

LOYALTY WITHOUT INTEGRATION

Macroprudential Governance and the Eurozone Periphery

By Giancarlo Grignaschi

Submitted to Central European University - Private University

Doctoral School of Political Science

Public Policy and International Relations

In Partial Fulfillment of the Requirements for the Degree of Doctor of Philosophy

Supervisor: Prof. Dóra Piroska

Vienna, Austria 2025

Copyright Notice

Copyright © Giancarlo Grignaschi, 2025. Loyalty without Integration: Macroprudential Governance and the Eurozone Periphery - This work is licensed under [Creative Commons Attribution \(CC-BY\) 4.0 International](#) license.

For bibliographic and reference purposes this thesis/dissertation should be referred to as: Grignaschi, G. 2025. Loyalty without Integration: Macroprudential Governance and the Eurozone Periphery. Doctoral dissertation, DSPS, Central European University, Vienna.

Author's Declaration

I, the undersigned, Giancarlo Grignaschi, candidate for the degree of Doctor of Philosophy in Political Science, hereby declare that the present thesis is my own work, derived from my research. The thesis does not contain any materials that have been previously written and published by another individual, with the exception of bibliographical references and annotations that provide appropriate acknowledgement. I also declare that no part of the thesis has been submitted in this form to any other institution of higher education for an academic degree.

Giancarlo Grignaschi

Vienna, 31/07/2025

*“Vedremo soltanto una sfera di fuoco,
più grande del sole, più vasta del mondo;
nemmeno un grido risuonerà e solo il silenzio come un sudario si stenderà
fra il cielo e la terra, per mille secoli almeno,
ma noi non ci saremo, noi non ci saremo.”*

Francesco Guccini and Nomadi, “Noi non ci Saremo”, 1994

Abstract

This dissertation investigates a central puzzle in the political economy of European integration: why do National Competent Authorities (NCAs) in Eurozone small host countries remain loyal to the current macroprudential framework, despite the unique challenges it imposes on them? Drawing on a combination of qualitative data and comparative analysis of five Central-Eastern European countries – Estonia, Latvia, Lithuania, Slovakia, and Slovenia – the study addresses the enduring asymmetries between core and periphery in EU financial governance. Through the novel concept of the Macroprudential Triangle, this dissertation frames the tension between three competing objectives: the resilience of credit institutions, the management of cross-border spillovers, and the adequate provision of credit to the real economy. The core hypothesis advanced and tested in this work posits that the high degree of autonomy embedded within macroprudential governance enables the peripheral NCAs to break down the challenges of the Triangle into politically manageable components to their advantage. This autonomy stems from three mutually reinforcing sources: decentralised decision-making, institutional prominence of macroprudential departments within national central banks, and limited supranational constraints. Such a configuration allows NCAs to strategically pursue domestic financial stability, maintain continuity with pre-crisis supervisory practices, and gain access to a transnational epistemic community – all without facing meaningful interference from supranational actors. By combining a core-periphery perspective with constructivist epistemology, the dissertation reconceptualises macroprudential governance not merely as a technical compound of structures and processes for financial regulation, but as a contested political arena shaped by perceptions, strategic agency, and institutional narratives. The findings challenge prevailing assumptions about supranationalisation and the capacity to

produce European public goods, showing how a suboptimal and asymmetric framework can still generate loyalty when it provides sufficient space for national control. In doing so, the dissertation contributes to broader debates on European integration, regulatory governance, and the politics of financial stability.

Acknowledgements

Acknowledgements. I suddenly remember that it's common (and good) practice to write acknowledgements. It is Wednesday night, just before submission, and there are so many people I am grateful for. I will acknowledge all of them... Easier said than done. Perhaps the ultimate purpose of the entire PhD was to learn how to write acknowledgements.

Paradoxically, I started thinking of this tiny section of the dissertation back in Budapest, when sharing an apartment with a dear Italian CEU fellow, who wrote the most beautiful Acknowledgements I've ever read – he even selected a soundtrack for the readers. It was a joy to. After that, I almost forgot about acknowledgements... Until now.

