

European Financial Governance after the Global Crisis: Explaining the Creation of the Banking Union through the Lens of Neofunctionalism

Ferenc Kollárik¹

Abstract: *This paper argues that the deepening of financial (banking) governance in the European Union (EU) after the Global Recession is best explained through the lens of neofunctionalism. The financial crisis of 2008-2009 was an exogenous shock that triggered the Eurozone crisis and revealed latent weaknesses and shortcomings of European economic governance (EEG). Fearing the high costs of a potential collapse, the Member States decided to restructure and strengthen the EEG system. Crisis management, however, produced a complex pattern of solutions. While state-centred integration theories help explain fiscal policy reforms, they cannot account for the supranational shift in financial governance. This paper examines the background and creation of the banking union based on a renewed neofunctionalist framework, centred on the revision of spillover dynamics to capture the complex interdependence of today's global economy and regional integration.*

Keywords: *neofunctionalism, integration theory, Economic and Monetary Union (EMU), economic governance, financial governance, banking union.*

Introduction

The development path of European integration has always been a pivotal topic in the history of the European Union (EU). This issue acquired even greater significance in the aftermath of the global recession, subsequently compounded by the sovereign debt crisis, both of which had a profound impact on the region. In the wake of these shocks, the potential collapse of the eurozone (or the entire EU) became a real threat (Aslett and Caporaso, 2016; Halmai, 2022). Therefore, fearing the enormous costs of disintegration, Member States decided to reorganise and strengthen the European economic governance (EEG) system. Despite the numerous elements of EEG, two primary domains (pillars) can be identified where the original structure of the Economic and Monetary Union (EMU) had proven inadequate for effective crisis management. While monetary policy, governed by the European Central Bank (ECB), has evolved into a genuine supranational policy area for countries that have adopted the euro, fiscal policy and financial (banking) regulation have remained in the hands of the Member States, resulting in a pronounced asymmetry within the EMU's structural

¹ Ferenc Kollárik is assistant professor at the Institute of Global Studies, Department of World Economy at Corvinus University of Budapest.

E-mail: ferenc.kollarik[at]uni-corvinus.hu.

The author reports there are no competing interests to declare.

framework.

In line with neofunctionalist reasoning, the development of European integration is attributed to positive responses to crises, during which cooperation between EU Member States deepens. Put differently, functional tensions and inefficiencies create demand for the extension of cooperation, which is facilitated by the so-called “community method”. In the vocabulary of neofunctionalism, this phenomenon is referred to as spillover. Consequently, in times of crisis, it is expected that Member States show willingness to transfer to supranational level various competences (or policies) to manage the crisis more effectively and improve the functioning of the integration. Looking back at the history of the European integration, this has usually been the case. Nevertheless, after 2008, this correlation became less evident due to the introduction of a highly complex crisis management model. While responses in the realm of fiscal policy were dominated mainly by intergovernmental solutions, a supranational shift was much more discernible in the financial (banking) system.

The aim of this paper is to answer the question of why and how, in accordance with neofunctionalist logic, the transformation of financial (banking) governance has resulted in a meaningful centralisation of the EEG system. However, this study adopts a novel perspective by proposing a modified neofunctionalist framework to account for the complex interdependencies of today’s global economy and regional integration through the re-operationalisation of the spillover mechanism. In fact, exogenous shocks from other regions may be strong enough to become endogenous (Schimmelfennig, 2018), compelling decision-makers to respond by deepening cooperation. The original version of neofunctionalism, though, did not pay much attention to such impacts (Hansen, 1969; Nye, 1970) as external events were considered marginal or insignificant. To provide a comprehensive framework for analysis, this paper introduces a compact twofold theoretical framework, since the spillover mechanism is divided into two parts: causes (or triggers) and results (i.e. institutional outcomes). This division facilitates the more transparent identification of tensions and responses when tracing the long-term development of regional integration. Although the main components of our model can be found in the literature of the neofunctionalist research programme, this paper brings something new by synthesising, expanding, and integrating them into a unified framework.

The paper proceeds as follows. The first part provides a chronological overview of the ontology and evolution of the neofunctionalist research programme (NRP) to lay the cornerstones and explain the development of neofunctionalism. The second part introduces the revised model, centred on the renewed and extended interpretation of spillover dynamics, as a methodological framework for further analysis. Finally, the third part applies this revised model to investigate the background process and institutional outcomes of financial governance, which culminated in the creation of the banking union. The paper ends with robust and thought-provoking conclusions.

Ontology and evolution of the NRP

The first (real) integration theory, neofunctionalism, emerged in the works of Haas (1958/2004, 1961, 1964), Lindberg (1963), and Haas and Schmitter (1964) during the 1950s and 1960s. The main objective of this school was to explain the long-term

developments of regional integration by linking economic and political integration. Although nowadays many people consider neofunctionalism as the explanatory theory of European integration, Haas initially intended to create a generalizable framework that could be used to interpret the evolution of other regional integrations as well. In the words of Haas (2001, p. 24), the guiding principle of the research programme was “[t]o understand how human collectivities can move beyond the nation-state”. A significant innovation of this theory is that it deduces the integration process from the complex interactions of various social groups.

Originally, neofunctionalism was built on two overlapping, yet distinct, definitions, which capture the phenomenon of integration. According to Haas (1958/2004, p. 16), “[p]olitical 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. The end result of a process of political integration is a new political community, superimposed over the pre-existing ones”.

Leon N. Lindberg, the other founding father of neofunctionalism, came up with a somewhat different definition. In his view, integration should be interpreted as “[t]he process whereby nations forgo the desire and ability to conduct foreign and key domestic policies independently of each other, seeking instead to make joint decisions or to delegate the decision-making process to new central organs; and the process whereby political actors in several distinct settings are persuaded to shift their expectations and political activities to a new centre” (Lindberg, 1963, p. 6).

