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THE POLITICAL ECONOMY OF EUROPEAN BANKING UNION

DAVID HOWARTH
& LUCIA QUAGLIA

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Preface

In June 2012, the euro area heads of state and government agreed to 'complete' Economic and Monetary Union (EMU) by creating an 'integrated financial framework' which was later labelled 'Banking Union', and which was to be based on four main components: a single framework for banking supervision; a single framework for the managed resolution of banks and financial institutions; a common Deposit Guarantee Scheme (CDGS); and a common backstop for temporary financial support. Banking Union was to make use of the European Union's (EU's) Single Rulebook on banking (notably, capital and liquidity rules). Between June 2012 and the end of 2015, three of the four components were negotiated and agreed, while negotiations on the common deposit guarantee scheme were launched in late 2015.

This book examines the making of Banking Union, explaining why two decades after the agreement on EMU, the euro area heads of state and government decided to embark on the transfer of significant powers over banking supervision, financial support, and resolution to the supranational level. Our study also explains why Banking Union took the shape it did and why other possibilities were not chosen. Above all, our study focuses on national government preferences on Banking Union, and we explain the outcome of intergovernmental negotiations as an uneven balance of these preferences. German preferences were most influential, but German policy-makers nonetheless had to compromise on a number of important issues.

Having both worked on EMU, central banking, and financial regulation in the EU, and on national banking systems, we were very well (if not uniquely) positioned to study Banking Union, which requires a good understanding of all these subjects. Oxford University Press was very supportive of our project from the very beginning, and we began working on the different chapters of the book in earnest.

While writing this book, we were faced with several challenges. First, Banking Union was a moving target and our content had to be repeatedly updated. As the book was sent to press, not all the Banking Union elements had been agreed—notably, the creation of a common DGS—or put into place, which means that our analysis of certain issues is necessarily provisional. Second, we wanted to write a book that could be both of interest to, and accessible to, economists, political scientists, and public policy and EU scholars. This required striking the (hopefully correct) balance between economic and political science analysis. For some chapters, this ambition was more difficult to achieve than for others. Third, there was a trade-off between analysing all the main elements of Banking Union and achieving a detailed analysis. Clearly, individual book-length studies can be written on each of supranational banking supervision and EU supervisory rules, resolution, deposit guarantee, fiscal support, and the EU Single Rulebook. We opted for broad coverage, and hence in each chapter we had to be selective as to the material included. We adopted a similar structure for each of the empirical chapters: we provide an overview of negotiations regarding the Banking Union element under discussion, and then we apply our analytical framework focused on how banking system configuration and moral hazard concerns shaped national preferences.

Our research was in part funded by the Luxembourg Fonds National de la Recherche through an INTER mobility-in fellowship (PEBU—ID 7555123), which financed Lucia Quaglia's year-long research stay at the University of Luxembourg. She wishes to thank the University of Luxembourg for hosting her during the 2014–15 academic year and the University of York for granting her research leave.

The primary research for this book could not have been completed without the help of many practitioners and experts in EU institutions, national governments, banks, and interest organizations. We were able to benefit from a large number of helpful interlocutors, who generously gave us their time despite busy schedules. We are very grateful to all of them. It was agreed with all the interviewees that, although we would likely use the information they provided us, they would not be identified. All errors, omissions, and interpretations in this book are ours.

In writing this book we drew on the research undertaken for a number of journal articles and book chapters that we published over the past four years on Banking Union and related subjects, including, notably: Howarth, D. and Quaglia, L. (2016), 'Internationalized Banking, Alternative Banks, and the Single Supervisory Mechanism', *West European Politics*; (2014) 'The Steep Road to Banking Union: Constructing the Single Resolution Mechanism', *Journal of Common Market Studies Annual Review*, 50 (s1); and (2013) 'Banking Union as Holy Grail: Rebuilding the Single Market in Financial Services, Stabilizing Europe's Banks and "Completing" Economic and Monetary Union', *Journal of Common Market Studies*, 49 (s1): 119–41.