To being with, I genuinely want to thank my supervisors – yes, I had two of them. My first supervisor taught me how to be strategic and believe in myself. My second supervisor was always present and never hesitated to point out what could be improved in my dissertation – and how to fix it – until the very last day. This work is, to a tangible extent, a direct consequence of their advice – both the advice I followed and the advice I did not.

As already mentioned, there is a long list of people close to my heart who deserve a place here. It would be too easy to say “I think of all of them” now, even if they are not explicitly named – although I actually do. Above all, my family – thanks to whom, and in some ways despite whom, I'm here – and my Italian friends, especially those four jokers I was lucky enough to grow up with. When it comes to those I met during the PhD journey, I am immensely grateful for my colleagues. I was hosted in two different labs at CEU: if you ever seek love and laughter, go knock on those doors. I wish all of them nothing but true happiness, for we shared one unforgettable experience. This includes the two DSPS Coordinators, lovely beings who deal daily with far more practical issues than any of us PhD candidate ever had to face.

Finally, there's a Brazilian, a German, and two Serbians – no, this is not a joke, and of course these people are far more than their nationalities. Each of them holds a place in this story, a place that comes naturally to assign to them, because it's tied to special moments, to the discovery of certain sides of myself, to the wonder of both similarities and differences – and, yes, even to astrological connections. But what joke works without the presence of an Italian? Well, there are actually two of them, who even had the patience to visit me just a couple of weeks before the submission of this thesis. Regrettably, I could not spend as much time with them as I wished.

Last but not least, meine Frau. I met her during the pandemic, while I was temporarily taking refuge in Brazil – God bless this country. The conditions that brought me there and the causal mechanism that tied us together are as interesting as the absence of contestation in peripheral countries despite the macroprudential triangle, but it is the outcome that matters. It is always fair to thank your loved ones for the support they provide – while expecting nothing in return. Instead, I thank her for all the times she was playfully mischievous and an adorable troublemaker, reminding me that life is a game and we have to make fun of each other.

TABLE OF CONTENTS

I.	INTRODUCTION	6
	The Political Economy of Macprudential Policy: A Puzzle	6
	The Macprudential Triangle.....	9
	A Core-Periphery Perspective: Distributive Issues Related to Bank Foreign Ownership ..	15
	European Integration and the Public Good of Financial Stability	18
	Methodology	22
	Epistemological Considerations.....	25
	Structure of the Dissertation	27
II.	PUZZLING LOYALTY: THE MACROPRUDENTIAL FRAMEWORK AND THE LIMITS OF INTEGRATION THEORY	29
	Introduction.....	29
	The Macprudential Framework.....	30
	A Case of Experimentalist Governance?	33
	Dual Lens on European Integration	34
	Economic Integration: Making the Market (and Watching over it)?	37
	Creating Political Arenas: Institutional Integration	45
	The Argument.....	53
	Conclusion	56
III.	MACROPRUDENTIAL TRIANGLE IN NUMBERS	58
	Introduction.....	58
	Methodological Notes	59
	Foreign Capital in the Banking Sector.....	61
	Governance	62
	Macprudential Tools and their Effects	64
	Financial Stability	66
	Cross-country comparison	69
	Failing – or likely to fail – banks	79
	Credit provision	83
	Cross-border Spillovers from Foreign Banks	89

Mechanisms and Channels of Transmission	91
Causal Pathways to Spillovers	93
The Impact on Small Host Countries	95
Conclusion	96
IV. BANKING INTEGRATION AND CRISES IN THE PERIPHERIES OF EUROPE	99
Introduction.....	99
Methodological Notes	101
Country Profiles and Comparative Insights.....	103
Early Transition and Privatisation: Shaping the Banking Sector for the New Millenium	105
Capital Inflows in the Banking Sector and Financial Stability Policy	111
FOLTF Banks Before and After the GFC	123
Home and Host Countries' Tensions within EU Financial Governance	139
Conclusion	145
V. ALIGNMENT AND INDIVIDUALISM: NATIONAL AUTHORITIES' RESPONSIBILITY TO THE DOMESTIC ECONOMY AND THEIR LOYALTY TO THE EUROPEAN FRAMEWORK	146
Introduction.....	146
Methodology	149
Technical Aspects	151
MP Governance: The Sources of NCAs' Autonomy	152
Resilience of the Domestic Banking Sector	158
The Transnational Epistemic Community of Macroprudential Regulators and the Relationship between Home and Host countries	168
Conclusion	175
VI. CONCLUSION	178
Argument and Findings.....	178
Contribution	180
From Re-Insurance to Re-Assurance	182
Experimentalism Revised	183
Policy Relevance	185
Limitations.....	187
Venues for Future Research.....	189