One can observe two significant discrepancies between the aforementioned definitions. First, Lindberg’s approach does not include any reference to an endpoint towards which the regional cooperation is expected to converge in the long run. Second, while Haas assumes that political actors shift their loyalties to an upper level, this element, i.e. loyalty, is not mentioned by Lindberg.

Defining integration already presupposes certain assumptions, based on which neofunctionalism attempts to make general statements about the direction, depth, and durability of cooperation. The original version of the theory can thus be summarised in five basic points that generate thrust for further integration (Niemann and Ioannou, 2015). First, neofunctionalists perceive integration as a process that evolves over the years and has its own intrinsic dynamics (Haas, 1958/2004; Lindberg, 1963). According to this assumption, integration is an automatic process, which does not require any (discretionary) decision from the EU Member States. Second, the integration process is shaped by various governmental and non-governmental actors capable of forming transnational coalitions with their international counterparts (Haas, 1964). More importantly, while acknowledging the primacy of states in establishing regional cooperation, neofunctionalism assigns a fundamental role to non-state actors as well. Third, the theory posits that actors, when pursuing their self-interest, are guided by the principle of bounded rationality (Haas, 1958/2004; Lindberg, 1963). Furthermore, they are able and willing to learn from their repeated interactions (games) to change and improve the *status quo* instead of preserving it – a significant difference compared to state-centred approaches. Fourth, regarding the decision-making process, the theory

assumes that integration progresses in a gradual and incremental manner. Finally, the cooperation of actors is characterised as a win-win scenario (or positive-sum game), in which all participants benefit to some extent from the cooperation (Haas, 1961).

The central (methodological) concept of the theory is the so-called spillover effect, or expansive logic of sector integration (Haas, 1958/2004; Tranholm-Mikkelsen, 1991), which gives momentum to the integration process quasi-automatically. This phenomenon suggests that countries are either extending cooperation to new areas or deepening existing cooperation, or perhaps doing both at the same time (Schmitter, 1969). Due to various interdependencies, integration in one sector will sooner or later necessitate cooperation in other policy areas, thereby leading to the deepening of the integration process. The existence of spillover effects suggests that policy domains are not isolated entities and extend beyond national borders. From a slightly different perspective, spillover can be regarded as the outcome (solution) of a conflict situation.

Notwithstanding the early success and popularity of neofunctionalism, the theory was subjected to criticism from time to time. Some critiques came from representatives of other theories, but significant modifications were also made within the neofunctionalist camp itself. The deceleration and stagnation of integration dynamics in the 1970s was the result of two major factors: (1) the prevailing attitude within French politics that paralysed the decision-making process in the European Communities (EC), and (2) the escalating protectionism triggered by the oil shocks and the ensuing economic crises. Due to these developments, the linear movement of the European integration was brought into question. Consequently, a novel, state-centred approach came to the fore and was coined as intergovernmentalism (Hoffmann, 1966).

Unsurprisingly, scholars in the neofunctionalist research programme had to reflect on the critiques and the negative political environment. Haas himself was the first to modify the original concept, arguing that economic integration does not always and automatically lead to political integration (Haas, 1967). In a later work, Schmitter (1970) identified multiple-actor strategies that display various combinations of integration and disintegration. He underlined, though, that the most likely scenario is the maintenance of the *status quo* (“conservation”) because abandoning it, by moving beyond the so-called indifference zone, is always more costly (at least in the short run) than maintaining it. Nevertheless, there may be significant and exceptional disturbances that cannot be managed by marginal steps within the zone of indifference.

Despite the many efforts, modifications, and refinements, the theory was unable to retain its explanatory power regarding the integration dynamics. This ultimately prompted Haas to declare his own theory obsolete in the mid-1970s, arguing that the explanatory power of the core assumptions was diminishing (Haas, 1976). As a result, neofunctionalism ceased to be a focus for research (Wincott, 1995), and scholars began to base their understanding of the logic of integration on the theory of complex interdependence developed by Keohane and Nye (1977).

Due to the ‘Eurosclerosis’ of the 1970s, the integration failed to progress, and neofunctionalism, despite all efforts, almost completely disappeared from the academic discourse. The turning point came in the 1980s, when, after nearly two decades of stagnation, Member States decided to pursue the strategy of moving forward. The

Single European Act (SEA), adopted in 1986, outlined the deepening of the integration, which practically meant the implementation of the single market by 1993. The SEA, as the first real amendment to the Rome Treaty, delineated the legal and other tasks that Member States had to assume to achieve the aforementioned objective. The presence of functional tensions was discernible as substantial non-tariff barriers to trade, coupled with a cumbersome decision-making process, made it impossible for the Member States to fully exploit the advantages of the customs union. It became increasingly obvious that the integration could avoid stagnation only by removing those barriers. In addition, the integration gained even greater momentum in the late 1980s, when the issue of the monetary union became a central point of discussion.

Recognising the functional linkages and pressures entailed by the single market and the monetary union, Tranholm-Mikkelsen intended to re-open the debate on neofunctionalism. He concluded that three types of spillover can be detected: functional, political and institutional (cultivated). The functional spillover exists because the free movement of capital is likely to increase the volatility of exchange rates that imposes additional costs on international trade. The political spillover emerges because Commissioners, Members of the European Parliament (MEPs), and various interest groups advocate for further integration to manage functional tensions. Finally, the active role of the European Commission in supporting the functional and political spillover is indicative of a cultivated (or institutional) spillover whereby (supranational) institutions promote further integration (Tranholm-Mikkelsen, 1991).

