged that the resolution regime for the EBU should include a centralized and exclusive decision-making authority responsible for all banks under the SSM. Therefore, according to Veron et al. (2013), centralization is highly needed because of the following reasons.

First of all, since bank resolution has to take high-risk decisions very quickly a high degree of centralization of authority is desirable. Secondly, an independent resolution authority would be more likely to reduce moral hazard by exercising less regulatory forbearance regarding the restructuring and closing of banks (Donnelly, 2013a). Also, EBU would be incomplete without a SRM which could hamper the proper functioning of the internal market of financial services. The establishment of a SRM would guarantee that supervision and resolution are performed at the same level for countries whose banks are supervised by the SSM. Besides, regarding the single resolution fund, according to Veron et al. (2013), a decentralized resolution regime cannot cope with a system that involves burden-sharing among MSs. A logical step after the creation of the SSM would be the establishment of a SRM because national taxpayers cannot be expected to support an institution which is supervised by the ECB (Beck et al., 2013). According to the IMF (Goyal et al., 2013), a credible resolution framework at EU level would also limit the potential burden on taxpayers by using the bail-in tool when necessary. And lastly, creating a SRM can resolve the financial trilemma¹¹ (see figure 2 in Annex I) (Schoenmaker, 2012).

Furthermore, I will conceptualize “political spillover” as the integration process of the SRM driven by economic elites and interest groups which seek policy coordination at the supranational level. The Commission, the EP, the IMF, the ECB, and the European Banking Federation (EBF), i.e. the European banking sector¹², constitute relevant actors involved in the regulation of the EU financial services sector. International expert bodies and epistemic communities composed by academic professionals and experts on banking regulation constitute also relevant actors in this policy field. According to Peterson (2001), the legislative agenda of the EU is negotiated between a wide range of

¹¹ The so-called financial trilemma refers to the fact that the objectives of financial stability, cross-border banking and national financial supervision/resolution cannot be reconcile. An alternative solution for this would be to transfer financial resolution to the EU level. If we keep bank resolution at the national level there will always be conflicts between home and host countries which prevents orderly resolution (Schoenmaker, 2012).

¹² It is important to mention that non-state actors are increasingly lobbying the Commission since this possesses the sole power to introduce EU legislation and to issue binding directives. As Majone has argued, European industries often prefer to have a single European regulation than differing national ones (Sandholtz, 1996).

policy stakeholders. The content is determined by the preferences of the EU MSs and by those of the Commission and the EP¹³.

I will conceptualize “cultivated spillover” as the role played by the Commission in instrumentalizing the functional pressures for the integration of the SRM by advocating the advantages of centralization. I consider the Commission to be more than an agent according to the principal-agent approach where the Council is the principal. In the context of the SRM, I expect the Commission to be the EU’s main “process manager” and has power of agenda-setting in legislation. MS cannot, without large costs, adequately monitor the Commission. The influence of supranational EU institutions like the Commission, EP, ECB, and other international actors is examined.

Lastly, I will conceptualize “path-dependence” as the dynamic whereby MSs have been locked in because of previous commitments. I conceptualize these institutional constraints looking at the creation of the internal market which makes possible for banks to operate cross-border and its unintended consequences for the MSs themselves.

After having conceptualized the main concepts of the theory, the following hypotheses will be tested for NF.

Hypothesis 1: *If Neofunctionalism is applicable, then functional spillovers will create incentives and demands on Member States to integrate banking resolution at EU level by introducing the SRM.*

If this theory is applicable, I expect that the functional incentives to cooperate based on positive-sum games to keep a high degree of interdependence (Pareto optimality) lead MSs’ governments to centralize resolution powers through the establishment of a SRM at EU level. I expect that the centralization of the SSM leads to the integration of the SRM in order to ensure the proper functioning of the single market in financial services. Therefore, the independent variable is the functional pressure and incentives to cooperate above mentioned and the dependent variable is the supranationalization or not of banking resolution powers.

Hypothesis 2: *If Neofunctionalism is applicable, then the institutional structure of the SRM will reflect for a great deal the wishes of the EU institutions and other international actors like the IMF, ECB, EBF and ESRB.*

If this theory is applicable, I expect that the preferences and interests of EU institutions and other international actors can be found in the final outcomes and official documents. The independent variable is the influence of these supranational institutions and the dependent variable is the integration process leading to supranationalization of banking resolution powers.

¹³ European institutions can be considered as “players” since they can influence political behavior and outcomes by becoming partially autonomous political actors inducing changes in domestic policies. Also, following P-A theory, once these international organizations have independent powers, countries cannot always control how these organizations are going to exercise their powers (Sandholtz, 1996).

Hypothesis 3: *If Neofunctionalism is applicable, then the SRM will empower the Commission as an ultimate authority in the integration process.*

If this theory is applicable, I expect the Commission to play the leading role in integrating the SRM. It is able to nudge the MSs toward new supranational agreements preventing them from following their own national interests. Therefore I expect the Commission to be a leader in terms of persuasion by offering solutions to upgrade the common interest and by framing issues as problems that need to be solved urgently (Stephenson, 2010). The Commission is a policy-maker making use of a wide range of tools to steer policy objectives and its members or elites are always learning by making use of epistemic communities (Stephenson, 2010). The independent variable is the success or not of the role played by the Commission and the dependent variable is the integration of the SRM.

Hypothesis 4: *If Neofunctionalism is applicable, then the preferences of the Member States will be constrained by previous institutional commitments like the creation of EMU and the Internal Market.*

If this theory is applicable, I expect that previous institutional commitments like EMU and the Internal Market influence and constraint MSs' decisions so that banking union and the creation of the SRM go ahead primarily for the eurozone countries that cannot extract themselves from the consequences of failed cross-border banks and have to move forward. The independent variables are the previous institutional commitments and the dependent variables are MSs' preferences.

2.3.2 Application of Liberal Intergovernmentalism to the SRM

In the first place, I will conceptualize “issue-specific interdependency – economic interdependence” and the “distribution of costs and benefits” (national preference formation) as follows. The policy area of the banking union and the SRM can be classified as socio-economic public goods provision (regulatory policies). Thus, there exists a two-dimensional pressure: from producers (banking sector) and from the public who is in favour of public goods provision (Moravcsik, 1993). Moreover, when talking about “economic interdependence” we can refer to the fact that MSs' financial sectors are interconnected and interdependent. Moreover, the “distribution of costs and benefits” can be linked to the establishment of a single resolution fund part of the SRM. Here the distribution of costs and benefits is seen as significant and certain.

Furthermore, I will conceptualize “intensity of national preferences” and “relative bargaining power” (interstate bargaining) as follows. According to LI, relative bargaining power has four determinants: asymmetries in the relative intensity of national preferences, asymmetrical interdependence (unilateral policy alternatives and the threat of non-agreement), alternative coalitions and threat of exclusion, and issue linkage and side-payments. With regards to relative bargaining power I will only focus on the first three variables. Thus, regarding “asymmetries in the relative intensity of preferences”, I assume that some MSs are more in favour of the SRM and are willing to assume the least risk of non-agreement. Therefore, they have less bargaining power. I

will then look at which countries have more intense preferences in reaching an agreement for cooperation and which ones enjoy higher bargaining leverage. Regarding “unilateral policy alternatives”, MSs that have a good unilateral policy alternative have more bargaining power since they can make the threat of non-agreement. Moreover, some countries may have more power resources, i.e. more ability to pay and a larger size and diversification of their financial services sector. I would expect that countries like United Kingdom, France and Germany can play this dominant role. I will look at which MSs have more gains under the status quo adopting unilateral policy alternatives and which MSs and other actors are advocating for institutional change by centralizing banking resolution. Regarding “alternative coalitions and the threat of exclusion”, I assume that certain MSs might be interested in forming an alternative coalition instead of adopting an agreement for policy cooperation. Here I will look at whether certain countries form a coalition in opposition to integration of the SRM.

To conclude, I will conceptualize “more credible commitment” (institutional choice) as follows. I assume that euro zone countries, whose banks were involved in the crisis with a high degree of interconnectedness due to cross-border investment to each other, have an interest in joint restructuring and resolution powers at the EU level in order to manage cross-border financial institutions. MSs may pool or delegate sovereignty to a supranational organization in order to guarantee credible commitments. Certain countries might need the commitment from other countries which might not favour the centralization of the SRM.

After having conceptualized the main concepts of the theory, the following hypotheses will be tested for LI.

Hypothesis 1: *If Liberal Intergovernmentalism is applicable, then Member States as actors calculate the utility of alternative courses of action and choose the one that maximizes their utility under the circumstances regarding the SRM.*

If LI is applicable, I expect that MSs which have effective domestic policy instruments, i.e. banking resolution toolbox, will aim at maintaining them and will oppose integration, whereas MSs which do not possess the right tools will favour policy integration. Here I expect domestic pressures to desire institutional change and a set of harmonised rules at EU level. In the first case, MSs are willing to assume more risks, can make threats of non-agreement and look for unilateral policy alternatives. On the contrary, MSs with less bargaining leverage cannot afford this and are expected to make concessions because they are more vulnerable. Also, the formation of alternative coalitions by the MSs and possible threats of exclusion are investigated. I assume that some powerful MSs from the Northern coalition such as Germany, the Netherlands and Finland can form an alternative coalition opposing the supranationalization of the SRM. As above mentioned, MSs are rational actors aiming at maximizing the utility of courses of action. The independent variable is the existence of an attractive unilateral policy alternative like a strong banking resolution toolbox of the MSs’ banking system

and the formation of an alternative coalition. The dependent variable is the pursue or not of integration.

Hypothesis 2: *If Liberal Intergovernmentalism is applicable, then the relative bargaining power of Member States, together with their positions which reflect the interests of domestic actors, explain the introduction of the SRM.*

If LI is applicable, I expect that the relative bargaining power of the MSs constitutes the main factor influencing decision-making in the integration process of the SRM. I will look at the intensity of national preferences, the distribution of costs and benefits, power resources, i.e. ability to pay, and the vulnerability of certain MSs. I will also look at the stability of the MSs' financial systems. I assume that MSs are asymmetrically interdependent. According to Dyson (2010), there exists "creditor" and "debtor" countries and this also plays a role in the interstate bargaining process. I assume that the outcomes will reflect the preferences of the most powerful MSs because their bargaining power is higher. The two main power resources in the case of banking resolution are: the ability of the MS to pay into a common fund as well as the size and stability of its financial services sector. The independent variables are asymmetrical interdependencies such as the different intensity of preferences, the size and stability (health) of the national banking systems, and the national financial resources (ability to pay). The dependent variable is the outcomes of the interstate bargaining process.

Hypothesis 3: *If Liberal Intergovernmentalism is applicable, then the SRM is introduced through intergovernmental negotiation and bargaining of Member States, rather than through the centralized authority of the EU institutions making and enforcing political decisions.*

If LI is applicable, I expect that the MSs' negotiation processes are the key factor for explaining the integration outcomes of the SRM. According to Moravcsik & Schimmelfennig (2009), the European Council has increased its influence and agenda-setting powers taking over from the Commission. The independent variable is thus the MSs' bargaining and the dependent variable is the integration outcomes of the SRM.

Hypothesis 4: *If Liberal Intergovernmentalism is applicable, then Member States choose to pool or delegate sovereignty, i.e. national banking resolution and restructuring powers, to EU institutions to enhance credible commitments.*

If LI is applicable, I expect that transaction costs are low in the case of the SRM and that MSs decide to pool or delegate sovereignty to EU institutions in order to achieve credible commitments from less cooperative MSs. According to Moravcsik & Nicolaidis (1999), governments take decisions to pool or delegate to international institutions after weighing the possible advantages and disadvantages of a credible commitment. The independent variable is the need for credible commitments and the dependent variable is delegation or not of power to a supranational organization.

2.3.3 Conclusion

As table 4 shows, the present study aims at testing four hypotheses of each theory. H1 (NF) is based on the abstract concept of “functional spillover” and functional pressures supported by EU institutions and supranational organizations which demand more centralized regulation. H1 (LI) is based on national preference formation. Both hypotheses aim at testing the demand for centralized regulation in the case of the SRM. The demand for a SRM with a centralized Resolution Authority and a SBRF is investigated. Next, H2 (NF) and H2 (LI) start to dive into the question of the supply of a SRM, and who is controlling the integration process. I will test whether the integration outcomes reflect the wishes of the supranational or the national actors. H3 (NF) and H3 (LI) will look at the role played by the Commission and other EU institutions. Here it will be tested whether the introduction of the SRM can be explained through the influence of the EU institutions or through intergovernmental bargaining between the MSs specifically looking at their respective bargaining power. And lastly, H4 (NF) and H4 (LI) aim at testing whether institutions constrain MSs’ decisions or it is the MSs the ones who use institutions to obtain their purposes. For example, institutions can be used to enhance credible commitments. But it can also be argued that MSs are constrained by previous institutional decisions like the creation of EMU and the internal market and therefore, they have to move forward to more integration even if this is not desired.