BIBLIOGRAPHY	193
APPENDIX A: CODING STRATEGY.....	210
Coding Strategy and Analytical Framework.....	210
List of Key Themes	211
List of Key Issues.....	214
APPENDIX B: INTERVIEW LIST.....	216
National Competent Authorities	216
Business Associations	216
Economists.....	217
Journalists	217
APPENDIX C: FINANCIAL STABILITY REPORTS.....	218
APPENDIX C: CONSENT INFORMATION SHEET	221
Form	221

LIST OF FIGURES

Figure II.1	32
Figure III.1	72
Figure III.2	74
Figure III.3	77
Figure III.4	79
Figure III.5	81
Figure III.6	83
Figure III.7	85
Figure III.8	86
Figure III.9	88
Figure III.10.....	88
Figure IV.1.....	113
Figure IV.2.....	115
Figure IV.3.....	118
Figure IV.4.....	120
Figure IV.5.....	122
Figure IV.6.....	124
Figure IV.7.....	125
Figure IV.8.....	126
Figure IV.9.....	128
Figure IV.10.....	130
Figure IV.11	132
Figure IV.12.....	133
Figure IV.13	135
Figure IV.14.....	136
Figure IV.15.....	137
Figure IV.16.....	139
Figure IV.17.....	141

LIST OF ABBREVIATIONS

BU – Banking Union

ECB – European Central Bank

EMU – Economic and Monetary Union

ESRB – European Systemic Risk Board

EU – European Union

IMF – International Monetary Fund

SSM – Single Supervisory Mechanism

SRB – Single Resolution Mechanism

SRF – Single Resolution Fund

WB – World Bank

I. INTRODUCTION

The Political Economy of Macprudential Policy: A Puzzle

The integration of financial markets within the European Union (EU) has led to significant interconnectedness between consumers and suppliers of capital across countries. While this is consistent with the declared goal of promoting capital mobility as one fundamental freedom of the European single market, the process has also resulted into disparities between countries that are net providers of capital and countries that are net consumers. In the banking sector, this imbalance is particularly reflected into the relationship between home and host countries. As recently as 2018, the Chair of the European Central Bank (ECB) Supervisory Board, Danièle Nouy, stated that the concepts of home and host supervision had effectively disappeared within the Banking Union (BU) (Nouy 2018). However, the distinction and its implications remain central. Among numerous related issues deserving investigation, this research addresses the implications of such relationship for the management of financial stability in small host countries within the Eurozone. The countries under examination are Estonia, Latvia, Lithuania, Slovakia, and Slovenia. In simple terms, being a host-country exposes the economies to increasing financial instability in the hazardous event of a banking crisis. This project is driven by the understanding that small host countries continue to have valid concerns regarding these implications, even in light of the measures implemented by the EU following the Global Financial Crisis (GFC).

There are two primary reasons for the relevance of this conundrum. First, the GFC is frequently seen as a pivotal moment in financial stability policy, as it raised awareness and spurred action regarding the understanding and prevention of systemic risk. Nonetheless, banking crises have persisted, with the industry continuing to report instances of troubles each year. Confining the scope exclusively to Europe and the cases handled by the Single Resolution

Board (SRB), several notable instances can be identified: in 2017, Banca Popolare di Vicenza and Veneto banca, as well as Banco Popular; in 2028, ABLV Bank; in 2019, AS PNB Banka; in 2022, Sberbank Europe AG.¹ Secondly, two strategic reports were released recently – one by Letta and the other by Draghi – which arguably converge on a fundamental point: the focus must shift from merely deepening the internal market to enhancing the EU's position in the realm of global economic competition (Moschella and Quaglia 2025). Letta asserted that “we have to transform these national champions into European champions, having an equal presence in different countries. We need to have the Airbus of banks” (Financial Times 2025). These affirmations prompt us to consider whether it is indeed appropriate to regard the home-host relationship as a matter that can be archived.