From the start of our research, several academics generously offered their advice, and several commented on parts of the book, conference papers, and other academic publications in which some of the findings of our research have been presented. In particular, we would like to thank Michele Chang, Shawn Donnelly, Kenneth Dyson, Henrik Enderlein, Ian Hardie, Dermot Hodson, Patrick

Leblond, Huw Macartney, Manuela Moschella, Ivo Maes, Renate Mayntz, George Pagoulatos, Uwe Pütter, Charlotte Rommerskirchen, Sebastian Royo, Tal Sadeh, Joachim Schild, and Amy Verdun.

We further benefited from a range of comments offered by participants at various conferences of the University Association for Contemporary European Studies, the European Union Studies Association, the British Political Studies Association, and the European Consortium for Political Research. We also wish to thank the four anonymous reviewers of the detailed book proposal. At the University of Luxembourg, Jakub Gren provided outstanding research assistance for data collection and the compilation of the bibliography; Moritz Liebe regularly provided information of interest and assisted with chart formatting; and Agnes Darabos efficiently copy-edited and formatted the manuscript. Last but surely not least, we wish to thank the series editor, Aimee Wright, for her prompt interest in and unfaltering commitment to our project.

Professors David Howarth and Lucia Quaglia,
Luxembourg and York,
May 2016

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List of Acronyms

ABI	Italian Banking Association
AQR	Asset Quality Review
BBA	British Bankers' Association
BCBS	Basel Committee on Banking Supervision
BaFin	German Federal Financial Supervisory Authority
BIS	Bank for International Settlements
BPCE	Banques Populaires et Caisses d'Epargne
BRRD	Bank Recovery and Resolution Directive
CACIB	Crédit Agricole Corporate and Investment Bank
CEBS	Committee of European Banking Supervisors
CEECs	Central and Eastern European countries
CME	Coordinated Market Economy
CMU	Capital Markets Union
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
DGS	Deposit Guarantee Scheme
EBA	European Banking Authority
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
EDIRA	European Deposit Insurance and Resolution Authority
EDIS	European Deposit Insurance Scheme
EDP	Excessive Deficit Procedure
EFC	Economic and Financial Committee
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
ELA	Emergency Liquidity Assistance
EMF	European Monetary Fund
EMS	European Monetary System

EMU	Economic and Monetary Union
EP	European Parliament
ERM	Exchange Rate Mechanism
ESA	European Supervisory Authority
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
EU	European Union
EU-27	the 27 EU member states prior to Croatia joining on 1 July 2013
FBF	French Banking Federation
FSA	Financial Services Authority
FSAP	Financial Services Action Plan
FSB	Financial Stability Board
FSCS	Financial Services Compensation Scheme
G20	Group of Twenty
GDP	gross domestic product
HLEG	High-Level Expert Group on Reforming the Structure of the EU Banking Sector
HSBC	Hong Kong and Shanghai Bank of Commerce
IMF	International Monetary Fund
LCR	liquid capital ratio
LLR	Lender of Last Resort
LTRO	Long-Term Refinancing Operation
MEP	Member of the European Parliament
MFI	monetary financial institution
MOU	Memorandum of Understanding
MPS	Monte dei Paschi di Siena
NCA	National Competent Authority
NFC	non-financial company
NSFR	net stable funding ratio
OCA	optimal currency area
OECD	Organisation for Economic Co-operation and Development
OMT	Outright Monetary Transactions
QMV	Qualified Majority Voting
RBS	Royal Bank of Scotland
SGP	Stability and Growth Pact
SMEs	small and medium-sized enterprises

SMP	Single Market Programme
SRB	Single Resolution Board
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
SSB	Single Supervisory Board
SSM	Single Supervisory Mechanism
TARGET	Trans-European Automated Real-Time Gross Settlement Express Transfer System
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
UK	United Kingdom
US	United States

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Introduction

In June 2012, EU heads of state and government agreed upon the need to create a 'genuine' EMU as called for by the four presidents (European Council 2012a).[1] This involved the construction of an 'integrated financial framework' which was later labelled 'Banking Union' and was to be based on four components: a single framework for banking supervision; a single framework for the managed resolution of banks; a common DGS; and a common backstop for temporary financial support (Council 2012; see also Van Rompuy 2012a, b). This backstop is related to the function of Lender of Last Resort (LLR) even though LLR was never officially presented as a component of Banking Union. Finally, there was the Single Rulebook in banking, which was a main underlying element of Banking Union, even though it applied to all EU member states.