Table 4. Main Testable Hypotheses of NF and LI in the Case of the SRM

Neofunctionalism	Liberal Intergovernmentalism
H1: If Neofunctionalism is applicable, then functional spillovers will create incentives and demands on MSs to integrate banking resolution at EU level by introducing the SRM.	H1: If Liberal Intergovernmentalism is applicable, then MSs as actors calculate the utility of alternative courses of action and choose the one that maximizes their utility under the circumstances regarding the SRM.
H2: If Neofunctionalism is applicable, then the institutional structure of the SRM will reflect for a great deal the wishes of the EU institutions and other international actors like the IMF, ECB, EBF and ESRB.	H2: If Liberal Intergovernmentalism is applicable, then the relative bargaining power of MSs, together with their positions which reflect the interests of domestic actors, explain the introduction of the SRM.
H3: If Neofunctionalism is applicable, then the SRM will empower the Commission as an ultimate authority in the integration process.	H3: If Liberal Intergovernmentalism is applicable, then the SRM is introduced through intergovernmental negotiation and bargaining of MSs, rather than through the centralized authority of the EU institutions making and enforcing political decisions.
H4: If Neofunctionalism is applicable, then the preferences of the MSs will be constrained by previous institutional commitments like the creation of EMU and the Internal Market.	H4: If Liberal Intergovernmentalism is applicable, then MSs choose to pool or delegate sovereignty, i.e. national banking resolution and restructuring powers, to EU institutions to enhance credible commitments.

Source: Own elaboration

3. Research Methodology and Operationalization

“A single case study research is a detailed examination of one setting, or a single subject, a single depository of documents, or one particular event”

Bruce L. Berg

(Berg, 2007, p. 283)

This chapter deals with the research design and methodology adopted in this study. The first part offers an overview of the research design and the second part focuses on the conceptualization, operationalization and measurement of the independent and dependent variables of the hypotheses previously formulated.

3.1 Research Design and Methodology

First of all, I will conduct a single case study research. Since the aim of the research is to gain a deep understanding of the topic by looking at relatively complex conceptual models and relationships, the single-case approach appears as the most logical option to choose. Also, case studies focus on process-tracing in order to better understand the causal mechanisms of the relationships and phenomena of interest (Gschwend & Schimmelfennig, 2007). Here I aim at tracing the conduct of the international negotiations, whereby EU institutions are included. Case studies like the one I propose have the advantage of operationalization and measurement of qualitative variables, i.e. construct validity. Therefore, high levels of construct validity can be achieved. However, among its limitations and trade-offs, are the selection bias and the lack of representativeness (Bennett, 2004).

Furthermore, the purposes of my research are first to describe and then explain the main concepts and patterns. According to Gerring (2012, p. 108), “Description rightly comes first; one must describe in order to explain (causally)”. Moreover, the research will follow a deductive and inductive approach. This means that it will move from theoretical expectations or hypotheses derived from the European integration theories selected to observations to test whether the expected patterns actually occur. But it will also try to move from the specific to the general, i.e. from empirical observations of the data of the SRM to the test of the hypotheses and then to the theory. And, with regards to the time dimension, it is a cross-sectional study since I aim at making observations of the SRM at one point in time.

Sampling

Since the main level of analysis is the European level and I am focusing on relevant political actors like the MSs, the Commission, the EP and other supranational organizations, it can be logical to take the actor’s interactions as units of analysis to study the outcomes of institutional supply in the case of the SRM. The units of observation are the preferences and interests expressed by the actors in EU policy

documents on banking union and SRM, the Commission's proposals for a BRRD and a SRM regulation, pieces of legislation, scientific literature written by academic experts, articles from relevant finance and European affairs journals (e.g. Financial Times, The Economist, The Telegraph, EUobserver, Europolitics), interviews, speeches, statements of the actors and Eurostat data on MS public interventions to support financial institutions and financial markets during the crisis.

Furthermore, regarding case selection, only relevant political actors have been selected. The most important actors that are included are: EU MSs, both non-eurozone and eurozone members; domestic actors; the EP; the European Commission; the European banking sector and its representative, i.e. the EBF, the ECB, the IMF, and the Scientific Advisory Committee of the ESRB. Analyzing the pressures from domestic societal groups in all 27 MSs, like those of political parties, will give an inconvenient and chaotic picture. Therefore, I will focus on the most important and larger MSs of the EU: Germany and the Northern coalition (The Netherlands, Finland and Sweden), France, Spain and the Southern coalition (Italy, Portugal and Greece) and the UK. Together, France and Germany are often able to push for a decision in the eurozone group. Germany is also one of the most powerful MSs in the so-called Northern coalition together with the Netherlands and Finland. The UK, on the other hand, is a powerful non-eurozone MS since it has the largest banking sector in the EU. Therefore, it plays an important role in decisions in the European financial market. Spain is one of the most important countries in the cluster of the Southern coalition since the banking crisis in this country reflected the existence of a vicious circle between the sovereign debt crisis and the financial crisis. Moreover, it is one of the programme countries of the ESM. Eastern Europe countries, even though also important in the European financial market, are not considered to have yet enough weight on decision-making and most of their financial capital is foreign-owned.

Data Collection and Data Analysis

Regarding the research method adopted for data collection and data analysis, I will adopt the unobtrusive research method of "content analysis" since I am mostly using qualitative data, i.e. documents and textual materials, as above indicated. In this research study, qualitative data analysis can be more useful than quantitative data analysis because it can be richer in meaning than quantified data and I am looking at verbal communication to infer actor's preferences and interests. Moreover, regarding data analysis, there are several procedures used in qualitative research to analyze the data. These are interpretative approaches, social anthropological approaches, and collaborative social research approaches (Berg, 2007). I will adopt the interpretative approach since my interpretation of the text materials will depend on the theoretical orientation of my research.

Content analysis can be described as "the study of recorded human communications" (Babbie, 2007, p. 320). Also, according to Babbie (2007, p. 322), "a few possible units of analysis for content analysis are: words, themes, characters, concepts, books, pages, paragraphs or lines". Some content analysis studies use "words" as units and focus on

frequencies but since in this research the actor's interactions and preferences have to be investigated I will use "themes" and "concepts" as the main units to count. "Themes" are useful units to count and they constitute simple sentences. "Concepts" include words grouped together into conceptual clusters (ideas) that constitute, in some instances, variables in a typical research hypothesis (Berg, 2007). This choice leads to focus more on latent content than on manifest content. This method is better designed for tapping the underlying meaning of communications, but its advantage comes at a cost to reliability and specificity (Babbie, 2007). Therefore, for example, for the theoretical concept of "intensity of national preferences" I will look if MSs focus specifically on an issue in their statements, policy documents, newspaper articles, etc. Thus, in analyzing the content of the text materials I look for themes and concepts where I can see on what issues the MSs have strong preferences in the context of the SRM.

3.2 Operationalization and Measurement

NF Variables

The main variables of this theory are measured for the present study as follows.

H1 – Functional spillovers (functional incentives): I will look at whether functional incentives end up in functional spillovers in the introduction of the SRM. For this purpose I will select the preferences and interests of the supranational organizations. I will check whether the functional incentives and recommendations of these actors can be traced and whether they end up in spillovers in the final outcomes.

H2 – Political spillover (SRM institutional structure): I will look at whether the final institutional structure of the SRM reflects the wishes of the EU institutions and the other supranational actors selected. In order to check the influence of the EP, I will look at the positions that could find a majority in the parliament and I will check whether these positions are expressed in resolutions and amendments. In the case of the IMF, the ECB and the scientific committees of the ESRB, I will check whether their recommendations for creating a centralized SRM can be seen in the final outcome.

H3 – Cultivated spillover (Commission's leadership): I will look at the central role played by the Commission and its agenda-setting powers. I will focus on two empirical indicators: the governance structure of the SRM and whether or not the Commission is supported by a powerful MS like the UK, France or Germany during the negotiations.

H4 – Path-dependence (institutional constraints): I will focus on the Maastricht treaty framework in EMU and the creation of the Internal Market in order to see whether MSs' positions can be constrained by this institutional framework. According to the Maastricht framework in EMU, fiscal policy should remain in the hands of the euro zone governments. This can be related to the use of the ESM and the fiscal implications for the MSs. Also, according to the principle of subsidiarity, the authority for regulation must be at the national level. This means that central banks are responsible for the financial institutions based within their national borders (Cohen, 2007).

LI Variables

The main variables of this theory are measured for the present study as follows.

H1 – Utility of alternative courses of action: I will look at whether MSs have a unilateral policy alternative. For example, I will focus on whether certain MSs have a special resolution toolbox in place. I will check which MS has a banking resolution system which already contains elements of the SRM such as the “bail-in” tool. This variable influences MSs’ national preferences.

H2 – Relative bargaining power: I will focus on empirical indicators that can shed light on MS asymmetrical interdependencies leading to a higher or lower degree of bargaining power. The indicators selected are: 1. distributional consequences of a pan-European single resolution fund for domestic actors; 2. MSs’ power resources, i.e. ability to pay into a common fund; 3. the size and stability of MSs’ financial markets; 4. the existence of an attractive unilateral policy alternative; 5. the formation of alternative coalitions in order to see whether there is an alternative coalition among MSs. This could lead to the exclusion of certain MSs and the development of a two-speed Europe. For instance, a coalition of MSs may decide to integrate the SRM pushing the other MSs to join or not. Moreover, I will try to identify which MS have most benefit under the status quo and which actors are more interested in institutional change. Also, these indicators are also part of the concept of “relative intensity of preferences”. I will then look at the issues MSs focus on with more interest in their statements in order to identify their preferences. I will also take into account the concept of “vulnerability”. The more vulnerable MSs will accept everything and make concessions as long as they get an agreement because they are in a more vulnerable situation: their relative bargaining power is lower compared to the one of other more powerful MSs.

H3 – Intergovernmental bargaining: I will look at whether the SRM is established through intergovernmental bargaining or by the EU institutions and the other supranational actors selected. Therefore, I will just follow the negotiations to see which actors are controlling the introduction of the SRM and in which form. I will try to ask the question: Who supplies the SRM and under which institutional framework?

H4 – Need for credible commitment: I will look at the MSs’ arguments to transfer resolution powers to the European level and the importance they give to achieve an agreement under the European institutional framework. At the end, when comparing hypotheses 4 of both theories, I want to test whether institutions constrain MSs or if it is the MSs the ones that delegate sovereignty in banking resolution after weighing advantages or disadvantages. So, what explains the transfer of sovereignty to international institutions? Centralized technocratic management or more credible commitment?

3.3 Conclusion

Table 5 summarizes the measurement of the main variables of the hypotheses derived from NF and LI. Three levels can be observed. The first refers to the demands for regulation. Here I will check whether functional incentives coming from EU institutions

and other supranational actors end up in functional spillovers. And I will look at whether MSs have a unilateral policy alternative that can influence their preferences for a SRM with a single Resolution Authority and a SBRF. Then, I want to test how the SRM is introduced: due to political and cultivated spillovers or due to interstate bargaining. The last level refers to the institutional choices. I want to test whether institutions constrain MSs or are used by the MSs to pursue their own interests.

Table 5. Measurement of the Main Variables

Neofunctionalism	Liberal Intergovernmentalism
H1 Functional spillovers: Do functional incentives coming from EU institutions and supranational actors end up in functional spillovers?	H1 Utility of alternative courses of action: Do MSs have an attractive unilateral policy alternative? (E.g. special bank resolution system)
H2 Political Spillover: Are the wishes of EU institutions and the other supranational actors selected reflected in the final institutional structure of the SRM?	H2 Relative bargaining power: What are the distributional consequences of a SBRF at EU level for the MS? Which are the powerful MS in terms of power resources?
H3 Cultivated Spillover/Commission's leadership: Are its agenda-setting powers reflected in the introduction of the SRM?	H3 Intergovernmental bargaining: Is integration the result of intergovernmental bargaining?
H4 Path-dependence/Institutional constraints: Is EMU institutional framework and the Internal Market constraining actors' decisions?	H4 Need for credible commitment: Can the transfer of sovereignty to international institutions be explained by the need for more credible commitment?

Source: Own elaboration

To conclude, with regards to the reliability and validity of my measurement, I think that my research strategy and my measurement can result in valid and reliable results for the following reasons. First of all, in some cases I will use different empirical indicators for the variables to look at the preferences of the relevant actors. For example, in the case of the variable “institutional structure of the SRM” (NF, H2), the measurement can be considered as having a high level of reliability, since this can be observed in the final outcome of the negotiations. However, regarding possible limits of my measurement, in the variable “utility of alternative courses of action” (LI, H1) I am only looking at one dimension which is the MSs’ banking resolution systems.

4. Empirical Analysis: Explaining the Integration Process of the SRM

“Yet while today’s EU treaties provide adequate foundation for the new supervisor and for a single resolution mechanism, they do not suffice to anchor beyond doubt a new and strong central resolution authority. While supervision keeps risk-taking in check, resolution is more intrusive. It is about apportioning the costs of risks, if they materialize, among stakeholders. If there is an activity that needs a solid legal base, it is resolution”

German Finance Minister Wolfgang Schäuble

(Schäuble, 2013, p. 2)

This chapter is the backbone of this study since it aims at conducting the empirical analysis. The first section gives an overview of the pre-crisis banking resolution landscape and the recommendations of the De Larosi re Report on bank resolution after the global financial crisis. The second section analyses the Commission’s proposals on bank resolution and provides a discussion of the negotiations on the SRM focusing on the possible institutional options available to the relevant actors. Supranational and national actors’ preferences and influence are identified and analysed. In the last section the corroboration of hypotheses is carried out. A deterministic approach is adopted in order to identify the most applicable theory. However, there exist some caveats since the aim is also to find a balance between both theories.

4.1 Pre-Crisis Banking Resolution Landscape and *De Larosi re Report*

After the 2008 global financial crisis, the European Commission introduced an initiative to design a new European financial architecture on the basis of the recommendations of the high-level expert group chaired by Jacques de Larosi re (Spendzharova, 2012). According to the De Larosi re report (2009), overall financial regulation was too weak. Crisis management and resolution was in hands of the national treasuries and there were no provisions regarding crisis resolution of pan-European banks (Pisani-Ferry & Sapir, 2010).