The decade following the launch of EMU is regarded as a relatively tranquil period in the history of European integration. However, the euphoria surrounding the single currency, the balanced economic and political environment, and the initial successes masked the serious structural weaknesses of the EU arising mainly from the asymmetry and incompleteness of the European economic governance (EEG) system.

The global financial crisis and the sovereign debt crisis brought in the spotlight the problems that had already, explicitly or implicitly, animated professional debates prior to the introduction of the euro. The crises revealed that without decisive steps towards further integration, the reversal of the integration process (i.e. disintegration) was a real scenario. As Baldwin and Giavazzi (2015, p. 36) note, with the collapse of Lehman Brothers and the subsequent crisis, “[t]he rose-garden feeling (...) started to disintegrate (...)”. As a result, the restructuring of the EEG system started in this turbulent constellation, and was characterised by the unique blend of national, intergovernmental, and supranational solutions.

As indicated above, neofunctionalism has evolved into a substantial and intricate research programme over the past few decades. Due to amendments, refinements, and other relational theories, the neofunctionalism has become the most thoroughly elaborated integration theory (Halmai, 2023). Nevertheless, this complexity renders the European integration process more difficult to trace and analyse through the lens of neofunctionalism. In order to surmount this challenge, the next section presents an eclectic analytical framework, which is sufficiently concise, and yet incorporates the most salient features of the widely comprehended NRP.

Reframing neofunctionalism: a revised concept of spillover

Defining an integration scheme: the three-dimensional integration space

Before presenting the modified neofunctionalist framework, it is imperative to elucidate the fundamental dimensions of the integration. The reason for this is that the horizontal and vertical directions of the integration are often interpreted differently in the literature. Therefore, in what follows, we apply the categorisation proposed by Leuffen, Rittberger and Schimmelfennig (2013) to clarify each dimension. Accordingly, the revised model is to be situated within a three-dimensional coordinate system (integration space). The integration space, denoted by Ω , is defined as the function of three variables: x , y , and z . In this context, x represents the territorial extension of the integration, y denotes the level of centralisation (depth), and z is the scope of cooperation (policy or functional extension/coverage).

Territorial extension (dimension x) depends on the number of participating countries in an integration scheme. In this regard, the accession or exit of one or more states signifies the increase or decrease in the number of member countries. This phenomenon can also be referred to as geographical spillover. Holding other dimensions constant, though, geographical spillover does not necessarily imply a qualitative change, i.e. a tighter or more efficient cooperation. The only observable outcome is a change in the geographical area of the integration.

The level of centralisation (dimension y) is referred to as vertical integration. However, one faces a problem with the dependent variable at this point. In order to address this issue, we do not determine a clear endpoint. Instead, in line with Haas's (1970) conceptualisation, the integration process is regarded as a continuous scale along which a progression towards a higher degree of cooperation can be observed in comparison to a preceding state. Therefore, it is possible to identify multiple dependent variables (critical milestones or new equilibria) along this scale without referring to a final state. This mode of thinking is also consistent with the concept of incrementalism, a key feature of neofunctionalism. Adopting this perspective, we do not view the European integration as a teleological process. Yet, we implicitly accept that some kind of endpoint may emerge in the long term.

The functional extension (dimension z) represents policy domains in which Member States cooperate to a certain degree. This dimension is referred to as horizontal integration. Given that almost all policy areas are integrated to some degree in the EU (Stone Sweet and Sandholtz, 1997), this dimension has reached its (quasi-) maximum. Evidently, in the context of other regional integrations, this dimension may hold greater importance.

The complex system of spillover mechanism: triggers and institutional outcomes

Similarly to the previous versions of neofunctionalism, the central methodological concept of the present model is the spillover. Nevertheless, we give a somewhat different (and broader) meaning to it. By spillover we mean a complex (two-pillar) mechanism that shifts the integration from an initial equilibrium (E_n) (neutrality zone) to a new one (E_{n+1}). As long as the initial equilibrium exists, the integration is in

the so-called neutrality zone. Thus, the spillover mechanism can be divided into triggers and institutional outcomes. Although the link between spillover and institutional outcomes already appears in the literature (e.g. Bergman and Müller, 2023), this study situates this relationship within a unified framework, which constitutes the key element of the revised model.

Triggers are defined as factors that destabilise the initial state of equilibrium, and exert pressure on the actors (i.e., the EU Member States) to stabilise the integration by exiting the neutrality zone. To incorporate both external and internal impacts into the model, a differentiation between exogenous and endogenous triggers is required.

Exogenous triggers are defined as factors external to integration. These factors may have an economic, political, security or environmental nature. However, it should be emphasised that they must be strong enough to have a significant impact on the functioning of the integration. The impact occurs when exogenous triggers become endogenous, i.e. when they affect the integration fundamentally and compel (or force) Member States to react by moving beyond the neutrality zone.

Nevertheless, it is also important to underline that endogenous triggers may appear in the absence of exogenous ones. This happens when tensions arise due to internal malfunctions (or regime failures). Following the categorisation of Tranholm-Mikkelsen (1991), we may distinguish between three types of endogenous triggers: functional, political, and institutional.

Functional triggers are detected when integration is working inefficiently for certain reasons in one or more policy areas. We stress again that this inefficiency must be powerful enough to cause a critical disturbance to the functioning of the integration, making the initial equilibrium unstable. To put it differently, if a disturbance cannot be managed efficiently by marginal adjustments within the neutrality zone, the likelihood of leaving the zone increases substantially. Most importantly, an underlying functional pressure becomes a trigger only when it induces severe (critical) malfunctions within the regime.