Before dismissing the inquiry, we want to ensure that we have the correct answers and the appropriate solutions to alleviate concerns regarding the internal market and competition in banking integration. Macroprudential (MP) policy plays a vital role in post-GFC European integration, one that is intimately linked with the preservation of capital mobility. Does the related scholarship address the issue comprehensively? In fact, the relationship between home and host countries unveils the ongoing underlying tension between core and peripheral countries within the BU. This dissertation presents three primary contributions to address the existing gap. First, this analysis begins by examining the challenges faced by the Eurozone peripheries through the framework of mainstream EU integration theories, highlighting discrepancies between established approaches and the actual experience of European integration. Second, it provides a novel conceptualisation of the home-host conflict – notably the *Macroprudential Triangle* – which addresses the tension through its foundational dynamics. Third, it differentiates between the empirical reality of financial stability, as indicated by the

¹ Reported years refer to the first action taken by the SRB for each case. However, all cases took long – possibly years – before being qualified as either “resolution” or “non-resolution”.

metrics established by EU and national institutions, and the perspective held by National Competent Authorities (NCAs) regarding this issue.

The main hypothesis posits that NCAs in peripheral Eurozone countries express loyalty to the current MP policy framework not despite, but *because of*, the specific institutional configuration of MP governance. In particular, this loyalty stems from a high degree of regulatory autonomy embedded in the framework, which enables NCAs to tailor MP policy to domestic priorities. The findings confirm that NCAs perceive MP governance as a domain in which they enjoy considerable room for manoeuvre. Despite the structural tensions outlined by the MP Triangle, NCAs manifest high confidence in their ability to manage these challenges within the current framework. This is made possible by the current governance arrangements, which constitute an opportunity to safeguard domestic financial stability while participating in EU-wide regulatory coordination. Loyalty, in this context, emerges not from blind acceptance or lack of alternatives, but from an active and strategic appropriation of the governance structure. While this study centres significantly on MP governance and the role of NCAs' autonomy within it, the findings also invite a broader reflection on European integration. This reflection is intentionally developed in the concluding chapter, rather than embedded into the initial hypothesis. By proceeding in two stages – first testing an institutional explanation, then reinterpreting the findings through integration theory – the dissertation preserves analytical clarity while also contributing to ongoing debates on experimentalist governance, supranationalism, and the symbolic dimensions of loyalty to the EU project.

Having established the empirical and theoretical puzzle concerning small Eurozone host countries' surprising adhesion to the MP framework, it is now necessary to provide a more precise analytical lens to examine the dimensions of this issue. To that end, I conceptualised the *Macprudential Triangle*, which fills the existing gap in understanding the unique challenges that small host countries face due to their condition of peripheral economies within

the Banking Union. The following sections will unpack these elements, including the structure of the Triangle and its consequences, the relevance of the core-periphery framework to fully grasp the magnitude of the challenge, and the ideal of financial stability as a public good.

The Macprudential Triangle

The literature shows that, generally speaking, financial distress in home countries can significantly affect host economies by disrupting credit supply. This occurs in countries where banks rely significantly on interbank markets (Jones and Underhill 2014). Popov and Udell examine the specific case of Central Eastern Europe (CEE): on one hand, they acknowledge the benefits of foreign banking in host countries, highlighting its role in enhancing efficiency and diversification, which are crucial for financial stability; on the other hand, they maintain that reduced interbank flows between parent banks and their subsidiaries have led to a reduction in credit availability for businesses in CEE countries (Popov and Udell 2012). As a result of the GFC, CEE countries suffered from disruptions to the internal capital reallocation of the major Western banks operating in their systems (Jones and Underhill 2014). However, the repercussions were ultimately mitigated and contained through the Vienna Initiative (Pistor 2012). Furthermore, Epstein clarified that foreign banks' tendency not to "cut and run" was more a result of the "second home market" model adopted by Western banks rather than the Vienna Initiative itself: the model rendered capital in those banks less mobile (Epstein 2014; see also Dal Maso 2022). And yet, in 2019, the then current Chair of the Single Supervisory Mechanism (SSM), Andrea Enria, acknowledged that host supervisors' concerns, as a matter of fact, remain valid (Enria 2019).