Prior to the crisis the only crisis management arrangement at EU level was a Memorandum of Understanding (MoU) of May 2005. It focused mainly on information sharing and it did not include any burden-sharing agreement between national treasuries (Pisani-Ferry & Sapir, 2010). Converging towards high global standards through the adoption of the IMF, FSF, Basel committee and G20 processes was considered to be essential. However, the implementation and enforcement of these standards could only be materialized if the EU achieves a powerful and integrated European system of regulation and supervision since it possesses the biggest capital markets in the world.

The Group recommended an EU-level resolution mechanism and the provision of EU authorities with adequate and equivalent crisis prevention and crisis intervention tools.

Moreover, it recommended that MSs should agree on more detailed criteria for burden sharing than those contained in the existing MoU.

4.2 The Creation of the SRM: Actors' Preferences and Influence

This section is divided in four subsections. The first one gives an overview of the Commission's proposals. The second and the third one address the preferences and interests of the national and supranational actors. And the fourth one offers a discussion of the final outcome of the negotiations underlying the role of power.

4.2.1 Commission's Proposals: From the BRRD to the SRM Regulation

The Bank Recovery and Resolution Directive (BRRD)

On 6 June 2012 the Commission published its proposal for a BRRD¹⁴. As a directive, it aims at harmonizing bank resolution practices across the MSs to reduce costs for taxpayers and restore bank stability (Gandrud & Hallerberg, 2013). Moreover, in June 2010 the EP also published a report with recommendations on cross-border crisis management and recommended greater integration of resolution powers (European Commission, 2012a).

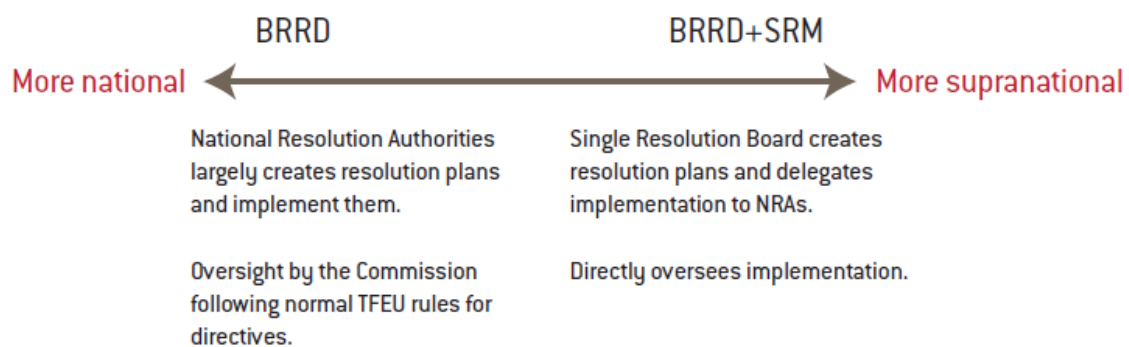
The legal base of this proposal is Article 114 of the TFEU since it aims at harmonising national laws on recovery and resolution of credit institutions and certain investment firms to ensure the proper functioning of the internal market in financial services (European Commission, 2012a). Moreover, the BRRD addresses crisis management including preparation, recovery and resolution. It covers all credit institutions and certain investment firms (European Commission, 2012a). Also, the proposal sets up a procedure whereby financial institutions are required to draw up recovery and resolution plans to be able to take early action to restore the viability of the institution in case its financial situation deteriorates (European Commission, 2012a).

Furthermore, the framework establishes that the resolution authorities should be empowered to apply the following resolution tools: sale of business, bridge institution, asset separation and bail-in (European Commission, 2012a). Regarding resolution funding, the framework sets up the European System of Financing Arrangements (ESFA) which is based on national financing arrangements allowing for the borrowing between them and its mutualisation in case of a group resolution (European Commission, 2012a). Since national resolution funds remain under the MS national mandate, from a legal point of view they may not be able to recapitalize banks that are not under their national mandate (Beck et al. 2013).

¹⁴ The proposal refers in its introduction to the steps taken by the G-20 Leaders who previously called for a "review of resolution regimes and bankruptcy laws in light of recent experience to ensure that they permit an orderly wind-down of large complex cross-border institutions" (European Commission, 2012a, p. 2). In November 2011, the G-20 agreed the Financial Stability Board (FSB)'s "Key Attributes of Effective Resolution Regimes for Financial Institutions" ("Key Attributes"). Their implementation should allow authorities to resolve financial institutions in an orderly manner without taxpayer exposure to loss from solvency support, while maintaining continuity of their vital economic functions (FSB, 2011).

To conclude, as figure 3 shows, the BRRD constitutes a *Member State-driven* resolution regime since it is the NRAs the ones in charge of creating the resolution plans and implementing them. And the Commission is responsible for supervising the resolution process. Moreover, if funds are required, these will be provided from a national resolution fund pre-funded by the MS banks (Gandrud & Hallerberg, 2013). However, national authorities remain in control and are able to keep specific national resolution tools and powers if these are compatible with the framework and the TFEU (European Commission, 2012a).

Figure 3. Different Possibilities for a European Resolution Regime



Source: Gandrud & Hallerberg (2013, p. 3)

Banking Union and SRM Regulation

On 26 June 2012 the President of the European Council, Herman Van Rompuy, published the report “Towards a genuine Economic and Monetary Union”. This was elaborated together with the Presidents of the Commission, the Eurogroup and the ECB. It proposed a stronger EMU architecture supporting the idea of integrated frameworks for budgetary matters, economic policy and for the financial sector (European Council, 2012). The European resolution scheme proposed in the report aimed at orderly winding-down troubled institutions and is primarily funded by contributions of banks to protect taxpayers. Moreover, the report proposed the creation of a common resolution authority in charge of the deposit insurance scheme and the resolution fund. Also, the report said the ESM could perform as the fiscal backstop (European Council, 2012).

On 12 September 2012, the European Commission published the report “A Roadmap towards a Banking Union”. It argued that a coordination framework was not enough in the context of a single currency. Also, it argued that bank supervision at EU level should be accompanied with the creation of an integrated bank crisis management (European Commission, 2012c). The EP made recommendations in this direction in its report from July 2010 on cross-border crisis management in the financial sector (European Commission, 2012c). Besides, the report argued that the single market and the banking union are mutually reinforcing processes because the banking union also belongs to the regulatory reform for the single market, the so-called single rulebook (European Commission, 2012c).

On 10 July 2013, the European Commission made a proposal for the creation of a SRM for the banking union. It argued that “A regulation is the appropriate legal instrument to avoid discrepancies in national transposition and to ensure a unified institutional mechanism and level playing field for all banks in the participating MS” (European Commission, 2013a, p. 7). It realized that the BRRD relying on a network of NRAs and resolution funds was not sufficient in cases where MSs shared supervision of banks within the SSM. The Council also recognized that bank supervision and resolution had to go hand in hand and be exercised by the same level of authority (European Commission, 2013a). The proposed SRM was meant to be created within the EU legal and institutional framework. Its legal base is also Article 114 of the TFEU (European Commission, 2013a).

The SRM introduces a centralized institutional set-up including the creation of a Single Resolution Board (SRB) where the Commission has powers to initiate the resolution process and to decide on the resolution tools to be applied to the financial institution concerned. Also, it has powers to decide on the use of the fund (European Commission, 2013a). The implementation of the SRB decisions will be done at the national level following the SRM Regulation and BRRD (European Commission, 2013a). The governance structure of the SRB is composed of the Executive Director, the Deputy Director, the representatives appointed by the Commission and the ECB, and the members appointed by each MS, representing the NRAs (European Commission, 2013a). Regarding the SRB voting arrangements, simple majority voting applies: one vote for home authority and one vote collectively for host authorities, equally divided by the number of them. There are no veto rights. Moreover, since this institutional structure takes place within the treaties, the SRB is accountable to the EP, the Council and the Commission for the implementation of the regulation (European Commission, 2013a). According to the proposal, the SRB shall start to function by 1 January 2015 and the bail-in tool shall apply from 1 January 2018.

Furthermore, the SRM regulation establishes a Single Bank Resolution Fund (SBRF). Since financial support to resolve banks improves the financial stability of other institutions and not only the one of those in the MS concerned, contributions to finance the support should not be limited to banks from a single MS (European Commission, 2013a). Every MS should set up financing arrangements with ex-ante contributions from banks and investment firms in proportion to their liabilities and risk profile (Commission, 2012b). Those banks which contribute most would also benefit most in case they have to be subject to resolution. Also, each national fund will finance the resolution of institutions located on its territory. In case of cross-border groups, national arrangements are required to contribute to a financing plan determined by the resolution authorities (Commission, 2012b). In a period of 10 years after the entry into force of the regulation, the target size of the fund should be at least 1% of covered deposits in the financial systems of the MSs. This target level corresponds to around 55 billion euro (European Commission, 2013a).

To conclude, as figure 3 shows, the SRM regulation which includes a single resolution authority and a SBRF together with the bank resolution powers of the BRRD can be considered as a European level-driven resolution regime because a European institution, the SRB, is in charge of indentifying troubled banks and design their resolution plans at EU level. The Commission and the SRB would be empowered to impose resolution plans on banks without the consent of the relevant governments¹⁵. This is seen as an important step toward a Federal Europe (Avaro & Sterdyniak, 2013). Also, the potential losses of a financial institution would have to be supported by all MSs participating in the banking union.

4.2.2 National Actors' Preferences and Interests

Member States' Preferences and Influence

UNITED KINGDOM

First of all, it is well acknowledged that the UK remains reluctant to transfer national sovereignty to the EU as it is not a euro zone member. In this sense, it is often argued that there exist many small countries in the world doing well without giving up their identities to a larger block (Bootle, 2014). The UK position on the SRM regulation and on banking union is very clear: the UK will not participate in the banking union project because the euro is not their currency. This was the argument of the British Prime Minister, David Cameron, who said that he would not demand British taxpayers to underwrite the debts of troubled banks in countries like Spain and Greece (Cameron, 2012). Mr. Cameron's statement was: "I can understand why eurozone countries may want to look at elements of banking union. Because we are not in the single currency, we won't take part in the profound elements of the banking union. I wouldn't ask British taxpayers to stand behind the Greek or Spanish deposits. It is not our currency, so that would be inappropriate to do. I understand why single currency countries have to look at deeper integration. I will make sure that Britain's interests, particularly in the single market and the openness and fairness of the single market are protected. That is key for Britain. We want the eurozone to succeed. We want the euro to solve the problems it faces, so that all European economies including ours can get back to healthy grow" (Cameron, 2012, p.1).

Furthermore, the position of the UK government was also emphasized by one of the EP's lead negotiators on the package, Vicky Ford MEP of the UK Conservatives who argued that the UK would not pay into the SBRF or take any liabilities for euro zone countries' decisions (BBC News, 2014). Moreover, UK's foreign minister, William Hague, said: "The government in the UK is clear, as you know, that we will not agree to any further transfer of power or competence from the national level to the EU". He added that the UK government was not in favour of creating a banking union as proposed by the European Commission (The News, 2012, p. 1).

¹⁵ See table 1 in Annex II for a detailed comparison of both Commission proposals.

To conclude, although the UK government stated that it is not willing to join the banking union and pay into the SBRF, it insists on equal treatment for participants and non-participants. The British government emphasizes that the Commission has to safeguard the treaties for all 28 members (Hewitt, 2013). Indeed for the UK government the proper functioning of the internal market in financial services remains a priority since many banks in London do most of their business on the euro zone.

GERMANY AND THE NORTHERN COALITION

The German finance minister, Wolfgang Schäuble, blocked and led the opposition to the Commission's proposal pushing instead for the idea of making national governments responsible for failing banks (Armitstead, 2013). According to European Voice (2014), Germany held a strong position with clear preferences during the negotiations with MSs and the MEPs, firmly determined not to give up control over the SBRF and authority to the Commission. By contrast, Germany pushed for the Council to be more in control in the SRB (EFE Economía, 2013b). German Chancellor Angela Merkel argued that a single resolution authority would need a treaty change. And after this announcement, Mr. Schäuble made a warning to Brussels saying that the limits of the law had to be respected (Barker, 2013). Germany's concerns refer to the fact that this country, having the biggest economy in the EU, is reluctant to accept any scheme that could oblige German taxpayers to bail out financial institutions in other EU MSs like Greece or Spain. And it does not want the SRM to cover all of the eurozone's 6,000 banks (BBC News, 2013b).

In an interview to the *The Financial Times* in May 2013, the German finance minister argued that an EBU including supervision, resolution, fiscal backstops and rules for deposit insurance had to be established urgently (Schäuble, 2013). However, he highlighted the need for a treaty change to set up a centralized resolution authority. He said: "Yet while today's EU treaties provide adequate foundation for the new supervisor and for a single resolution mechanism, they do not suffice to anchor beyond doubt a new and strong central resolution authority" (Schäuble, 2013, p. 2). And he added: "While supervision keeps risk-taking in check, resolution is more intrusive. It is about apportioning the costs of risks, if they materialize, among stakeholders. If there is an activity that needs a solid legal base, it is resolution" (Schäuble, 2013, p. 2). Therefore, the path that the Commission proposed for a SRM was a rocky one since a solid legal foundation was needed for it (Armitstead, 2013). According to the German Constitutional Court, this European reform, which has an impact on national budgets, may not be completely legal since it may produce negative effects on German taxpayers. Concerns also arise from the assessment of contributions to a common resolution fund, which finds its origin in the specific approach to creditor and deposit protection in the banking system of Germany. In this sense, it is important to mention that regulatory reforms like the SRM impose costs derived from restructuring on banks.