From June 2012, three of the components of Banking Union were discussed and adopted. The regulation for the establishment of a Single Supervisory Mechanism (SSM) was adopted in October 2013, followed by the Bank Recovery and Resolution Directive (BRRD) in June 2014, and the regulation on the Single Resolution Mechanism (SRM) in July 2014. New requirements for national Deposit Guarantee Schemes (DGSs) were finalized in June 2014. In November 2015, the Commission launched a proposed regulation for the creation of a European Deposit Insurance Scheme (EDIS). The European Stability Mechanism (ESM)—which was established by an intergovernmental treaty finalized in 2012 to replace the temporary European Financial Stability Facility (EFSF)—began operation in September 2012. In June 2012, the euro area member states envisaged that, subject to certain conditions, the ESM could provide financial support to ailing banks as well as to the governments of countries experiencing severe financial difficulties (Euro Area Summit 2012). The adoption of EU capital requirements legislation in April 2013

[1] The four presidents were the presidents of: the European Council, Herman Van Rompuy; the European Commission, Jose Manuel Borroso; the European Central Bank, Mario Draghi; and the Eurogroup (the ministers of finance of the euro area member states), Jean-Claude Juncker.

reinforced the Single Rulebook—although considerable national discretion and many lacunae remained.

The proposal for Banking Union amounted to a radical initiative to rebuild financial market confidence in both banks and sovereigns—especially in the euro area periphery—to stabilize the national banking systems exposed directly to a vicious circle between the international financial crisis and the euro area's sovereign debt crisis, and to reverse the fragmentation of European financial markets. Banking Union was also to bring about a significant transfer of powers from the national to the EU (to be precise, the Banking Union) level.[2] The decision to create Banking Union represented a major development in European economic governance and European integration history more generally. At the same time, the form of Banking Union eventually agreed amounted to a considerable dilution of the vision presented in the so-called 'four EU presidents report', 'Towards a Genuine Economic and Monetary Union', of December 2012 (Van Rompuy 2012b).

Banking Union was also significant because not all EU member states joined: as of June 2016 it included only countries participating in the euro area even if other EU member states were able to opt in. Hence, Banking Union increased the trend towards differentiated integration in the EU (Dyson and Sepos 2010; Schimmelfennig 2016), which in itself posed a major challenge to the EU as a whole and to the opt-out countries—first and foremost the United Kingdom (UK), given the size of its financial sector and its interconnection with the euro area.

This book is informed by two main questions. First, what was the rationale behind the move to Banking Union in 2012? Second, why was a certain design for Banking Union agreed?

The Argument

A two-step explanation is articulated in this book. We first explain the economic rationale of Banking Union by building on the concept of the financial trilemma, and examining the implications of EMU for both euro area member states and non-euro area countries. The book takes as a starting point Dirk Schoenmaker's 'financial trilemma' (2013), which examines the interplay of financial stability, international banking, and national financial policies, arguing that any two of the three objectives can be combined—given the rise of globally systemic important banks—but not all three: one has to give. For Schoenmaker, the international financial crisis of 2008–9 provided

[2] For a range of articles on the creation of supranational banking supervision, see the special issue of *West European Politics* (2016), guest edited by David Howarth and Huw Macartney.

clear evidence of the trilemma. We argue that in the EU, the trilemma was made particularly acute for those member states which adopted the single currency. On the one hand, EMU reinforced financial (banking) integration in the euro area. On the other hand, monetary union undermined national financial policies because the function of LLR could no longer be performed at the national level. Moreover, national resolution powers were constrained by euro area fiscal rules.

Consequently, for euro area member states that sought to maintain the currency union, the safeguard of financial stability could best be achieved at the supranational level—as demonstrated by the sovereign debt crisis. Euro area member states agreed (in some cases with great reluctance) to move to Banking Union, which was to replace the third element of Schoenmaker's trilemma, namely 'national financial policies', principally regulation, supervision, and resolution. The UK was positioned differently with reference to the trilemma because the UK did not participate in monetary union; thus, British policy-makers had less reason to seek participation in Banking Union.