The most prominent concerns possible imbalances in how costs and benefits are distributed within the existing framework for banking supervision and resolution. Since the

creation of the Economic and Monetary Union (EMU), the institutions established to support the system have concentrated mainly on ensuring the stability of the single currency. The persistent debate regarding the theory of an Optimum Currency Area (OCA) indicates that the present institutional framework was designed primarily with a focus on money, rather than on financial stability (Jones and Underhill 2024). This is especially true for the BU, which, from the beginning, was “aimed to shore up the euro more than anything else, and as such was focused much more on the Eurozone than on the EU as a whole” (Piroska and Epstein 2023, 183). Consequently, despite the centralisation efforts after the GFC (represented by the BU), national interests may still prevail. This could result in a scenario where the financial burdens of failing banks are unevenly borne by host countries, rather than being shared equitably throughout the Eurozone (Singh 2020). Economists affiliated with the World Bank showed that CEE Eurozone countries are among the most impacted economies, primarily because of the significant presence of foreign banks in their financial systems (World Bank 2019).

Building on these findings, the present study focuses on an important component of the post-GFC European architecture, namely the macroprudential (MP) framework.² The dissertation contends that CEE small host countries in the Eurozone face a unique challenge arising from financial integration— one that remains insufficiently explored by the existing literature. Particularly, this challenge affects the management of financial stability and is here framed as the *Macroprudential Triangle*. The Triangle suggests that financial stability relies on the adjustment of three policy objectives:

- 1) *MP policy*, understood as a focus on the quality of credit and the resilience of credit institutions;

² The MP framework is composed of two elements: MP governance; MP policy.

2) *Cross-border spillovers* stemming from financial interconnectedness, particularly the negative unwanted effects of MP policies;

3) Adequate *credit provision*, understood as the quantity of credit supplied to the real economy.

These policy objectives may not always manifest simultaneously as part of a compound challenge, as they can arise independently. Nevertheless, it is reasonable to examine their interplay, as they pertain together to the natural dynamics of integrated financial markets. The challenges of the Triangle compound when tightening MP policy to enhance resilience simultaneously triggers cross-border spillovers – due to foreign capital withdrawal – and restricts credit provision, thereby amplifying financial fragility instead of reducing it. This tension is especially acute in small host countries, where the limited effective autonomy of foreign-owned banks combined with external dependence prevent effective balancing of these three objectives.

In principle, all Member States may encounter this practical challenge. However, in the case of Eurozone small host countries, the three policy objectives take on a unique impact because of two structural conditions:³

a) The *dependence on foreign capital*, which emerge as a defining characteristic of the banking systems examined in this study – partly as a consequence of the *eradication of capital controls*;

b) The *absence of a fully integrated, supranational governance system*, which would incorporate monetary policy, micro-prudential supervision, and MP policy into one single framework to provide financial stability as a public good – *i.e.* to the benefit of all.

³ None of the structural conditions is individually sufficient to the outcome, they are rather insufficient-necessary part of a sufficient-necessary combination.

Furthermore, the Triangle is based on an important theoretical principle: the countercyclical nature of MP policy, which is generally intended to manage excessive credit growth. This becomes evident in the lack of MP tools aimed at promoting or increasing credit provision.⁴ While there is broad consensus on the importance to enhance the resilience of the financial system, opinions diverge regarding the appropriateness of employing MP policy to limit credit growth (Schoenmaker and Wiertz 2016). What is certain, however, is that MP policy is typically viewed as credit-constraining and is primarily employed for this purpose (Alam et al. 2019). A recent study conducted by the International Monetary Fund (IMF) indicates that tightening any MP policy tool analysed is particularly associated with household credit growth: measures that directly restrict loan supply have the most pronounced adverse effects (Alam et al. 2019). Importantly, these measures are the most widely implemented by the countries under examination (Eller et al. 2020).