Furthermore, in the same interview to *The Financial Times*, Mr. Schäuble argued that since the amendment of the treaties would take time, a two-step approach could be

already adopted with a resolution mechanism based on a network of national authorities once the SSM is operational, the BRRD is adopted and the Basel III capital requirements are in place (Schäuble, 2013). Moreover, he argued: “Instead of a single European resolution fund – which the industry would take many years to fill – such a model would lean on national funds, which already exists in several member states” (Schäuble, 2013, p. 2). Germany proposed effective European coordination and a decentralized approach to deal better with the MSs’ differing bank resolution and restructuring laws (Schäuble, 2013). The German government proposed a “timber-framed” banking union instead of an EBU “made of concrete”, as figure 4 shows. Following the words of Mr. Schäuble: “This would be a timber-framed, not a steel-framed, banking union. But it would serve its purpose and buy time for the creation of a legal base for our long-term goal: a truly European and supranational banking union, with strong, central authorities, and potentially covering the entire market” (Schäuble, 2013, p. 2). Moreover, the German government proposed that the single resolution authority and single resolution fund could operate through an intergovernmental body rather than within the EU structures and aimed at emphasizing this during the negotiations (Spiegel Online International, 2013).

With regards to the establishment of a potential fiscal backstop for the SBRF, the German government supported the idea of using the ESM as a last resort. However, this is meant to operate with loans with the subsequent conditionality. This could increase the debt of certain MSs’ national public sectors in case the bank stress tests of the SSM find out that some of their banks have to be recapitalized (Gual, 2013). Germany’s concerns relate to its national domestic politics and the protection of its taxpayers’ money.

Figure 4. The Design of Banking Union

	Banking union “made of concrete”	“Timber-framed” banking union
Supervisory Mechanism	Single	Single
Rules/capital requirements	Harmonization	Harmonization
Bail-in rules	Harmonization	Harmonization
Resolution mechanism	Single authority	College of national authorities
	Common resolution fund (private, pre-established)	National resolution funds (private, pre-established)
	Supranational fiscal backstop	National fiscal backstop + ESM
Deposit guarantee schemes	Common DGF (private, pre-established)	Harmonized national DGFs (private, pre-established)
	Supranational fiscal backstop	Backstops: 1. Loans between DGFs 2. National fiscal authority 3. ESM

Source: Gual (2013, p. 22)

Although the German government had a strong position on the SRM, there existed also internal divisions in the German domestic politics arena. In this sense, the centre-right Christian Democratic Union (CDU) and the German Socialist party (SPD) differed with regards to the institutional set-up of the single resolution fund. While the CDU and Mr. Schäuble supported the establishment of a network of national resolution funds, the SPD finance expert, Carsten Scheider, favored the establishment of a pan-European resolution fund (Gammelín & Hulverscheidt, 2013). Thus, the conservative coalition including also several members of the pro-business Free Democrats (FDP) opposed to the Commission's proposals. Christian Lindner, a leading FDP member, claimed that an EBU would just be "a new, admittedly creative, way to tap German solvency. Every eurozone country has to take responsibility for its own banks" (EUbusiness, 2012, p. 1). And CDU member Michael Fuchs said: "our savers cannot be liable' for the deposits of people in other countries" (EU business, 2012, p. 1). By contrast, the greens are in favour of European decision-making (Die Grünen, 2013). However, the conservative coalition remained more powerful and brought Germany's preferences to the negotiations.

To conclude, certain countries of Northern Europe such as Sweden, the Netherlands and Finland expressed their concerns about the Commission's proposal due to its potential influence and powers on European banking resolution. For instance, the Swedish Finance Minister, Anders Borg, argued that there may be conflict of interests since the Commission is in charge of making decisions in two fields: state aids and resolution (El País, 2013). And the Swedish Prime Minister argued that, even though Sweden will not participate in the EBU, it joins the UK and Germany in opposing the Commission's proposal (El País, 2013). Other Northern European countries like the Netherlands and Finland also supported the German government like they did in other occasions, for example when negotiating the intergovernmental fiscal compact of 2011.

FRANCE

According to Spendzharova (2013), some MSs like France supported the centralization of European financial regulation. The French government favoured the creation of a single EU-wide rescue fund (Hewitt, 2013). The French finance minister, Pierre Moscovici, was in favour of giving the Commission the responsibility for pushing the "red button". And he said that he wanted the SRM to be set on ambitious and solid foundations (EFE Economía, 2013c). However, although the French government shared the need for a pan-European resolution fund with countries like Spain, Germany approached France by supporting the Commission's decision to give France two extra years to meet its deficit target. Mr. Schäuble said that France was committed to carry out structural reforms and that sometimes countries have to be given more time to meet targets (EUobserver, 2013). But the German finance minister was less enthusiastic to show more "solidarity", something that France was demanding (EUobserver, 2013). It is often argued by Germany that these two countries have a special responsibility for Europe (EUobserver, 2013).

According to European Sting (Lacon, 2013), during the European Council meeting of 22 May 2013 in Paris, the French President François Hollande and Angela Merkel reached an agreement on the EBU. However, instead of a strong central and financially independent resolution authority, both countries supported the creation of a cooperation network in bank resolution where NRAs were responsible, and the exclusion of the ESM as possible fiscal backstop. It is argued that France fully accepted the position of the German government. In fact, however, the French government had never fully supported the Commission's proposal for a strong resolution authority (Lacon, 2013). Certain degree of issue linkage with other EU matters and the French reluctance to cede more powers to the EU can be observed in the country's position since the French finance minister, Pierre Moscovici, also said that France would never agree to cede more sovereignty to the EU unless problems of youth unemployment are solved in the eurozone (EUobserver, 2013).

Furthermore, it can be argued that France sold the South in order to safeguard the Berlin-Paris axis. France belongs to the core of the European financial markets and its SMEs are also favoured by the cheap ECB liquidity like the German ones. It is the Southern European SMEs from countries like Spain, Greece, Italy and Portugal which do not get banking credit and their interest costs for borrowing are at least triple than in core Eurozone countries (Lacon, 2013).

To conclude, at the end the French government adopted the German position. The justification for the change of the French position was that a strong banking union with a central bank resolution authority with access to the ESM as a fiscal backstop required amending the European treaties (Lacon, 2013).

SPAIN AND THE SOUTHERN COALITION

First of all, in opposition to other MSs, Spain is one of the euro zone countries that aim for an ambitious EBU (Carbó, 2013). According to the Spanish Finance Minister Luis de Guindos, Spain fully agreed with the Commission's proposal for a SRM (EFE Economía, 2013a). Also, other Southern European countries like Italy were more enthusiastic about rapid centralization (Barker, 2013). And the Portuguese Finance Minister Maria Luis Albuquerque stated at a Council meeting in March: "We would need something credible and strong for the immediate future. The stronger and the more credible it is, the less likely it becomes that we may actually need it" (Christie, 2014, p. 1). These countries in the EU periphery believe that the decision to wind up a failing bank should be taken by an EU-wide institution like the Commission (Hewitt, 2013).

According to the Spanish Prime Minister Mariano Rajoy, the top priority for Spain was to reach an agreement. During the negotiation period, he argued: "We would prefer to have a single resolution fund and a single authority which could be the Council or the Commission. Other countries have a different view and prefer to have a sum of national resolution funds with the pan-European fund intervening only when national funds would not. Anyway, we hold a positive position and we are willing to listen to everybody because our priority is to finish the design of the EBU and the SRM"

(Moreno, 2013, p. 4). He also argued that what worried him the most was Europe and hoped that Germany, one of the most important and powerful eurozone countries due to its GDP, was sure about the direction that the EU was taking (Moreno, 2013).

To conclude, even though the Spanish government prefers the Commission to be the main decision-maker instead of the Council, it adopts a flexible and positive position because the country needs to reach agreement. It emphasizes that the key issue is to close the EBU and that the election of the Council or the Commission would not constitute a line of disagreement for Spain (Moreno, 2013, p. 4).

4.2.3 Supranational Actors' Preferences and Interests

EU Institutions' Preferences and Influence

EUROPEAN COMMISSION

The Commission's preferences regarding the SRM include the establishment of a single resolution authority or SRB capable of deciding if and when to close a bank overriding if necessary its home state and without any vetoes that could block a resolution (Barker, 2013). The Commission considers itself as the independent and legitimate authority to carry out these functions. Moreover, it is in favour of a common resolution fund financed by both big and small banks (Barker, 2013). Especially here it held a completely different view than other eurozone MSs like Germany which proposed an intergovernmental treaty for the creation of the SBRF. Both the Commission and the European Council opposed to this proposal and disagreed with the German finance minister on the need for a treaty change (EUobserver, 2013).

According to the Commission (2013a), although intergovernmental tools outside the EU institutional framework have been necessary in other cases to tackle governance flaws in the design of EMU, these can undermine the democratic quality of EU decision-making. Thus, the establishment of the SRM within the EU treaties and institutional framework, as it was the case with the SSM, was an essential step to complete EMU and ensure the democratic order of the EU. According to Spiegel Online International (2013), the European commissioner for economic and monetary affairs and European Commission vice president, Olli Rehn, warned that Germany was turning to intergovernmentalism and that that was the arena of big countries. He also argued that if the European project was meant to fully integrate smaller MSs into the decision-making process, then the "community method" had to be used. Moreover, Michel Barnier said that he had taken the legal concerns into account but pointed out that the euro zone could not wait for a treaty change and that the EU already found a way to do it in the current treaty (Barker, 2013).

Lastly, senior Commission officials were confident that they were going to get political support even from Germany and the Northern coalition for the creation of a SRM to complement the SSM (Barker, 2013).

EUROPEAN COUNCIL

According to Veron et al. (2013), in December 2012 the European Council agreed on a “Roadmap for the completion of the Economic and Monetary Union” which included the establishment of a SRM. The Council argued that a SRM was needed saying: “In a context where bank supervision is effectively moved to a single supervisory mechanism, a single resolution mechanism will be required, with the necessary powers to ensure that any bank in participating MS can be resolved with the appropriate tools” (Veron et al., 2013, p. 4). Therefore, the Council supported the centralization of bank resolution powers and the creation of a single resolution authority and SBRF.

EUROPEAN PARLIAMENT

First of all, most MEPs always supported the Commission’s proposal for a centralized strong resolution authority and a SBRF. Therefore, they opposed the intergovernmental treaty proposed by Germany which placed a major part of the EBU beyond the reach of EU oversight. This plan to go outside the EU treaties set MSs on a collision course with MEPs (Keating, 2013). Elmar Brok, a senior centre-right MEP from Germany, said that the idea of having an intergovernmental treaty was “nonsense” and that they proposed it because they were afraid of the EP (Keating, 2013). The intergovernmental treaty would cut the powers of the EP and the European Court of Justice, and weaken the Commission’s control (Keating, 2013).

Furthermore, the French Liberal MEP Sylvie Goulard said that she was concerned about this tendency to strike intergovernmental agreements and added: “It is meant to be a single resolution fund, but this IGA could potentially lead to national governments having vetoes” (Keating, 2013, p. 2). Indeed, according to Spiegel Online International (2013), MEPs argued that Chancellor Angela Merkel was aiming at giving big MSs too much power.

To conclude, the President of the EP, Martin Schultz, argued that this proposal for an IGA had twisted the European idea into the opposite direction. It makes the EU a tool which MSs could use to enforce their interests. The EU project, which was meant to balance the interests of all MSs, was threatened by brutal power politics where the powerful MSs are the main decision-makers¹⁶ (Spiegel Online International, 2013).

Other International actors’ Preferences and Influence

INTERNATIONAL MONETARY FUND (IMF)

The IMF supported and promoted the centralization of banking resolution and restructuring at EU level. This international organization argued that by transferring the responsibility for financial support from the national to the supranational level, individual sovereigns would be protected from banking sector weaknesses (Goyal et al.,

¹⁶ Although intergovernmentalism may guarantee a greater legitimacy, national vetoes make more difficult to reach decisions. And less powerful countries tend to be bullied by more powerful states (The Economist, 2011).

2013). Moreover, during the negotiations phase, the head of the IMF, Christine Lagarde, argued that the EBU had to be completed quickly. She said: “A lot has been done in relation to banking union. If I have a message today it is that that particular part of the ship needs to be finished, needs to be completed and speed is of the essence” (BBC News, 2013a, p. 1).

Furthermore, the IMF carried out financial sector assessments in several euro zone MSs like Greece, Portugal and Spain. It made recommendations and issued guidelines for a centralized SRM. For instance, it argued that a credible resolution framework at EU level would also limit the potential burden on taxpayers by using the bail-in tool when necessary. The IMF followed the creation of the EBU and made statements to argue in favour of the establishment of a strong and centralized resolution authority and resolution fund to complete the SRM for the eurozone. Thus, the preferences of this international organization were in line with those of the EU institutions.

EUROPEAN CENTRAL BANK (ECB)

On 17 December 2012, the ECB President, Mario Draghi, argued during an ECON Committee that the second priority for 2013 from the ECB’s perspective was the completion of the EBU with the creation of a SRM (Veron et al. 2013). Moreover he stated: “Banking union should help speed up the repair of banks – that is if, as I hope, we end up with a strong resolution mechanism (...) We need a mechanism that allows non-viable banks to be wound down without financial stability risks, as we see in the US” (Armitstead, 2013, p. 1). Also, he pointed out that the EMU was not created for some MSs to be always creditors and others to be debtors (Armitstead, 2013).