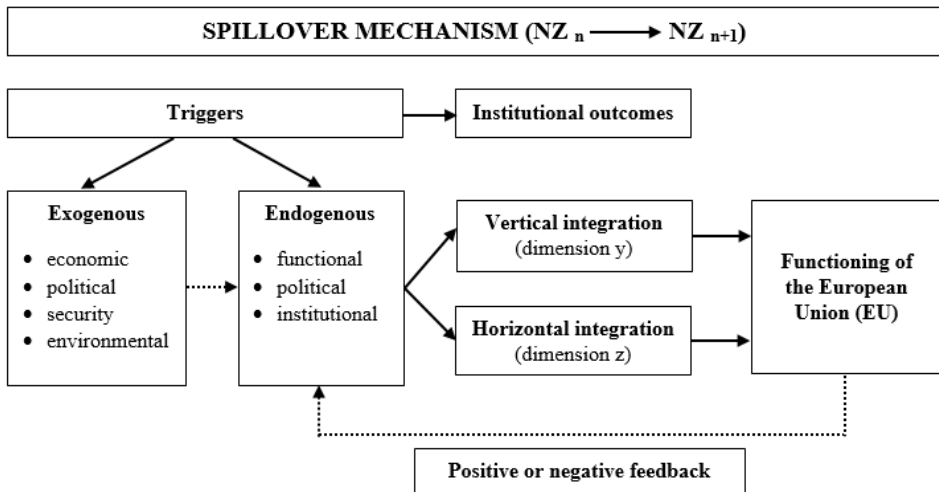
In our conceptual framework, the category “political triggers” is employed in a relatively broad sense. We define it as the integrative role of political actors who consider supranational solutions, namely horizontal and/or vertical integration, as beneficial or indispensable. By political actors, we refer to all agents or interest groups that exert a direct or indirect influence on European politics. Within this context, the most relevant actors are those who explicitly articulate their support for further integration. This group encompasses a wide array of entities, including politicians, political parties, governmental and non-governmental organisations, interest groups, financial institutions (and financial markets in a broader sense), domestic firms, transnational/multinational corporations (TNCs/MNCs), the media, and public opinion. Given their capacity to shape politics, we consider these actors to be key components of our model.

Finally, the category “institutional triggers” refers to the (potentially) pro-integration activities of supranational institutions like the European Commission (EC), the European Parliament (EP), the European Court of Justice (ECJ), and the European Central Bank (ECB). It should be emphasised, however, that such pro-integration activities may be driven either by the functional dissonances or by the institutions’ own

intentions to expand their authority and competences. Naturally, functional triggers may also create opportunities for the latter dynamic to unfold.

Exogenous and/or endogenous triggers may lead to different institutional outcomes. For instance, in line with the three-dimensional integration space outlined above, triggers might result in horizontal and/or vertical integration. Given that the horizontal integration (dimension z) has already reached its maximum level (z_{max}), the relevant institutional outcome pertains solely to the vertical dimension (y). As noted earlier, horizontal movement can be assessed by changes in the number of policy areas in which Member States cooperate within the integration framework. *Figure 1* presents the modified analytical framework.

Figure 1. The modified neofunctionalist framework



Source: Author's construction

Vertical integration refers to the transfer of new or existing competences to the upper levels of integration, a process that necessarily involves supranational actors (institutions) in decision-making on the policies for which competences were delegated. Drawing on Börzel (2005), we employ a three-level scale to operationalise the degree of centralisation. The first level is *intergovernmental cooperation* characterised by minimal supranational involvement. In this arrangement, the Council and/or the European Council play(s) the key role, and unanimity constitutes the dominant rule, although supranational institutions may possess narrowly circumscribed decision-making powers. The second level corresponds to the *joint decision-making* method, in which the Council and the European Parliament negotiate the final legislative outcome based on a proposal submitted by the European Commission. Finally, the third level reflects *supranational centralisation*, referring to decision-making procedures in which supranational actors are empowered to take unilateral actions (Börzel, 2005). According

to this categorisation, vertical integration may also be observed when new actors, institutions, or mechanisms emerge with partially or fully supranational competences.

It is a crucial question whether triggers result in institutional outcomes along the horizontal and/or vertical dimension. In this sense, Nicoli (2020) identifies various factors that enable us to anticipate these results. As regards the vertical integration (dimension y), the nature of policy, the degree of common identity, and governance interdependencies might facilitate the spillover mechanism. At the same time, the degree of pre-existing integration, the autonomy of supranational actors, and policy interdependence are the most important factors that can lead to horizontal integration (dimension z).

Before turning to the last component of our analytical framework, one fundamental remark must be made. Because the integration process is shaped by the complex interplay between politics and society, the institutional outcomes can never be predicted with absolute certainty – a limitation that applies to all integration theories. In the absence of ‘exact laws,’ the most that can be stated is that the *likelihood* of exiting the neutrality zone increases *significantly* when functional, political and/or institutional triggers are present. In other words, under such conditions one may expect an institutional response (outcome) that is qualitatively distinct from the marginal adjustments occurring within the neutrality zone. Moreover, it should be noted that functional triggers may arise from either incremental developments or abrupt, sudden changes.

Potential impacts of institutional outcomes: the feedback mechanism

Horizontal and/or vertical integration affect(s) the functioning of the integration, which, in turn, generates a feedback mechanism. Broadly speaking, two types of feedback can be distinguished: a positive and a negative one. When the institutional outcome improves the functioning of the EU, we have a positive feedback, which can be simple or dynamic. The simple one occurs when the initial triggers disappear without generating new ones. In this case, a stable equilibrium (neutrality zone) sets in. In practical terms, the original problem is resolved through the institutional response (horizontal and/or vertical integration), and this response does not produce additional triggers. By contrast, the dynamic positive feedback may arise when the institutional response leads to another unstable equilibrium, thereby generating new endogenous triggers. Therefore, EU Member States must undertake further actions that produce new institutional outcomes. These measures may involve modifications or fine-tuning of earlier decisions. Thus, dynamic feedback exerts a kind of multiplier effect on the functioning of the integration. The process comes to an end only when a particular outcome restores a stable equilibrium. In contrast, the negative feedback, occurs when an institutional outcome proves harmful or ineffective. If Member States provide an inappropriate or inadequate response to the triggers, the initial problems persist rather than being resolved.