Central and Eastern European member states of the EU that were not part of the euro area faced competing rationales. On the one hand, their banking systems were dominated by foreign-(principally euro area) headquartered banks—albeit with significant variation across countries, ranging from just over 50 per cent to almost 100 per cent of total bank assets and retail market share (Spendzharova 2014). These member states thus had an incentive to join Banking Union because they were less able to safeguard financial stability domestically. On the other hand, the high level of foreign bank penetration gave policy-makers in these countries an incentive to promote the development of domestic banks (a form of 'banking nationalism'), which could be better achieved by retaining national control over banking supervision and remaining outside Banking Union (Mero and Piroska 2016; Spendzharova 2014).

Second, we seek to explain the design of Banking Union through an examination of national policy-maker preferences on the core Banking Union components. Indeed, the countries that faced the trilemma in its most acute form because they were euro area members had different preferences on the various elements of Banking Union. We develop a comparative political economy analysis to understand the preferences of national policy-makers in key member states as stemming principally from the configuration of the national banking system. We also examine the concerns of policy-makers in certain member states regarding the moral hazard for banks and sovereigns potentially created by the different elements of Banking Union. This two-part political economy analysis is necessary in order to understand the position of national policy-makers on the allocation of direct supervisory powers in Banking Union (to the European Central Bank [ECB] or

National Competent Authorities [NCAs]), the allocation of resolution powers and deposit protection (Banking Union or national level), and the provision of financial assistance to governments and ailing banks (source, limits, and conditions).

The configuration of national banking systems—and, in particular, the internationalization of the activities of banks headquartered in the six member states (including the 'domestic reach of internationalization'), foreign penetration, as well as systemic patterns in banking activities—shaped the preferences of national policy-makers on the SSM, the SRM, and the common DGS. Those countries in which the reach of internationalization into the national banking sector was relatively limited were keen to exclude purely domestic banks (generally, smaller 'alternative'—that is, public, savings and cooperative—banks) from the scope of the SSM and SRM. They also opposed a common DGS. We also argue that there is a direct link between the national banking system and moral hazard concerns. The preoccupation of national policy-makers with moral hazard derived in large part from the 'manageability' for governments of real and potential bank losses—i.e., the 'manageability' of the sovereign–bank nexus. Moral hazard was of greater concern for policy-makers in countries that were less likely to need financial support in Banking Union because their banking system was in sufficiently rude health and/or because these governments had a sufficiently strong fiscal position that would enable them to withstand real and potential bank losses. Moral hazard was less of a concern for policy-makers in countries that would likely need to access external financial support in Banking Union because their banking system was in poorer health and/or their domestic fiscal position was weaker. Policy-makers in countries concerned about moral hazard—notably Germany—sought to establish clear limits to their financial assistance to ailing banks and governments in countries hit by the sovereign debt crisis. These concerns help to account for the limited scope of the SRM agreed, the delay to an agreement on a common DGS, the limited amount of ESM funds made available, and the strict conditionality attached to their use.

Finally, the asymmetric distribution of bargaining power during the Banking Union negotiations, which were skewed in favour of Germany, accounts for the prioritization of certain components of Banking Union rather than others. Germany was a 'constrained veto player' (Bulmer and Paterson 2013): agreement to do nothing on supervision, fiscal support, and resolution was not a possibility. This inability to accept the status quo gave other euro area member states a degree of influence over the design of the SSM, the SRM, and the ESM. As of July 2016, it remained to be seen if the German government could resist the pressure of a number of member states, the European Commission and the European Central Bank on the creation of the EDIS. The assumption of asymmetrical influence results in our decision to examine the preferences of policy-makers in the five euro area member states (France, Germany, Italy, the Netherlands, and Spain) with the largest economies and banking systems, plus the UK. Whereas Germany was reluctant to accept Banking Union, France, Italy, and Spain were strongly in favour, with the Netherlands keen on supervision but cautious on funding mechanisms. The UK is included as the main non-euro area country with a large financial sector outside Banking Union—as Begg (2012) puts it, the UK was 'the elephant in the room'. The preferences of British policy-makers were less relevant to the design of Banking Union; however, British preferences were reflected in support for but aloofness from the SSM, the SRM, and the use of ESM funds.