Furthermore, the ECB President argued that the stress tests could not be carried out unless there was an operational resolution mechanism and an adequate resolution fund at a pan-European level. This pan-European backstop was not included in the provisional banking union, the one that the German government called a “timber-framed” banking union (Gual, 2013). Moreover, the ECB said that it was not necessary to change the treaties and that the SRM could be established under Article 114 of the TFEU (EFE Economía, 2013b). Moreover, according to Coeuré (2013), the ECB stated that the design of the BRRD, as a new regulatory framework for the EU was an achievement since many MSs did not have a resolution framework before the financial crisis.

With regards to the governance of the SRM and its decision-making structure, the ECB supported the establishment of a strong and independent single resolution authority since effective resolution is not only about strong rules but also about fast decision-making. The single resolution authority should be able to take decisions quickly in the interest of all MSs and to make use of a SBRF financed by the banks (Coeuré, 2013). In this sense, participant MSs in the EBU must give up sovereign power and be willing to deepen European integration and thus, strengthening EMU (Constâncio, 2014). However, the ECB recognized that large powerful countries must stop providing their domestic banks with public support. This means that their competitiveness in the euro

zone might be diminished when looking at bank's ratings and funding costs (Constâncio, 2014). And countries with vulnerable public finances would no longer be able to support and save their national champions (Constâncio, 2014). Moreover, the degree of discretion of NRAs in applying the bail-in rules should be as restricted as possible (Coeuré, 2013).

To conclude, according to the ECB Vice President Constâncio (2014), Jean Monnet's functional method of integration is still fully operational since from an institutional innovation like EMU and the SSM, others like the SRM become necessary. And nothing is lasting without institutions like the Commission which is at the heart of the process by strengthening the rules and allows all MSs to benefit from the single currency (Trichet, 2011).

EUROPEAN BANKING FEDERATION (EBF)

First of all, the EBF¹⁷ supported the banking union project as a complement to EMU and promoted the single rulebook and its application. It argued that the banking union framework had to make progress to correct the fragmentation of financial markets and break the link between the banks and the sovereigns. Also, it should ensure a level playing field and create an efficient common crisis management system for banks of MSs participating in the SSM (EBF, 2013c).

With regards to the creation of the SBRF, the EBF stated that the establishment of resolution-financing arrangements for the SRM was necessary. However, not all EBF Members found that a single resolution fund was feasible¹⁸. Some of Europe's banks believed that a SBRF could not be established at least in the short term since significant preconditions had to be fulfilled. In this sense, the EBF said that all participating MSs had to be at the same level regarding the legacy assets of the financial crisis. And most importantly, there had to be an assessment of the balance sheets of all the SSM banks in the first place. Moreover, as an essential element of resolution financing, the EBF was in favour of the broad use of the bail-in tool. It supported a common approach to bail-in which is harmonized in the Single Market (EBF, 2013a). According to Europe's banks, "there must only be very limited national discretion for NRAs to exclude eligible liabilities from the application of the bail-in, with appropriate safeguards, in order to preserve financial stability or ensure the effective application of bail-in" (EBF, 2013a, p.1). And the EBF favoured a timeframe of at least 15 years to build these funds (EBF, 2013b).

Furthermore, regarding the governance structure of the SRB, the EBF argued that this board should have a strong legal basis, i.e. a treaty change if needed (EBF, 2013c). It argued that a supranational resolution authority would have the benefit of taking into

¹⁷ The Board of the EBF is composed of the presidents of 32 national banking Associations, which are mainly CEOs of the most important European banks (EBF, 2013d).

¹⁸ For instance, the Federation of Finnish Financial Services did not favour the creation of a SBRF (EBF, 2013c).

account the interest of the European Single Market and economy when acting and thus, could avoid the pressure of local or foreign creditors (EBF 2013c).

With regards to the deployment of the ESM as a fiscal backstop, the EBF was in favour of using the ESM as a backstop but points out that a solution had to be found for financial institutions in non-eurozone countries that might join the SSM (EBF, 2013c).

To conclude, the EBF favors an independent single resolution board and SBRF for a quick decision-making process. This was stated by the Chief Executive of the EBF, Guido Ravoet, who said: “For us, the Single Resolution Mechanism – with an independent Board and fund - is the logical next step in the Banking Union process, which we strongly support. It will ensure a consistent application of the recently agreed Bank Recovery and Resolution framework for banks within the Single Supervisory Mechanism (SSM)” (EBF, 2013e, p. 1). And he added: “It is crucial that the SRB is able to take decisions regarding all banks within the SSM whether directly or indirectly supervised by the ECB. An efficient and timely decision-making process for the resolution of cross border banks in the SSM will be of the utmost importance” (EBF, 2013e, p. 1).

SCIENTIFIC ADVISORY COMMITTEE OF THE ESRB

The ESRB constituted an institutional response to guaranteeing systemic stability. The mission of this organization is to identify any problems that may arise in a financial institution and take proper action by coordinating national regulators in case of a possible contagion. The ESRB is chaired by the ECB until 2016 (Donnelly, 2011).

According to Donnelly (2013a), the ESRB supported the adoption of the bail-in tool and highlighted the need for ex ante funded funds since asking banks for capital during a financial crisis would be negative for the economy and inefficient because institutions lack capital. Moreover, the Scientific Advisory Committee part of this organization called for the establishment of a single resolution authority and fund since both were necessary in order to place supervision and resolution on the same foot and to break the vicious doom loop between banks and sovereigns. Therefore, this Committee supported a combination of supervision, resolution and DGS at EU level with access to the ESM as a fiscal backstop. The Committee expressed also concern that the Council did not mention this.

To conclude, the ESRB was also in favour of transferring competencies and resources to the European level in order to achieve financial stability and an integrated financial market (Donnelly, 2013a).

4.2.4 Final Outcome: The Role of Power in the Negotiations on the SRM

On 19 December 2013 the Council reached a general agreement on a proposed SRB and SBRF for the SRM. It covered all banks supervised by the SSM. The agreement consisted of a draft regulation on the SRM and a decision by eurozone MSs committing them to negotiate by 1 March 2014 an IGA on the functioning of the SBRF (European

Council, 2013a). According to the IGA, the SRM would enter into force on 1 January 2015 and the bail-in tool and resolution functions would apply from 1 January 2016.

According to European Voice (Keating, 2013), the MSs opted for an IGA for banking resolution in order to meet Germany's concerns. As previously mentioned, this country was worried about establishing this mechanism under EU law since this could make it liable for the debts of banks in other MSs and be likely to collide with its constitutional court. Thus after the negotiations in Brussels a draft compromise was achieved which was mainly based on Germany's position.

The main legal elements of the Commission's proposal for a SRM regulation that were altered as a result of the negotiations were the functioning of the SBRF together with the fiscal backstop provisions, as well as the governance structure and decision-making process of the SRB.

SBRF: Functioning and Voting Arrangements

The agreement introduced arrangements for transferring national contributions to the fund and their mutualisation over a period of 10 years. During the transition period, the financing system is meant to be based on a network of national resolution funds and the IGA should decide how costs could be shared (Barker & Spiegel, 2013). According to the Council (2013a), during the first year the bank resolution costs after bail-in would come from the compartments of the MSs where the banks are located¹⁹. As table 2 of Annex II shows, when the fund has to be used in a resolution case, the costs are born by the compartments of the relevant home and host countries taking into account the amount of contributions the banking group had contributed to each of the MSs' national compartments (European Council, 2013b). Moreover, with regards to the voting arrangements of the SBRF, big MSs are given more voting power to block the use of common resolution funds. In intergovernmental agreements voting power is linked to financial contributions. This gives powerful countries greater weight. Most finance ministers opposed to this voting arrangement. Germany, the Netherlands and Finland could be a blocking minority according to the requirement for a two-thirds majority based on the ECB capital key (Barker & Spiegel, 2013). Besides, regarding the SBRF backstop, during the initial phase of the fund, financing was planned to be available from the MSs' national sources or from the ESM (European Council, 2013a). However, this agreement did not manage to create a common backstop for the fund (Waterfield, 2013).

Governance Structure of the SRB

The governance structure of the SRB would consist of an executive director, four full-time appointed members and the representatives of the NRAs of the participating MSs.

¹⁹ The IGA provisions concerning the functioning of the fund established that participating MSs had the following obligations: 1. to transfer the contributions raised at national level in accordance with the BRRD and SRM Regulation to the fund; and 2. to allocate the contributions to their respective compartments during the transitional period. These compartments would merge and disappear at the end of the transitional period (European Council, 2013b).

The Commission and the ECB would be permanent observers (European Council, 2013a). Also, in case the Commission opposes to a SRB decision or thinks it should be changed, it will have to submit a proposal to the Council, and this will make a decision (European Council, 2013c). According to BBC News (Peston, 2013), it is worth to note that MSs' finance ministers did not fully delegated decision-making on banking resolution to the SRB. MSs remained in charge of the decision-making process. Moreover, at Germany's insistence, the Council of EU finance ministers represented in the SRB has a veto by simple majority vote. Therefore, although many technocrats are involved in the process, the final decision is considered to be political (Telegraph Staff, 2013).

Lastly, the Commission did not agree with the IGA²⁰ and especially the EP expressed concern about the result of the negotiations. Sven Giegold, a German Green MEP and member of the EP's economic and monetary financial affairs committee said that the MSs' compromise would empower the Council to use public funds for resolution purposes (Keating, 2013). However, the EBF members welcomed the Council's agreement (EBF, 2013e).

Trilogue Agreement on SRM

On 20 March 2014 the Council reached an agreement with the EP on the SRM regulation (Council of the European Union, 2014). According to this agreement the SRM will be governed by two texts: a SRM regulation and an IGA covering some specific aspects of the functioning of the SBRF (European Commission, 2014).

According to Europolitics (Malhère, 2014), the main line of disagreement between the Council and the EP was the transitional period for the mutualisation of the national funds. As previously mentioned, the Council set a transitional period of 10 years. But the EP opposed to this long pooling period. At the end a compromise was reached for a transitional period of 8 years as demanded by the EP. Although the design of the fund was in line with Germany's demands, the MEPs managed to guarantee the earlier mutualisation of the fund (Barker, 2014). The MEPs welcomed the compromise showing that they had the power to make Mr. Schäuble make concessions. The Green MEP Sven Giegold stated: "The European Parliament is powerful. We can wake up Wolfgang Schäuble at 5.30am and he actually made concessions" (Barker, 2014, p. 1). However, according to the EBF members, this build-up period of 8 years differed from the 10 years that is allowed in the BRRD. They argued that this could cause competitive distortions in the single market since it places a burden on banks covered in the SSM (EBF, 2014a).

²⁰ Commissioner Michel Barnier argued: "the Commission does not agree on every point in the general approach, but real progress has been made in very little time. Many of you are asking if I am disappointed that the Commission is no longer the trigger. I am not. I always made clear the trigger should be an European institution but I was open as to which one. I said so again last week when I explained the hybrid system being created was too complex. In many ways today's agreement is actually better than last week's texts. And the text is a good basis to start negotiations with the European Parliament" (European Commission, 2013b, p. 2).

Furthermore, the governance structure of the SRB and decision-making procedure was only slightly modified to give the Commission a formal role to assess the discretionary aspects of the SRB's decisions on approving or rejecting resolution schemes. However, the Commission and the ECB remain permanent observers. And none of the participants in the deliberation would have a veto (European Commission, 2014).

To conclude, the ECB will be in charge of recommending the resolution authority to take action on a troubled bank. Then the resolution authority's decision to take action will have to be approved by the Commission. If this does not agree with the decision, MSs will have the final say (European Voice, 2014). MEPs did not manage to cancel MSs' decision to create the SBRF under an IGA. MSs like Germany succeeded in imposing its preferences (European Voice, 2014).

Interstate Negotiations and Member States' Relative Bargaining Power

National governments in ECOFIN meetings and European Council sessions are predominant in the decision-making stage, and this was mainly characterised by interstate bargaining, with the largest MSs at centre-stage. The German finance minister engineered such a proposal and together with other countries of the Northern coalition, was the political driving force for its approval, with the support of the French government and no noticeable opposition from the Spanish government and other national executives of the Southern coalition.

According to El País (2014), Germany did not change its position and its finance minister Wolfgang Schäuble even made a threat to the EP saying that Germany would block the SRM if the agreement reached in December was changed. On the other hand, the EP President Martin Schulz sent a letter to President Jose Manuel Barroso demanding the Commission to take more action in order to ensure that the EP did not fall outside the agreement. Martin Schultz argued that the decision taken by the Council was questionable. However, Schäuble can afford to make these threats of non-agreement because otherwise the SRM would not be established eliminating the chance to create a SBRF for the eurozone (Pérez, 2014).

Furthermore, supranational or nongovernmental actors were crucial at the agenda-setting stage of the process, which began with the Commission's proposal for a SRM regulation based on the BRRD. The Commission and other supranational actors like the IMF and the ECB acted as policy entrepreneurs by defining problems – namely, the need for a crisis management framework for bank resolution at EU level – and by proposing concrete solutions. The EP, which was not involved in the agenda-setting stage, participated in the co-decision procedure with the Council. However, the influence of supranational institutions was greater in the agenda-setting phase and minimal during the negotiation stage. But previous integration and hence increased economic interdependence originated from the creation of the internal market and EMU provided the background for the reform.

The explanation for the Council compromise on an IGA to establish a SBRF and a more decentralized governance structure for the SRB lies in the relative bargaining power of

the MSs during the interstate negotiation process. This is determined by the MSs' intensity of preferences, their power resources, the size and strength of competing coalition of states and patterns of asymmetric interdependence. This interpretation and discussion of empirical results constitutes a first step for the corroboration of hypotheses carried out in the next section.

Relative Intensity of Preferences

The determinants of MSs' relative intensity of preferences include: 1. the distribution of costs and benefits; 2. the existence of unilateral policy alternatives and threats of non-agreement; 3. the existence of alternative coalitions and threats of exclusion; and 4. the intensity of preference at the margin.