Let us summarise the key elements of our modified neofunctionalist framework. The central concept of the model is the spillover, understood as a complex, multi-pillar mechanism that shifts the integration from an initial neutrality zone to a new one. Exogenous and endogenous triggers constitute critical factors that destabilise

the initial equilibrium and, with high probability, give rise to institutional outcomes (horizontal and/or vertical integration) that establish a new equilibrium. Ultimately, these outcomes affect the functioning of the EU and generate either positive or negative feedback.

Deepening the financial governance: the creation of the banking union

In this final section, we apply the revised neofunctionalist framework to explain the emergence of the banking union by systematically identifying the relevant triggers and the corresponding institutional outcomes. Rather than merely describing the sequence of events, the analysis focuses on how exogenous and endogenous pressures interacted to produce vertical integration (an upward movement along dimension y) within the European financial governance system.

The global crisis constituted a powerful exogenous trigger that fundamentally destabilised the existing equilibrium of the EMU. Although the crisis originated outside the EU, it rapidly became endogenous as it exposed structural weaknesses in the European financial system. Most importantly, it revealed that financial stability, understood as “(...) *the on-going capacity of banks to meet the demands of their depositors and other creditors*” (Donnelly, 2014, p. 982), could not be sustained within a fragmented regulatory framework. As a result, the crisis transformed the financial stability into a collective European public good, thereby creating strong incentives for joint action (Mérő and Piroška, 2013).

From a neofunctionalist perspective, the crisis generated a set of functional triggers that made the pre-crisis institutional configuration no longer viable. Among these, five interrelated factors can be identified: (1) systemic financial instability, (2) the absence of macro-prudential regulation, (3) moral hazard associated with the “too big to fail” doctrine, (4) the lack of integrated supervisory and resolution mechanisms, and (5) the bank-sovereign nexus, often described as a “diabolic loop” (Cooper and Nikolov, 2018). Importantly, these triggers did not exert equal pressure. In particular, the bank-sovereign nexus transformed the sectoral instability, i.e. the *status quo*, into a systemic threat to the EMU, thereby acting as a critical functional trigger that significantly increased the likelihood of exiting the neutrality zone.

The crisis also demonstrated that micro-prudential regulation alone was insufficient to ensure system-wide stability. The accumulation of systemic risks, combined with their potentially high social costs (Mérő, 2012), highlighted the necessity of macro-prudential oversight (Hennessy, 2014). This mismatch between the level of market integration and the fragmentation of financial regulatory competences clearly represents a functional dissonance, which generates pressure for further integration. Similarly, moral hazard dynamics reinforced these tensions by incentivising excessive risk-taking among systemically important financial institutions, thereby amplifying vulnerabilities within the system (Mérő, 2012).

These functional pressures were further exacerbated by institutional deficiencies. Prior to the crisis, key elements of a comprehensive regulatory framework – e.g. integrated supervision, resolution mechanisms, and deposit insurance – were either absent or insufficiently developed (Frankel, 2015). Hence, crisis management relied heavily on national governments, which in turn strengthened the bank–sovereign

nexus. This mutually reinforcing dynamic illustrates how unresolved functional tensions can generate negative feedback, further destabilising the system and increasing the demand for supranational solutions (Benczes, 2019).

Despite the growing intensity of these pressures, the initial institutional response remained limited. The establishment of the European System of Financial Supervision (ESFS) in 2010 can be interpreted as an instance of incomplete functional spillover. While it introduced a two-pillar supervisory structure and strengthened macro-prudential oversight through the European Systemic Risk Board (Brunnermeier *et al.*, 2016), it failed to address the deeper inconsistencies between integrated financial markets and nationally fragmented governance. Consequently, the ESFS did not restore equilibrium, and functional pressures persisted.

At the same time, political triggers began to emerge more visibly. Non-state actors, including business associations and think tanks, actively promoted the need for deeper integration by framing financial stability as a shared European concern. For instance, BusinessEurope (2011) emphasised the importance of credible resolution frameworks and risk mitigation, while the Bruegel Institute advocated for a form of “banking federalism” (Véron, 2011). These interventions can be understood as a form of political spillover, whereby societal actors reinforced functional pressures and contributed to shifting preferences towards supranational solutions.

The escalation of the sovereign debt crisis in 2012 marked a turning point, as the accumulation of functional and political pressures made comprehensive reform unavoidable. At this stage, institutional triggers also became prominent. Supranational actors, most notably the European Commission and the European Central Bank (ECB), played a proactive role in shaping the reform agenda (European Commission, 2012; De Rynck, 2016). The ECB, in particular, expanded its policy toolkit in response to the crisis, thereby increasing its capacity and willingness to support centralised solutions. This dynamic reflects the importance of the institutional trigger, whereby institutions actively promote further integration.

The ensuing institutional outcome was the creation of the banking union, which represents a significant step towards vertical integration (dimension γ) in the EMU. However, the specific design of its pillars reveals that integration was both driven by functional necessity and political considerations.