Our political economy analysis of Banking Union thus has, as a secondary focus, the intergovernmental and inter-institutional bargaining on the different components. Ours is not an analysis of EU policy-making per se. Rather, we focus on explaining the preferences of policy-makers (notably governments) of the five euro area member states with the largest economies and banking systems. Our specific focus on the preferences of German policy-makers stems from the assumption that the German government had the greatest influence over the final agreement but that it did not have veto power.

The Structure

This book is structured into two parts. The first consists of three chapters that set out the background to Banking Union and the building blocks of the analytical framework. The second part of the book consists of five chapters that apply the analytical framework to examine the main components of Banking Union.

Chapter 2 begins by reviewing the literature on the politics and economics of EMU, asking to what extent the explanations put forward with reference to the establishment and the design of EMU might have explanatory power with regard to the establishment and the design of Banking Union. This chapter then reviews the literature on Banking Union. It elucidates the two-step analytical framework underpinning this study of national preferences: namely, the concept of the trilemma, which explains the functional drive towards Banking Union; and the main features of national banking systems which, together with the concern for moral hazard, account for the preferences of national policy-makers on the Banking Union's main components. These factors combined with an asymmetric distribution of bargaining power, resulting in an asymmetric design of Banking Union.

Chapter 3 examines the causes and consequences of the international financial crisis (2007–9) and the euro area's sovereign debt crisis (from 2010), which set the background to the intergovernmental negotiations on Banking Union, and which largely explain its timing. It is argued that the sovereign debt crisis created a doom loop between the instability of national banking systems, which needed to be bailed out in a number of euro area member states, and the fragility of public finances, which were becoming unsustainable in much of the euro area periphery. The crisis thus brought to the fore the financial trilemma, which was made particularly acute by monetary union.

Chapter 4 discusses the configuration of the EU's six largest banking systems: notably those of Germany, France, the Netherlands, Italy, Spain, and the UK. The key features of national banking systems that explain national preferences on Banking Union and its specific elements are outlined. These key features include the degree and form of the internationalization of the activities of nationally based banks and foreign bank penetration. The 'manageability' of the sovereign–bank nexus—notably explained in terms of the health of national banking systems and the state of public finances—explains varying national preoccupation with moral hazard.

Chapter 5 presents two main arguments regarding national preferences on the establishment of the SSM. First, moral hazard concerns pushed otherwise disinterested governments—notably, the German government—to accept the need for supranational supervision, especially over banks in member states in need (or potentially in need) of financial support for banks. Second, the internationalization of national banking systems explains interest in supranational supervision. Countries in which the 'domestic reach of internationalization' was high—mainly through consolidated and semi-consolidated groups of 'alternative' banks—favoured a low threshold for direct ECB supervision (and the reverse). For EU member states not participating in the euro, the incentive to join the SSM depended on the degree of 'internationalization' and 'Europeanization' of their national banking systems, and also on the level of banking nationalism.

Chapter 6 examines national preferences on the BRRD that applied to all EU member states, and on the SRM, which was the second component of Banking Union. Moral hazard concerns—linked to the 'manageability' of current and possible bank losses—and the degree of internationalization of the national banking system, including the 'domestic reach of internationalization', explain German and Dutch preferences on the BRRD (bail-in followed by bail-out), and reluctance on the SRM and the use of the ESM as a common fiscal backstop for resolution. Spanish and Italian preferences stemmed from limited concern for moral hazard—thus, a reluctance to accept bail-in and an interest in building confidence by mutualizing risk through a large Single Resolution Fund (SRF).

Chapter 7 examines the inconclusive discussions on a common DGS, starting with the revision of the 1994 directive on the harmonization of national DGSs. We argue that the difficult harmonization of national schemes and the failure to agree to create a common DGS were due to different national preferences stemming from two main factors. First, the different configurations of existing national DGSs were linked to the different configurations of national banking systems. Second, German moral hazard concerns stemmed from concerns related to the ex-post design of most euro area national schemes and the fear that well-funded pre-existing German schemes would inevitably be called upon to cover the deposits of foreigners in foreign banks. The Italian and Spanish governments insisted, again, that all member states would benefit from increasing the confidence of financial markets by mutualizing bank risk.