Regarding UK's intensity of preferences, the UK firmly opposed the Commission's proposal for a pan-European SBRF and SRB. The British government declared that it did not want its taxpayers to pay the debt of banks of other MSs and that this country was not willing to join the EBU and SRM. However, according to European Voice (Keating, 2013), George Osborne, the UK's finance minister, said to his counterparts that the UK was in favour of a banking resolution mechanism and would not stand in the way of an agreement. It is important to mention that while the euro area represents the vast majority of the EU's banking assets, the UK covers the majority of banking assets in the rest of the EU (see figure 4 in the Annex I) (Veron, 2012). However, even though the EU financial services market is ranked as the most important market by 62% financial services professional in the UK in 2011, 68% agreed with the following statement of the survey: "The UK Government should take back more control from the EU over financial regulation and governance even if it risks compromising the possibility of easier access to other European countries" (ComRes, 2011, p. 2). Moreover, UK had a unilateral policy alternative to banking union which was to continue with its own national restructuring laws which include bail-in provisions (Commission, 2012b).

With regards to the French government's relative intensity of preferences, this country favoured the creation of a pan-European SBRF since it is considered to get more benefits due to its economic circumstances. The French government focused on this issue and on the concept of solidarity among the EU MSs. However, it was less willing to accept a centralized SRB where the Commission would be empowered. This fact together with the approach of the German government to get French support made France back Germany's proposal for the creation of the SRM through an IGA. Moreover, it could be argued that France had to some extent a unilateral policy alternative since it has recently introduced mechanisms at national level to resolve failing banks. The ACPR (*Autorité de Contrôle Prudentiel et de Résolution*) manages the deposit guarantee and resolution fund (FGDR). Financial institutions have to elaborate resolution plans which have to be approved by the ACPR. This authority is also able to remove the bank managers, transfer the establishment and enables the FGDR to intervene in order to make the losses be borne by creditors and shareholders

(Avaro & Sterdyniak, 2013). The FGDR guarantees the stability of the French banking system in this way (FGDR, 2014). This regime can be seen as pursuing the same objectives as the Commission proposal and it is compatible with it (Commission, 2012b).

Regarding the relative intensity of preferences of Germany and other countries from the Northern coalition, the German government's main interests were to protect its taxpayers and to avoid that the Commission would get too powerful in the SRB. Its preferences respond to the fact that Germany sees itself as the MS which would have to contribute the most to the SBRF assuming most of the costs. This asymmetry in the distribution of costs and benefits makes the German government block the Commission's proposal. And it succeeded in imposing its preferences partly because its preferences in creating a pan-European SBRF were not as intense as those of other countries like France and Spain. Therefore, the German government achieved MSs' compromise for an IGA. Moreover, according to Frach (2010), German finance industry accounts for the largest share of stakeholders in European financial market regulation. Thus, domestic interest groups such as the German banking industry have influence on Germany's preferences on the Commission's proposals in financial market regulation in general²¹. It is also argued that the several types of German banks (commercial banks/Kreditbanken, savings banks/Sparkassen and corporative banks/Genossenschaftsbanken) do have different demands on European intervention on resolution. The interests of corporate, public and saving banks collide with the interests of German universal banks.

Furthermore, in October 2008 Germany established the Special Financial Market Stabilization Fund (SoFFin) which was administered by the newly established German Federal Agency for Financial Market Stabilization (FMSA) (Allen & Overy, 2012). This SoFFin was meant to be a resolution fund for the German financial institutions using tools such as recapitalizations, risk transfers and bad bank schemes (Allen & Overy, 2012). Moreover, the Restructuring Act was based on the bail-in mechanism and was intended to avoid future bail-outs using taxpayers' money and tackle the issue of moral hazard (Allen & Overy, 2012). The BaFin was provided more interventionary powers and special resolution tools were introduced (Allen & Overy, 2012).

Lastly, regarding the intensity of preferences of Spain and the Southern coalition, the Spanish government was in favour of a pan-European SBRF as proposed by the Commission. This country like France is also expected to benefit the most from the fund. Also, countries like Spain, Portugal and Greece supported a strong and

²¹ Some authors have argued that national authorities in Europe have a "banking nationalism" that makes them to both want to support their domestic banks and impede that these banks are acquired by foreign banks. One of the main reasons for banking nationalism is that domestic banks are often a major purchaser of their MS government's bonds. Also, banking nationalism has consequences not only for how strictly banks are bailed-in, but also decisions about to whom a bank is sold (Gandrud and Hallerberg, 2013).

independent SRB led by the Commission. Moreover, the Spanish government expressed its urgent need to reach an agreement and create a SRM maintaining a positive and flexible position during the negotiations. This country and those of the Southern coalition had therefore a lower bargaining leverage due to their vulnerability. The fact that they were the most in the need to reach an agreement made them weaker in the negotiations. Besides, Spain was one of the European countries who have faced the crisis without having any clear resolution mechanisms at national level²² (Gual, 2013). The Spanish authorities were advised to include forced resolution options in the legislation such as the possibility to override shareholders' rights, perform mandatory transfers of assets and liabilities and establish bridge banks (IMF, 2012). Therefore, Spain did not have a special bank resolution and restructuring regime in the period before the crisis. It did not include many of the provisions such as the bail-in principle laid down in the Commission's proposal. Regarding the intensity of preference at the margin, due to time pressure and uncertainty about the collapse of the negotiations, the governments of the Southern coalition made concessions when they accepted the IGA as an institutional structure for the SBRF.

Power Resources available to the MSs

The empirical indicators of MSs' power resources include: 1. MSs' economic situation during and after the global financial crisis (e.g. GDP growth); and 2. Ability to pay into a pan-European resolution fund.

With regards to the UK's financial stability, as figure 5 in Annex I shows, this non-euro zone country has a relatively low national sovereign exposure (57% approx.) in comparison to euro zone countries like Germany, Spain and Italy, for example. Moreover, according to Eurostat (2014a), which provides data on the difference between government revenue and expenditure that shows the net impact on the EDP deficit/surplus due to direct government interventions during the financial crisis, in 2013 the impact in the UK was negative compared to a positive one in 2012 (See graph 1 in Annex I).

Regarding the French economy during and after the global financial crisis, this country had one of the lowest DGP growths in 2012 and 2013 as figure 3 in Annex I shows (Eurostat, 2014b). During these years the country's public debt raised to a record level (Willsher, 2013). Moreover, Germany accused France of being "Europe's biggest problem child" since the French industry is increasingly losing its competitiveness (Vasagar, 2013). It has been argued that, with this weakened economy, the French Prime Minister, François Hollande, desperately needed Germany's support for his

²² The Spanish financial safety net architecture for the banking sector includes the Bank of Spain (BdE, *Banco de España*), the Deposit Guarantee Fund (FGD, *Fondo de Garantía de Depósitos*), and the Orderly Bank Restructuring Fund (FROB, *Fondo de Reestructuración Ordenada Bancaria*). The Ministry of Finance (Mde, *Ministerio de Economía y Competitividad*) is responsible for financial policy covering rules and measures aiming at guaranteeing financial stability. The main objective of the FGD is to guarantee depositors and to ensure the continuity of credit institutions. After the global financial crisis, this institution was taken over by the FROB which is responsible for restructuring the Spanish banking industry (IMF, 2012).

appeal to delay EU budget deficit targets (Carnegy, 2013). Therefore, the French government does not have the ability to both pay for its banks and into a common resolution fund. Moreover, with regards to the stability of its financial sector, according to Eurostat (2014a), in France the impact of interventions on government deficit in 2013 was negative but less than in 2012 (See graph 1 Annex I) (Eurostat, 2014a). Also, France has many large national banks like BNP Paribas with a high level of competitiveness.

According to The Economist (2011), certain Northern European countries such as Germany, the Netherlands, Sweden and Finland, have survived to the crisis better than France and Southern European countries like Spain and Portugal. In particular, Germany is considered to be the biggest economy in the EU and the MS with the highest rate of GDP growth from 2011 to 2013, as figure 3 in Annex I shows (Eurostat, 2014b). Therefore, Germany has the ability to pay for its banks and into a common fund. Germany may feel less exposed to the crisis than other European countries and it is reluctant to risk its taxpayers' money. Also, the German Chancellor, Angela Merkel, does not talk so much about "solidarity" during meetings except to highlight that it must be subject to discipline (The Economist, 2011). Moreover, regarding the stability of its financial sector, in Germany the impact on government deficit in 2013 was negative but less than in 2012 (See graph 1 in Annex I) (Eurostat, 2014a). However, Germany also bailed out some of its large credit institutions such as the *Deutsche Industriebank AG (IKB)*, the *Westdeutsche Landesbank (WestLB)* and the *Landesbank Baden-Württemberg (LBBW)*. According to Bulmer and Paterson (2013), Germany emerged as a reluctant hegemon in the eurozone crisis where its principal creditor status placed it in the driving seat. Disagreements and objections from other states faded.

Lastly, regarding the Spanish economy during and after the global financial crisis, this country had one of the lowest percentages of GDP growth from 2011 until 2013 as figure 3 in Annex I shows (Eurostat, 2014b). From the perspective of the financial markets, during the crisis and before the intervention by the ECB, there was a huge rise in the risk premia of the periphery government debt in comparison with the German bund (Gual, 2013). Moreover, according to Eurostat (2014a), in 2013 the increase in deficits was particularly large in countries like Greece due to bank resolutions and recapitalizations. In Spain the impact in 2013 was negative but less than in 2012 (See graph 1 in Annex I) (Eurostat, 2014a). With regards to the stability of its financial sector and the vicious loop between sovereign and bank debt, weak sovereigns like Spain can cause problems to local financial institutions. The key factor is the local orientation of these banks ("local bias") particularly regarding their holdings of sovereign debt. In 2011, Spain had one of the highest percentages of national sovereign exposure (See figure 5 in Annex I) (Gual, 2013). All these data points out that Spain did not have any ability to both successfully pay for its banks if necessary and into a common resolution fund. This lowers the relative bargaining power of the country.

Size and Strength of Competing Coalitions of States

The determinants of the size and strength of competing coalitions of states include: 1. the power resources of the MSs conforming the coalition; and 2. the ability to pay of the MSs.

During the negotiations on the SRM, there were mainly two important coalitions: the Northern and the Southern coalition. The Northern coalition, led by Germany, was composed of economically powerful MSs. In the SBRF established through an IGA, countries which contribute the most to the fund have more weight on decision making. It gave big countries a greater say on when it could be used (Barker & Spiegel, 2013). Therefore, MSs with more ability to pay are more in control of banking resolution at EU level. This is the reason why Germany proposed an IGA for the functioning of the SBRF and a new governance structure for the SRB. By contrast, the countries of the Southern coalition are not powerful and remain vulnerable during the negotiations. At the end, intergovernmentalism is the terrain for powerful states.

To conclude, these asymmetric interdependences among the MSs mean that some MSs are more dependent on a pan-European SBRF than others. And, some have stronger economies and more power resources than others. Therefore, those MSs from the Northern coalition will have more bargaining power and succeed in the interstate negotiation process.

4.3 Corroboration of Hypotheses

The testable hypotheses are divided into the dichotomy of demand for and supply of regulation, i.e. SRM.

4.3.1 Demand for a SRM at EU level

<i>H1(NF): If Neofunctionalism is applicable, then functional spillovers will create incentives and demands on Member States to integrate banking resolution at EU level by introducing the SRM</i>	<i>H1 (LI): If Liberal Intergovernmentalism is applicable, then Member States as actors calculate the utility of alternative courses of action and choose the one that maximizes their utility under the circumstances regarding the SRM</i>
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First of all, regarding H1 (NF), the crisis highlighted the absence of resolution arrangements at EU level to handle troubled cross-border institutions and to protect the taxpayer. Therefore, there was a demand for regulation in financial services to achieve greater EU financial integration by creating a common EU resolution framework (Commission, 2012b). This demand for a SRM at EU level came from supranational actors, i.e. EU institutions and other international organizations like the IMF and ECB, as well as nongovernmental actors. The fact that a SRM with a pan-European SBRF and a centralized SRB is essential to guarantee the proper functioning of the EBU and SSM, as well as of the internal market in financial services triggers integration in bank

resolution. Functional incentives to integrate bank resolution powers end up in functional spillovers since a SRM regulation with resolution tools such as bail-in is adopted in the final outcome for those purposes. However, the EU came up with a hybrid construction where the SBRF is established by an IGA and the MSs are the main decision-makers in the SRB.

According to Quaglia (2007), it is well acknowledged that financial integration and consequently, the regulation and supervision of financial activities have always been a sensitive area for the MSs. However, the EU took a big step initiating the reform of the European financial sector and implementing the recommendations laid down by the De Larosi re report and supranational actors. On the contrary, the establishment of an EU-wide crisis resolution and burden sharing mechanism still falls short of what was recommended. Still H1 (NF) could be considered to be accepted.

With regards to H1 (LI), even though the crisis gave the Commission an opportunity for reform, MSs' political constraints and reluctance to hand in resolution powers to the Commission prevailed (Kudrna, 2012). MSs calculated the utility of alternative courses of action. For instance, the Northern coalition did not demand a high degree of centralization. But France and the Southern coalition demanded more centralized regulation. The Northern coalition, especially Germany, had a unilateral policy alternative, i.e. a strong financial sector backed up by a special resolution regime including the bail-in tool. On the other hand, the Spanish financial sector remained economically weak and lacked a proper resolution system to save its banks. This hypothesis can be considered as accepted because MSs calculated the best way to achieve a SRM.