The Single Rulebook (SR) can be interpreted as a horizontal harmonisation mechanism that supports vertical integration by reducing regulatory fragmentation. By standardising rules across Member States, most notably through the Capital Requirements Directive IV and the Capital Requirements Regulation, it addresses one dimension of functional dissonance (Cappiello, 2015; Benczes, 2019). Nevertheless, its primary contribution lies in facilitating subsequent institutional developments rather than constituting a fully-fledged supranational outcome in itself.

The establishment of the Single Supervisory Mechanism (SSM), by contrast, represents a clear case of functional trigger leading to vertical institutional outcome. The centralisation of supervisory competences at the level of the ECB addressed the inconsistency between integrated financial markets and national supervision (Quaglia, 2013). However, the governance structure of the SSM also reflects political constraints,

as supervisory responsibilities are shared with national authorities. This hybrid arrangement indicates that, although functional pressures pushed integration beyond the neutrality zone, Member States' preferences limited the depth of supranationalisation. Accordingly, the SSM constitutes a case of partial vertical integration.

A similar pattern can be observed in the Single Resolution Mechanism (SRM). The creation of a centralised resolution framework addressed directly the functional need for orderly crisis management and the mitigation of the bank–sovereign nexus (Howarth and Quaglia, 2014). At the same time, its institutional design, characterised by the involvement of multiple actors, including the European Commission and the Council, reflects a compromise between supranational efficiency and national control (Schäfer, 2016; Tröger and Kotovskaia, 2022). Thus, the SRM also represents a case of partial supranationalisation, shaped by the interaction between functional imperatives and political constraints.

The absence of a European Deposit Insurance Scheme (EDIS) provides an additional insight into the limits of the spillover mechanism. Despite persistent functional pressures and strong economic arguments in favour of risk-sharing (Wolff, 2016), political resistance among EU Member States has prevented the completion of the banking union (Howarth and Quaglia, 2018). This case illustrates that spillover is conditional rather than automatic.

In sum, the creation of the banking union can be understood as the outcome of the interaction between functional, political, and institutional triggers that collectively pushed the EMU beyond its previous equilibrium. The resulting institutional architecture represents a significant, albeit incomplete, shift towards supranational governance. While vertical integration has clearly advanced, the persistence of hybrid arrangements across its pillars indicates that integration remains constrained by member state control.

From the perspective of the revised neofunctionalist framework, this case shows that spillover dynamics can generate substantial institutional changes, but not necessarily full centralisation. Instead, the outcome is a differentiated form of integration, in which supranational and intergovernmental elements coexist. This finding underscores the importance of analysing not only the presence of spillover, but also the conditions under which it leads to deeper integration.

Conclusions

The establishment and evolution of European financial governance represent a critical test case for understanding the dynamics of European integration in the post-crisis period. The global financial crisis and the subsequent sovereign debt crisis exposed deep structural vulnerabilities within the Economic and Monetary Union (EMU), revealing that monetary integration was not matched by equivalent progress in financial governance. These asymmetries generated significant functional pressures, which ultimately destabilised the pre-crisis equilibrium of European economic governance.

Against this background, this paper set out to explain the creation of the banking union through a revised neofunctionalist framework that reinterprets spillover as a

structured mechanism linking triggers, institutional responses, and feedback effects. Rather than assuming that integration is automatic or linear, the model emphasises the contingent nature of institutional change, shaped by the interaction of exogenous shocks, endogenous functional tensions, and political and institutional mediation.

The empirical analysis of the banking union demonstrates that the crisis operated initially as an exogenous trigger, which rapidly became endogenous by exposing systemic inconsistencies within the EMU. These pressures generated multiple functional triggers, most notably the bank–sovereign nexus, regulatory fragmentation, and the absence of integrated supervisory and resolution mechanisms. In response, political and institutional actors gradually reframed financial stability as a shared European public good, thereby facilitating the emergence of supranational solutions.

The creation of the banking union reflects a clear case of vertical integration driven by spillover dynamics. Yet, its internal architecture reveals the limits of supranationalisation. While the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) represent significant steps towards centralisation, their hybrid governance structures indicate that integration remained partial and politically constrained. At the same time, the failure to complete the banking union through a European Deposit Insurance Scheme (EDIS) further confirms that spillover effects are not self-executing, but depend on the alignment of functional necessity with political feasibility.

From a theoretical perspective, these findings support the core argument of the revised neofunctionalist framework. Spillover should not be understood as a deterministic mechanism, but rather as a conditional process of transformation, in which institutional outcomes emerge only when functional pressures, political support, and institutional triggers converge. In this sense, integration is neither linear nor automatic, as it proceeds through a series of unstable equilibria and partial adjustments.

More broadly, the case of the banking union illustrates that post-crisis European integration is best characterised as a form of differentiated supranationalisation, where deepening occurs selectively across policy domains and institutional pillars. The EMU crisis did not produce uniform integration across fiscal and financial governance. In fact, it generated asymmetric responses, with financial governance exhibiting the strongest, but still incomplete, move towards centralisation.

Ultimately, the revised framework helps to clarify why the EU was able to overcome the immediate crisis without collapsing, and at the same time failed to achieve full institutional completion in key areas. Thus, the banking union represents both an achievement of crisis-driven integration and a demonstration of its structural limits. Future integration is therefore likely to continue along a path of incremental adjustment, shaped by recurring functional pressures and persistent political constraints rather than by comprehensive institutional redesign.

References:

- Aslett, K., and Caporaso, J., (2016). “Breaking Up is Hard to Do: Why the Eurozone Will Survive?”, *Economies*, Vol. 4, Issue 4, pp. 1-16. Available at:

<https://doi.org/10.3390/economies4040021>.