Chapter 8 explores national preferences on the fiscal backstop in Banking Union and the related issue of LLR for both banks and sovereigns. The chapter first analyses the central role performed by the ECB in boosting stability during the international financial and sovereign debt crises—despite EU treaty provisions banning bail-outs for governments. It then examines the creation and design of the temporary EFSF and its permanent successor, the ESM, both established to help tackle the sovereign debt crisis in the euro area. National preferences regarding the operation of the ECB and the establishment of these support mechanisms were shaped by two competing rationales: the desire to prevent the break-up of EMU, and the need to limit moral hazard created through intervention to help sovereigns and banks.

Chapter 9 discusses the 'regulatory' element of Banking Union: namely, the Single Rulebook in banking. It first discusses the main preferences of national policy-makers in the negotiations on the Basel III accord, which set new capital and liquidity rules for internationally active banks. It then examines the transposition of Basel III into the EU's Capital Requirements Directive (CRD IV), arguing that some of the compromises on the definition of capital, the leverage ratio, and liquidity rules reached in the Basel III negotiations were reopened in the EU negotiations because of the application of the rules to all EU banks. The chapter also discusses the recent EU legislation on bank structural reform. Overall, we show that considerable national discretion with regard to the so-called Single Rulebook in banking regulation and supervision remained because of different preferences stemming from the configuration of the national banking system.

The concluding chapter summarizes the main findings of the book, outlines the main challenges ahead for Banking Union (including its potential implications for EU member states that do not participate in the euro area), and puts forward proposals for further research. It also discusses the 'Five Presidents' Report' (2015) entitled *Completing Europe's Economic and Monetary Union* which stated several objectives. One of these was a 'Financial Union' for euro area member states, which was to consist in large part of a problematically labelled Capital Markets Union (CMU) to apply to the entire European Union.

2

Understanding Economic and Monetary Union to Understand Banking Union

This chapter begins by reviewing the literature on the politics and economics of EMU, asking to what extent the explanations put forward regarding the establishment and the design of EMU might have explanatory power with reference to the establishment and the design of Banking Union. It then reviews the literature on Banking Union, which, with some notable exceptions, so far has mainly focused on the economic and legal aspects of the Banking Union's main components. Finally, the chapter elucidates the analytical framework underpinning this study—namely, the concept of the trilemma, which explains the functional drive towards Banking Union; the main features of national banking systems which, together with the concern for moral hazard, account for the different preferences of national policy-makers on the Banking Union's main components; and the asymmetric distribution of bargaining power among member states. The factors provide a convincing explanation of the asymmetric design of Banking Union agreed between 2012 and 2014.

Lessons from the Literature on Economic and Monetary Union

The extensive corpus of scholarly work on the establishment and the design of EMU is reviewed concisely in this section (see also Sadeh and Verdun 2009). Theoretically, the purpose is to tease out the main explanations for EMU put forward by scholars in political science and political economy, asking to what extent these accounts can be applied to explain the establishment and the design of Banking Union. We seek to position the analytical approach adopted in our study in relation to this previous work. Empirically, the aim of this section is to explain how in several ways Banking Union can be seen as the completion of EMU. Controversial issues that were papered over or side-stepped in the negotiations on EMU re-emerged forcefully once the final stage of EMU began in 1999, generating different types of 'asymmetry'.

By and large, the explanations for EMU in political science can be grouped under three main headings: neofunctionalism, constructivism, and intergovernmentalism. Moreover, there are political economy approaches that have investigated EU member state preferences on the main components of EMU—namely, monetary policy, exchange rate policy, and fiscal policy—as well as the 'winners' and 'losers' from EMU. These explanations are considered in turn.