To conclude, the theory most successful at explaining the demand for a centralized SRM at EU level is NF since functional incentives and demands for integration come from supranational and nongovernmental actors. By contrast, at the national level, not all MSs' national governments demand centralized regulation in this policy field.

4.3.2 Supply of a SRM at EU level

<i>H2 (NF): If Neofunctionalism is applicable, then the institutional structure of the SRM will reflect for a great deal the wishes of the EU institutions and other international actors like the IMF, ECB, EBF and ESRB</i>	<i>H2 (LI): If Liberal Intergovernmentalism is applicable, then the relative bargaining power of Member States, together with their positions which reflect the interests of domestic actors, explain the introduction of the SRM</i>
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With regards to H2 (NF), the final institutional structure of the SRM reflects mainly the interests of the most powerful MSs in the eurozone, i.e. the preferences of Germany and other countries of the Northern coalition. These were the establishment of the SBRF through an IGA and empowerment of the MSs in the SRB. Therefore, the preferences of

the supranational actors are not reflected that much. Indeed MSs supported the creation of an EU-wide resolution framework with a resolution authority and a resolution fund in order to ensure the proper functioning of the single market in financial services. Also, they favoured the adoption of the bail-in tool and the deployment of the ESM as a public financial backstop for the fund. However, even though these have been created, the institutional structure of the SRM reflects MSs' preferences. EU institutions and international organizations were influential as policy entrepreneurs taking into account the demand for regulation from interest groups and defining problems.

The Commission has agenda-setting powers but the EP is widely considered as a weak parliament (Tsebelis, 1994). Moreover, according to Tsebelis (1994), if the positions of the Council and the Commission are not the same and if each actor selects the best alternative for itself, the EP sometimes has the power to impose its preferences upon the actors through clever selection of its proposals. The requirement for successful parliamentary proposals is an absolute majority in the EP. This needs congruence on the part of socialists and Christian Democrats from different MSs. However, this type of alliance is not frequent at national level. This is also not the case in the SRM negotiations. Socialists and Christian Democrats held opposing views in Germany, for example (Tsebelis, 1994). MSs' governments control the speed of integration and the Council is able to overrule the EP (Tsebelis, 1994). This hypothesis is rejected.

With regards to H2 (LI), MSs' national executives played the leading role in the negotiation process of the SRM and the influence of supranational actors was minimal. Bargaining theory explains the introduction of the SRM. Some MSs like France, Spain and the Southern coalition supported the centralization of the SRM. However, Germany and the Northern coalition were not willing to transfer resolution powers involving fiscal implications to the EU level (Kudrna, 2012). These MSs seemed to impose their preferences on weaker MSs pursuing short-term rather than long-term interests (ECFR, 2012). Therefore, the outcome of the interstate bargaining is an IGA as proposed by the most powerful MS: Germany. This is based on the MSs' relative bargaining power. Regarding the relative intensity of preferences, France and Spain based their statements on supporting the creation of a pan-European SBRF with the ESM as a backstop. However, Germany and the Northern coalition opposed to this and based their position on establishing national funds to protect their taxpayers and restrict the power of the EU institutions in the governance of the SRB.

The German government's preferences reflected the interests of powerful domestic groups like the German banking industry concerned with the distribution of costs and benefits of the SBRF. And lastly, regarding MSs' power resources, Germany and the Northern coalition were more powerful economically having more ability to pay both for its banks and into a common fund. Therefore, they enjoyed a higher bargaining power. By contrast, France, Spain and the Southern coalition were less powerful. The final outcome was achieved through interstate bargaining where the most powerful MSs played the dominant role since their relative bargaining power was the highest. This hypothesis is accepted.

<i>H3 (NF): If Neofunctionalism is applicable, then the SRM will empower the Commission as an ultimate authority in the integration process</i>	<i>H3 (LI): If Liberal Intergovernmentalism is applicable, then the SRM is introduced through intergovernmental negotiation and bargaining of Member States, rather than through the centralized authority of the EU institutions making and enforcing political decisions</i>
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With regards to H3 (NF), in the integration process of the SRM and final outcome the Commission as high authority does not play a leading role, even though it is an actor with agenda-setting powers. It acts as a policy entrepreneur but it does not have any influence in the negotiations. This can be due to the fact that it is not supported by a powerful MS. This EU institution does not constitute the ultimate authority in the integration process of the SRM because the outcome of the negotiations is an IGA where MSs are in control of bank resolution at EU level. This hypothesis is rejected.

With regards to H3 (LI), the SRM is introduced by intergovernmental bargaining and partly by an IGA, except the SRM regulation which is established under the EU treaties. EU institutions are not making or enforcing decisions because MSs remain in control of the process of integration. The EP and the Commission pushed for a pan-European fund with a strong external credit line where Brussels would have the final say on decisions rather than the MSs (Barker, 2014). Therefore, this hypothesis is accepted.

<i>H4 (NF): If Neofunctionalism is applicable, then the preferences of the Member States will be constrained by previous institutional commitments like the creation of EMU and the Internal Market</i>	<i>H4 (LI): If LI is applicable, Member States choose to pool or delegate sovereignty, i.e. national banking resolution and restructuring powers, to EU institutions to enhance credible commitments</i>
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With regards to H4 (NF), the preferences of the MSs seem to be constrained by previous institutional commitments like the creation of the Internal Market and EMU because previous integration and hence increased economic interdependence provided the background for the reform. Previous integration led to further integration in the field of bank resolution. MSs' preferences are constrained by the fact that their most important financial institutions operate cross-border in an internal market of financial services. Therefore, a SRM at EU level is seen as necessary by all actors. Moreover, MSs' preferences are also constrained by the fact that the Maastricht design for EMU left fiscal policy in the hands of national executives. This makes the use of the ESM as fiscal backstop difficult because there is not a fiscal authority at European level. EMU was only conceived as a monetary union, and it did not become yet a fiscal and political union (Salines et al, 2012). This hypothesis is accepted.

Regarding H4 (LI), it could be argued that MSs like Spain and France delegate or pool national sovereignty to the new hybrid mechanism in order to achieve credible commitments from other MSs like Germany. Even though they do not achieve what they aimed for, they still transfer powers because they need an agreement and a credible

commitment from MSs which are not in a necessity of a pan-European resolution fund. France and the Southern coalition gave much more importance to reach an agreement under the European institutional framework. Therefore, the transfer of sovereignty of these countries responds to their interest in securing an agreement. Moreover, the MSs from the Northern coalition are using institutions to guarantee their interests. This hypothesis is accepted.

4.4 Conclusion

On the whole, as table 6 shows, the four hypotheses derived from LI are accepted, subject to some caveats. The national executives were the main actors in the decision-making stage, though they were only consulted in the agenda-setting stage by the Commission. The policy outcome reflects the preferences of the main players – namely Germany and the Northern coalition. In the formation of national preferences, the banking industry as domestic interest groups influenced the MSs' national governments. The most successful theory at explaining the supply of a SRM at EU level is LI. Other features of the process fit well with liberal intergovernmentalist assumptions such as the concern of MSs' governments about the loss of national sovereignty and the reluctance to delegate decision-making powers. However, NF does not fully explain the integration process of the SRM. While it is successful at explaining the demand for a SRM at EU level, it is not applicable to explain the supply of this new mechanism.

Table 6. Analytical framework and main findings

Theories	Hypotheses	Empirical results	Outcome
NF	<i>H1 Functional spillovers will create incentives and demands on MSs to integrate banking resolution at EU level by introducing the SRM.</i>	Functional pressures from previous integration triggers integration in this policy field and demand for regulation.	+
	<i>H2 The institutional structure of the SRM will reflect for a great deal the wishes of the EU institutions and other international actors.</i>	The final outcome barely conformed to the preferences of supranational actors (e.g. bail-in).	-
	<i>H3 The SRM will empower the Commission as an ultimate authority in the integration process.</i>	This actor was important in the <i>agenda-setting</i> stage but had minimal influence in the <i>decision-making</i> stage.	-
	<i>H4 MSs' preferences will be constrained by previous institutional commitments like the creation of EMU and the Internal Market.</i>	Path-dependency of the SM and EMU can be observed (e.g. increased economic interdependence, fiscal policy left to MSs).	+
LI	<i>H1 MSs calculate the utility of alternative courses of action and choose the one that maximizes their utility under the circumstances regarding the SRM.</i>	MSs had different preferences for a SRM. They calculated the best way to achieve a SRM protecting their interests.	+
	<i>H2 The relative bargaining power of MSs, together with their positions which reflect the interests of domestic actors, explain the introduction of the SRM.</i>	The final outcome conformed to the preferences of the most powerful MSs. Financial interest groups were active, though not only through domestic channels (e.g. EBF).	+
	<i>H3 The SRM is introduced through intergovernmental bargaining, rather than through the centralized authority of the EU institutions.</i>	MSs were the main actors in the <i>decision-making</i> stage. But SRM is a hybrid construction: SRM regulation and SBRF (created by IGA).	+
	<i>H4 MSs choose to pool or delegate sovereignty to EU institutions to enhance credible commitments.</i>	MSs from the Southern coalition transfer sovereignty to enhance credible commitments.	+

Source: own elaboration

Note: "+" = accepted; "-" = rejected

5. Final Conclusion

The present study aimed at testing the applicability of two European integration theories, NF and LI, in the case of the SRM. To do so, a congruence analysis has been carried out in order to see which theoretical approach is more successful at explaining the institutional supply of this mechanism. Even though the main focus is on institutional supply, the demand for centralized regulation is also investigated. The research question to be answered was: *“Why is there such a great gap between demand for and supply of a Single Resolution Mechanism (SRM) with a centralized Resolution Authority and a Single Bank Resolution Fund (SBRF) at EU level and how can Neofunctionalism and Liberal Intergovernmentalism explain the establishment of this crucial element of banking Union?”* In order to answer it, the main assumptions and theoretical expectations of NF and LI were outlined and explained. Then, their abstract concepts and analytical frameworks were applied to the case of the SRM.

The point of departure of this study was that the establishment of a SRM at EU level represented an ambitious project for the EU since it implied an unprecedented transfer of sovereign power for the MSs in the eurozone. However, the outcome of the negotiations turned out to be a mismatch between the wishes of some actors which demanded a centralized and supranationalised SRM and the actual outcome. This study shows that NF is successful at explaining the demand for centralized regulation. In the case of LI, regarding the stage of national preference formation, it was shown that not all MSs expressed a need for a centralized SBRF at EU level. Moreover, even though NF is successful at supplying part of the SRM, i.e. regulation with bail-in principle among others, the theory most successful at explaining the supply of regulation is LI since the institutional set-up for the SRM was supplied by a process of interstate bargaining in which the most powerful states like Germany and other countries of the Northern coalition managed to impose their preferences. The EU experienced further integration in this policy field, but not in the way desired by EU institutions and other international actors. The integration process was blocked by certain MSs who had a unilateral policy alternative, and a high degree of relative bargaining power based on their power resources, i.e. ability to pay in case their financial institutions get into trouble, and on their intensity of preferences. The result of the negotiations was, therefore, a hybrid mechanism. Power politics is the answer for the research question.

Furthermore, in order to provide this answer to the research question, I followed a list of sub-questions. To answer the first one, I used the Commission’s proposals to explain the main legal elements of the SRM. The next sub-question referred to the development of the Commission’s proposals for a SRM. The answer of this sub-question is important to highlight the influence of EU institutions pushing for a SRM with a centralized single resolution authority and an EU-wide SBRF and the role played by some MSs slowing down and constraining the EBU ambitious project. The answer to this sub-question is connected to the next one which asked which of the theories is more successful at explaining the integration process of the SRM. Influence of the preferences and interests of the supranational actors is barely observed in the final outcome of the negotiations.

And therefore, it is very likely that the main objectives for the creation of a SRM for EBU will not be fully achieved. The hybrid SRM designed for the transitional period is considered to be complex and lengthy. It does not fully break the vicious circle between banks and sovereigns since it will rely on resolution funds financed from the national compartments of each MS up to a period of eight years. Also, it lacks a pan-European backstop that could operate as a lender of last resort for the SBRF.

With regards to policy implications that can derive from the answer to the research question, it can be relevant to highlight the possible implications of the hybrid institutional structure adopted for the SRM. The establishment of this mechanism represents the largest transfer of sovereignty for MSs since the Maastricht Treaty. However, the SRM was established by an IGA which was not submitted to a referendum. It was agreed between the Council and a few MEPs. Thus, it remains to be seen who will be responsible for democratic oversight of this complex system. The Commission and the EP dreamt about it. MSs' national parliaments could do it partly. But at the end of the day the ECB will have the control (Garach, 2014). The deployment of intergovernmental tools outside the EU framework undermines the democratic quality of EU decision-making. Therefore, the fact that the SBRF exists outside the EU treaty framework would raise major questions about judicial review. Moreover, according to Guérot and Leonard (2011), there has been a shift from community method to the intergovernmental Union method.

And lastly, regarding possible limitations of this study and future lines of research, a study designed to assess exclusively the explanatory power of LI would have discussed the process of national preference formation more thoroughly. For future lines of research the different varieties of capitalism in the eurozone and the impact of the SRM in these could be added. Moreover, the governance and future functioning of the SSM and the SRM together could be investigated. For instance, once the stress testing carried out by the ECB is finished. And assessing the democratic legitimacy of this new intergovernmental agreement could be another future line of research in the field of European bank resolution and restructuring.