- Benczes, I., (2019). “Az európai bankunió politikai gazdaságtana” (*The Political Economy of the European Banking Union*), *Köz-Gazdaság*, Vol. 14, Issue 4, pp. 48-62. Available at: <https://doi.org/10.14267/RETP2019.04.05>.
- Baldwin, R., and Giavazzi, F., (2015). Introduction, in Baldwin, R., and Giavazzi, F. (eds.), *The Eurozone Crisis: A Consensus View of the Causes and a Few Possible Solutions*, CEPR Press, London.
- Bergman, J., and Müller, P., (2023). “Spillover dynamics and inter-institutional interactions between CSDP and AFSJ: moving towards a more joined-up EU external migration policy?”, *Journal of Ethnic and Migration Studies*, Vol. 49, No. 12, pp. 3005-3023. Available at: <https://doi.org/10.1080/1369183X.2023.2193712>.
- Börzel, T., (2005). “Mind the Gap! European integration between level and scope”, *Journal of European Public Policy*, Vol. 12, Issue 2, pp. 217-236. Available at: <https://doi.org/10.1080/13501760500043860>.
- Brunnermeier, M., James, H., and Landau, J.-P., (2016). “*The Euro and the Battle of Ideas*”, Princeton University Press, Princeton and Oxford.
- Business Europe, (2011). ‘Letter to Herman van Rompuy’, *Business Europe*, March 4, Brussels. Available at: <https://www.eauxglacees.com/IMG/pdf/2011-00377-E.pdf>.
- Cappiello, S., (2015). “The EBA and the Banking Union”, *European Business Organization Law Review*, Vol. 16, Issue 3, pp. 421-437. Available at: <https://link.springer.com/article/10.1007/s40804-015-0016-9>.
- Cooper, R., and Nikolov, K., (2018). “Government Debt and Banking Fragility: The Spreading of Strategic Uncertainty”, *International Economic Review*, Vol. 59, No. 4, pp. 1095-1925. Available at: <https://doi.org/10.1111/iere.12323>.
- De Rynck, S., (2016). “Banking on a union: the politics of changing eurozone banking supervision”, *Journal of European Public Policy*, Vol. 23, Issue 1, pp. 119-135. Available at: <https://doi.org/10.1080/13501763.2015.1019551>.
- Donnelly, S., (2014). “Power Politics and the Undersupply of Financial Stability in Europe”, *Review of International Political Economy*, Vol. 21, Issue 4, pp. 980-1005. Available at: <https://doi.org/10.1080/09692290.2013.801021>.
- European Commission, (2012). “Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions”, COM(2012) 511 Final, September 12, Brussels. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012PC0511>.
- Frankel, J., (2015). “Causes of Eurozone crises”, in Baldwin, R., and

Giavazzi, F. (eds.), *The Eurozone Crisis: A Consensus View of the Causes and a Few Possible Solutions*, CEPR Press, London.

- Haas, E.B., (1958/2004). *The Uniting of Europe: Political, Social and Economic Forces, 1950-1957*, Stanford University Press, Notre Dame, Indiana.
- Haas, E.B., (1961). "International Integration: The European and the Universal Process", *International Organization*, Vol. 15, Issue 3, pp. 366-392. Available at: <https://doi.org/10.1017/S0020818300002198>.
- Haas, E.B., (1964). "*Beyond the Nation-State: Functionalism and International Organization*", Stanford University Press, Stanford.
- Haas, E.B., (1967). "The Uniting of Europe and the Uniting of Latin America", *Journal of Common Market Studies*, Vol. 5, Issue 4, pp. 315-343. Available at: <https://doi.org/10.1111/j.1468-5965.1967.tb01153.x>.
- Haas, E.B., (1970). "The Study of Regional Integration: Reflections on the Joy and Anguish of Pretheorizing", *International Organization*, Vol. 24, Issue 4, pp. 606-646. Available at: <https://doi.org/10.1017/S0020818300017495>.
- Haas, E.B., (1976). "Turbulent fields and the theory of regional integration", *International Organization*, Vol. 30, Issue 2, pp. 173-212. Available at: <https://doi.org/10.1017/S0020818300018245>.
- Haas, E.B., (2001). "Does Constructivism Subsume Neo-Functionalism?", in Christiansen, T., Jørgensen, K.E., Wiener, A. (eds.), *The Social Construction of Europe*, London: SAGE Publications.
- Haas, E.B., and Schmitter, P.C., (1964). "Economics and Differential Patterns of Political Integration: Projections about Unity in Latin America", *International Organization*, Vol. 18, Issue 4, pp. 705-737. Available at: <https://doi.org/10.1017/S0020818300025297>.
- Halmai, P., (2022): "Responsibility Versus Solidarity? Key Issues for the EMU Reform", *Romanian Journal of European Affairs*, Vol. 22, Issue 1, pp. 85-103. Available at: <https://rjea.ier.gov.ro/wp-content/uploads/2022/05/Art.-6.pdf>.
- Halmai, P., (2023). "Krisis és integráció" (*Crisis and integration*), in Benczes I. and Szunomár Á. (eds.), *Változó világ (A changing world)*, Akadémiai Kiadó, Budapest.
- Hansen, R., (1969). "Regional Integration: Reflections on a Decade of Theoretical Efforts", *World Politics*, Vol. 21, Issue 2, pp. 242-271. Available at: <https://doi.org/10.2307/2009822>.
- Hennessy, A., (2014). "Redesigning financial supervision in the European Union (2009-2013)", *Journal of European Public Policy*, Vol. 21, Issue 2, pp. 151-168. Available at: <https://doi.org/10.1080/13501763.2013.853601>.
- Hoffmann, S., (1966). "Obstinate or Obsolete? The Fate of the Nation-State