A small number of academic studies adopt neofunctionalism to explain the establishment of EMU (see, e.g., Verdun 2002; Wolf 2002). Neofunctionalism, which is the oldest theory of European integration, dating back to the 1960s, is based on three main tenets. Neofunctionalism predicts an 'ever closer union'—that is, the deepening of political and economic integration in Europe over time. It emphasizes the concept of economic and political 'spillovers' from previous integration and from one policy area to another. Finally, it assumes the shifting of the loyalty of interest groups from the national level to the EU level. In the early 1990s, neofunctionalism was partly subsumed into the 'supranational governance' approach (Sandholtz and Sweet 1998), which was less over-deterministic than neofunctionalism about the final integration outcome, and emphasized the role of supranational actors in pushing integration forward.

The few studies that explain the establishment and design of EMU from a neofunctionalist perspective mainly argue that EMU was the result of spillover from previous integration, first and foremost the Single Market and European monetary integration. For these studies, the turning point was the establishment of the European Monetary System (EMS), specifically the Exchange Rate Mechanism (ERM) that set in place a system of semi-fixed exchange rates among the participating countries.[1] Furthermore, the studies that adopt a supranational governance approach to the establishment of EMU (Sandholtz and Sweet 1998) point out the strategic role of the Commission in driving the project forward (see also Jabko 1999).

Economic spillover was itself the core element of the official European Commission justification for EMU. The Commission and a number of federalist-minded economists insisted that the gains of the Single Market could not be optimized without a single currency—notably, in the influential publication *One Market, One Money* (European Commission 1990; see also Emerson, Gros, and Italianer 1992). Following similar reasoning, some federalist-leading

[1] The literature on the EMS is extensive: see Buiter, Corsetti, and Pesenti (1998), De Grauwe and L. Papademos (1990), Fratianni and Von Hagen (1992), Giavazzi and Giovannini (1989), Giavazzi, Micossi, and Miller (1989), and Gros and Thygesen (1998).

economists, building on the Mundell–Fleming 'unholy trinity' of fixed exchange rates, full capital mobility, and national monetary policies, added the Single Market to the trinity, which then became an 'inconsistent quartet' in the EU (Padoa-Schioppa 1982). Like the Commission, a number of economists also stressed the instability of the ERM of the EMS (Eichengreen et al. 1993)—especially given currency speculation—and the functional need to move from the ERM's semi-fixed exchange rate to EMU.

A number of academic studies forward an ideational or constructivist approach to understanding the establishment and the design of EMU. There are several variations of constructivism, but what they all have in common is the explanatory power assigned to ideas or 'policy paradigms' (Hall 1993), defined as a set of causal beliefs concerning a certain policy area, rather than material (mostly economic) interests. Constructivist accounts generally emphasize the importance of socialization in international or EU fora as a way to facilitate ideational convergence. Some authors (e.g., Schmidt and Radaelli 2004) point out the role that 'ideational entrepreneurs' play in paradigm change and in diffusing new ideas. Others investigate the presence and activity of 'epistemic communities', defined as a set of actors sharing the same 'episteme' or world view (Haas 1992).

Some ideational approaches to the establishment and design of EMU focus on the role of central bankers as an epistemic community supporting a stability-oriented design for EMU, based on central bank independence and anti-inflationary goals (Marcussen 2000; Verdun 1999). Other works consider a broader set of actors, not only central bankers, in the ideational convergence towards EMU. McNamara (1998, 1999) traces the 'currency of ideas'—that is, the spread of the stability-oriented macroeconomic paradigm from Germany to other member states (see also Quaglia 2004). McNamara argues that this ideational convergence among macroeconomic elites across the EU explains why it was possible to reach an agreement on EMU as well as the specific 'sound money' and 'sound public finance' (Dyson 1994) design chosen for EMU. The stability-oriented design agreed for EMU in the Maastricht Treaty (Treaty on European Union [TEU]) of 1992 was remarkable, if compared to previous blueprints for EMU put forward in the Werner report (1970) or the MacDougall report (1977), which had a strong Keynesian imprint.[2]

The majority of scholars have adopted implicitly or explicitly an intergovernmentalist approach in order to explain the establishment and the design of EMU (see, e.g., Moravcsik 1998; Sadeh 2009). There are various versions of intergovernmentalism; their common denominator is the focus on national interests and the decision-making power of national governments negotiating

[2] Furthermore, some authors also consider identity, especially a Europeanized identity among the elite, as a factor in promoting or hindering EMU support in the member states (Risse et al. 1999).