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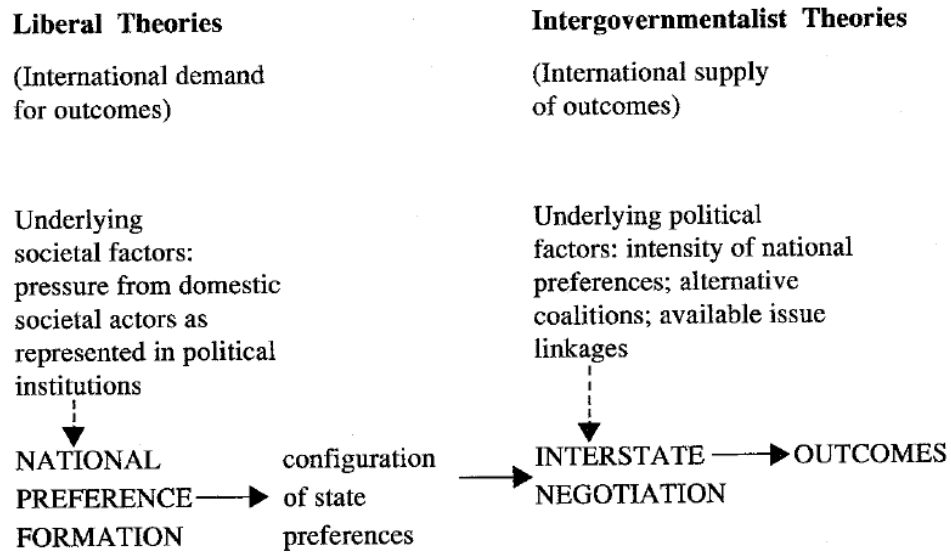
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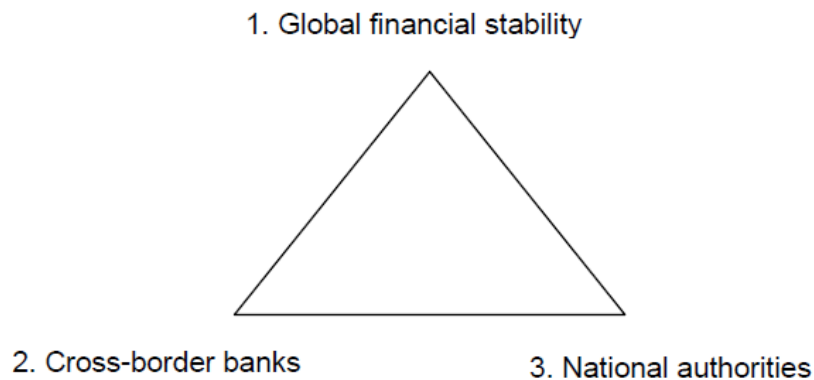
ANNEX I

Figure 1. Moravcsik's Model of a Two-Level Game



Source: Moravcsik (1993, p. 482)

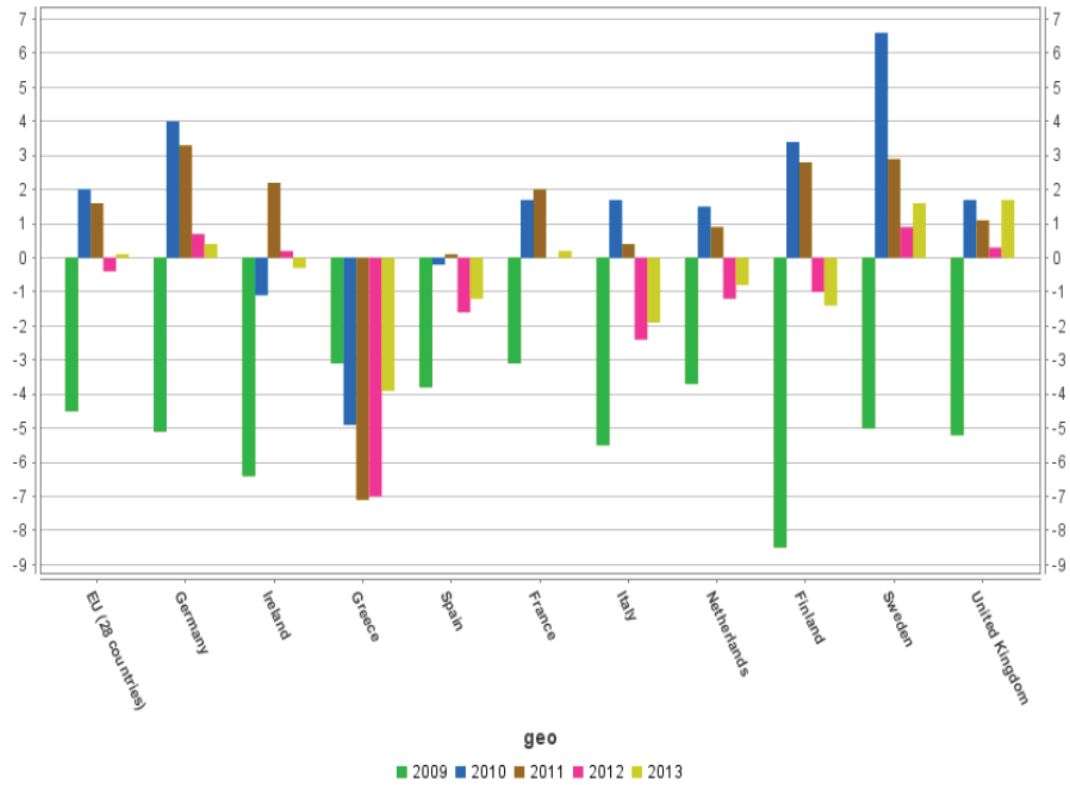
Figure 2. The Financial Trilemma



Source: Schoenmaker (2012, p. 5)

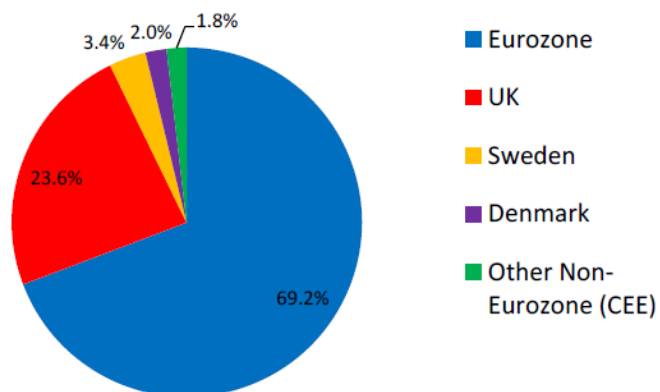
Figure 3. Real GDP Growth (2009, 2010, 2011, 2012, 2013)

Real GDP growth rate - volume
Percentage change on previous year



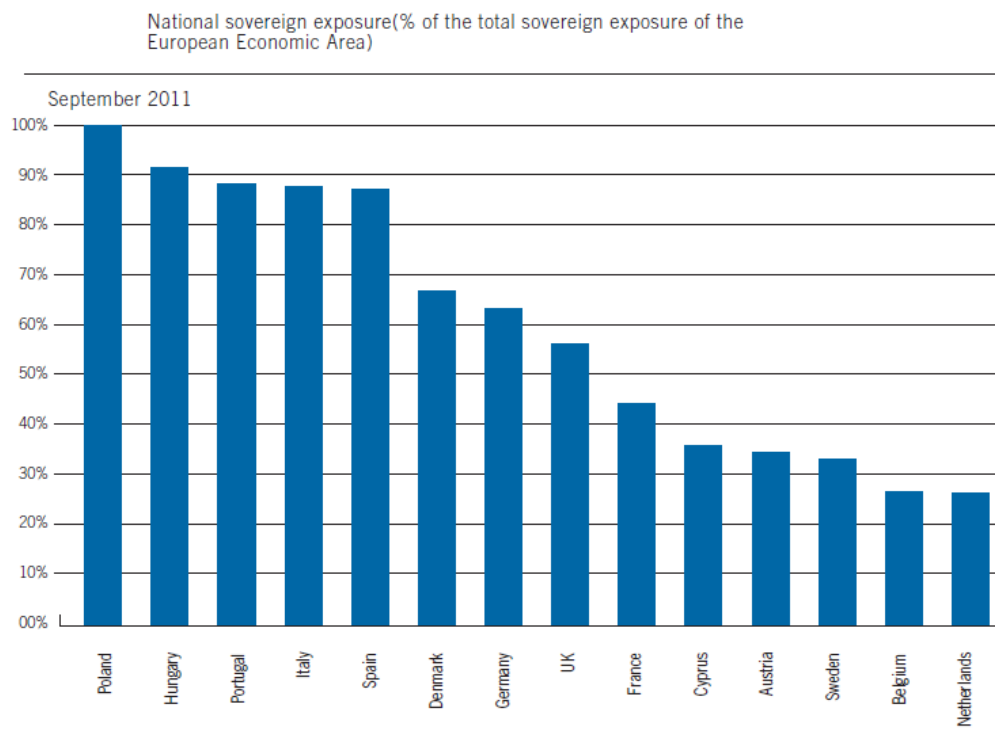
Source: Eurostat (2014b)

Figure 4. Total Assets of Credit Institutions in EU Member States (June 2011)



Source: Veron (2012, p. 9)

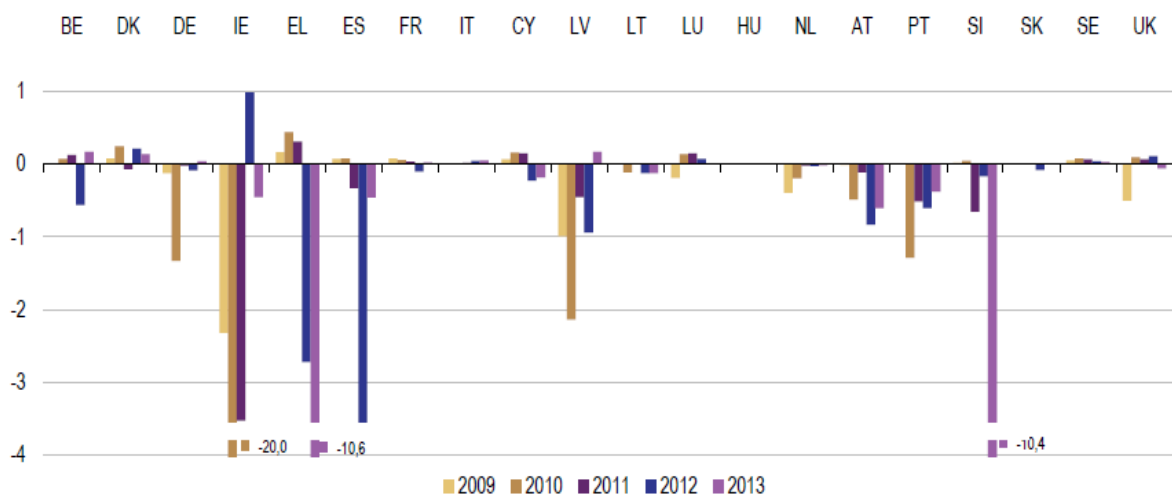
Figure 5. Local Bias of the Banks in Different European Jurisdictions



NOTE: Gross exposure. Average per jurisdiction of the banks analyzed by the EBA.

Source: Gual (2013, p. 9)

Graph 1. Impact of Interventions on Government Deficit (% of GDP)



Source: Eurostat (2014a)

ANNEX II

Table 1. Comparison of the initial and summer 2013 Commission proposals

	Which level decides which banks to resolve & how?	
	Original Commission proposal, summer 2012 (BRRD)	Commission proposal, summer 2013 (BRRD + SRM-SBRF)
<i>Who creates a recovery plan to prevent the failure of a troubled bank?</i>	Banks create their own plans which are approved by the relevant supervisor (either national or SSM).	Banks create their own plans which are approved by the relevant supervisor (either national or SSM).
<i>Who initiates resolution of a failed bank?</i>	Member States' supervisors based on rules set out in the BRRD.	Resolution Board based on information provided by the ECB and based on rules set out in the BRRD. The Commission approves the Resolution Board's decision.
<i>Who creates the bank resolution plan?</i>	NRA with recommendations from the Systemic Risk Board and European Banking Authority.	The Commission creates the general plan, with the Executive portion of the Resolution Board determining the specific plan. Both are guided by the BRRD toolkit.
<i>Who creates cross-border resolution plans?</i>	Resolution Colleges including the national resolution authorities and the EBA.	The Commission creates the general plan, with the Executive portion of the Resolution Board determining the specific plan. Both are guided by the BRRD toolkit.
<i>Who implements the plan?</i>	NRA	NRA
<i>Who oversees the implementation?</i>	Commission to the extent that the NRA's actions violate the BRRD.	Resolution Board
<i>Sanctions for non-compliance with EU directives/plans?</i>	Commission following the normal procedures as per the TFEU.	The Resolution Board can circumvent the National Resolution Authority and directly implement the part of the plan the NRA is not in compliance with.
<i>How is the plan funded?</i>	National Resolution Funds	Single Bank Resolution Fund

Source: Gandrud & Hallerberg (2013, p. 4)

Table 2. Functioning of the SBRF under the IGA

Year	<u>Step 1:</u> Use of paid in means in national compartment	<u>Step 2:</u> Use of the available paid in means in all compartments making up the SRF, including any remaining paid in means in the national compartment in question	<u>Step 3:</u> In case of any remaining costs
1	100%	10%	Use of remaining financial means in the directly involved national compartments + Possible extraordinary ex post levy on national banking sector in + Bridge financing from national backstop or ESM programme according to agreed procedures
2	90%	20%	
3	80%	30%	
4	70%	40%	
5	60%	50%	
6	50%	60%	
7	40%	70%	
8	30%	80%	
9	20%	90%	
10	10%	100%	
11	0%	100%	

Source: European Council (2013b, p. 7)