- and the Case of Western Europe”, *Daedalus*, Vol. 95, Issue 3, pp. 862-915. Available at: <https://www.jstor.org/stable/20027004?seq=1>.
- Howarth, D., and Quaglia, L., (2014). “The Steep Road to European Banking Union: Constructing the Single Resolution Mechanism”, *Journal of Common Market Studies*, Vol. 52, Issue S1, pp. 125-140. Available at: <https://doi.org/10.1111/jcms.12178>.
 - Howarth, D., and Quaglia, L., (2018). “The difficult construction of a European Deposit Insurance Scheme: a step too far in Banking Union?”, *Journal of Economic Policy Reform*, Vol. 21, Issue 3, pp. 190-209. Available at: <https://doi.org/10.1080/17487870.2017.1402682>.
 - Keohane, R., and Nye, J., (1977). *Power and Interdependence: World Politics in Transition*, Little & Brown, Boston.
 - Leuffen, D., Rittberger, B., and Schimmelfennig, F., (2013). *Differentiated Integration: Explaining Variation in the European Union*, Palgrave Macmillan, Basingstoke.
 - Lindberg, L.N., (1963). *The political dynamics of European economic integration*, Stanford University Press, Stanford, California.
 - Mérő, K., (2012). “A bankszabályozás kihívásai és változásai a pénzügyi-gazdasági válság hatására” (*Challenges and changes in banking regulation due to the financial and economic crisis*), *Verseny és szabályozás (Competition and regulation)*, Vol. 5, Issue 1, pp. 129-166. Available at: <https://kti.krtk.hu/file/download/vesz2011/bankszabalyozas.pdf>.
 - Mérő, K., and Piroska, D., (2013). “A makroprudenciális bankszabályozás és –felügyelés keretrendszerének kialakulása” (*Establishing a framework for macroprudential banking regulation and supervision*), *Hitelintézeti Szemle (The Financial and Economic Review)*, Vol. 12, Issue 4, pp. 306-325. Available at: <https://www.bankszovetseg.hu/Content/Hitelintezeti/306-325ig-Mero.pdf>.
 - Nicoli, F., (2020). “Neofunctionalism revisited: integration theory and varieties of outcomes in the Eurocrisis”, *Journal of European Integration*, Vol. 42, No. 7, pp. 897-916. Available at: <https://doi.org/10.1080/07036337.2019.1670658>.
 - Niemann, A., and Ioannou, D., (2015). “European economic integration in times of crisis: a case of neofunctionalism?”, *Journal of European Public Policy*, Vol. 22, Issue 2, pp. 196-218. Available at: <https://doi.org/10.1080/13501763.2014.994021>.
 - Nye, J., (1970). “Comparing Common Markets: A Revised Neo-Functionalist Model”, *International Organization*, Vol. 24, Issue 4, pp. 796-835. Available at: <https://doi.org/10.1017/S0020818300017537>.
 - Quaglia, L., (2013). “Financial regulation and supervision in the European Union after the crisis”, *Journal of Economic Policy Reform*, Vol. 16, Issue

- 1, pp. 17-30. Available at: <https://doi.org/10.1080/17487870.2012.755790>.
- Schäfer, D., (2016). “A Banking Union of Ideas? The Impact of Ordoliberalism and the Vicious Circle on the EU Banking Union”, *Journal of Common Market Studies*, Vol. 54, Issue 4, pp. 961-980. Available at: <https://doi.org/10.1111/jcms.12351>.
 - Schimmelfennig, F., (2018). “European integration (theory) in times of crisis. A comparison of the euro and Schengen crises”, *Journal of European Public Policy*, Vol. 25, No. 7, pp. 969-989. Available at: <https://doi.org/10.1080/13501763.2017.1421252>.
 - Schmitter, P., (1969). “Three Neo-Functional Hypotheses about International Integration”, *International Organization*, Vol. 23, Issue 1, pp. 161-166. Available at: <https://doi.org/10.1017/S0020818300025601>.
 - Schmitter, P., (1970). “A Revised Theory of Regional Integration”, *International Organization*, Vol. 24, Issue 4, pp. 836-868. Available at: <https://doi.org/10.1017/S0020818300017549>.
 - Stone Sweet, A., and Sandholtz, W., (1997). “European integration and supranational governance”, *Journal of European Public Policy*, Vol. 4, Issue 3, pp. 297-317. Available at: <https://doi.org/10.1080/13501769780000011>.
 - Tranholm-Mikkelsen, J., (1991). “Neo-Functionalism: Obstinate or Obsolete? A Reappraisal in the Light of the New Dynamism of the EC”, *Millennium: Journal of International Studies*, Vol. 20, Issue 1, pp. 1-22. Available at: <https://doi.org/10.1177/03058298910200010201>.
 - Tröger, T., and Kotovskaia, A., (2022). “National interests and supranational resolution in the European Banking Union”, *SAFE Working Paper*, No. 340, pp. 1-28. Available at: <https://www.econstor.eu/bitstream/10419/250047/1/1788879961.pdf>.
 - Véron, N., (2011). “Testimony on the European debt and financial crisis”, *Bruegel Policy Contribution*, No. 2011/11, Bruegel, Brussels. Available at: <https://www.econstor.eu/handle/10419/72100>.
 - Wincott, D., (1995). “Institutional Interaction and European Integration: Towards an Everyday Critique of Liberal Intergovernmentalism”, *Journal of Common Market Studies*, Vol. 33, Issue 4, pp. 597-609. Available at: <https://doi.org/10.1111/j.1468-5965.1995.tb00553.x>.
 - Wolff, G., (2016). “European Parliament testimony on EDIS”, Bruegel Institute, Brussels. Available at: https://www.bruegel.org/system/files/wp_attachments/EDIS-EP-statement.pdf.