As for the first structural condition, dependence on foreign capital does not inherently lead to adverse outcomes. For instance, well-capitalised multinational banks are widely recognised for their potential benefits to host economies.⁵ This benefit was especially appreciated during the reorganisation of banking systems in the wider transition that occurred after the fall of socialist regimes. It also proved to be an advantage several years later, in the aftermath of the GFC (Epstein 2014). However, dependence on foreign capital also present significant challenges, as will be discussed in the dissertation. Disadvantages typically arise when the interests of states connected by capital flows diverge, or during crises when banks are at risk of failing. An important illustration of differing interests is the regulation of buffers

⁴ To be clear, one could argue that all MP tools are ultimately designed to ensure the provision of credit during periods of financial distress, particularly when credit institutions may be less willing to lend. However, this does not alter the fundamental principle that, during periods of economic expansion, MP policy is expected to constrain credit growth.

⁵ For a review of the main arguments in this literature, see Nelson (2020).

for systemically important (SI) banks, where the rate established by the home country significantly restricts the policy choices accessible to the host country. The threat posed by failing banks, instead, materialises as the costs that might be borne by taxpayers in the host country. This concern is reflected in the tendency of peripheral states to adopt more macroprudential measures compared to core states. This may induce preoccupation as aggressive MP policy may lead to relatively higher costs in terms of negative credit growth. Moreover, it is important to note that small host countries have largely adopted systemic risk monitoring methodologies tailored to the structures and dynamics typical of large economies – where capital come from.⁶

Regarding the absence of a supranational MP governance, this condition does not imply that there is no coordination of macroprudential policies at the European level. Such coordination exists to a certain degree, primarily through information exchange intended to foresee and mitigate potential negative outcomes. Rather, it highlights that financial stability is not pursued as a public good in the EU. The core issue is the absence of a uniform approach for tackling financial instability, a problem further exacerbated by the insufficient effectiveness of supranational powers. Although a theoretical supranational authority exists in the form of the European Systemic Risk Board (ESRB), its powers remain effectively limited, while National NCAs maintain significant autonomy in implementing MP measures. One key implication of this asymmetry is the so-called *inaction bias*: “[a]lthough the framework does not prevent authorities from taking action [...] whether it facilitates swift responses when necessary remains in doubt” (Stellinga 2021, 1453). To be clear, the ECB possesses the authority to impose higher MP requirements than those set at the national level when conditions

⁶ As explained by Thiemann (2024), the common monitoring framework was developed thanks to the significant contributions of economists from the ECB and the ESRB. Furthermore, my interviews indicate that these joint efforts have often prioritized the incorporation of conditions and concerns typical of large economies that host the headquarters of multinational banks.

indicate heightened risk.⁷ However, this authority has never been utilised and operates in a unidirectional manner, since the ECB is unable to impose requirements that are less stringent than those set by NCAs. A second significant implication concerns the synergies and conflicts between monetary policy – which is entirely centralised in the ECB – and MP policy (Cassola et al. 2019). The absence of an impartial (*i.e.* supranational) coordination mechanism between these two policy spheres across the Eurozone leads to inefficiencies. A more centralised approach may assist in tackling the “disparity between individual and collective rationality”, a recurring challenge in the production of public goods (Underhill and Jones 2023, 1587). In particular, the Eurozone’s centralised monetary policy may inadvertently amplify credit growth in some regions while having little effect in others, further complicating financial stability management (Schoenmaker and Wierdsma 2016).

If all of this holds true, the sustainability of the MP framework is puzzling and raises a political question: **why do Eurozone peripheries decide to not express their discontent with the current MP framework – and to what extent does this decision reflect loyalty versus a lack of effective voice mechanisms?** One might reasonably expect to observe signs of opposition to the current governance of the MP Triangle, or at least some indication of discontent from the states that could be adversely affected. Nonetheless, the peripheries of the Eurozone have shown no desire to alter the existing arrangement. While the MP Triangle alone may not offer adequate justification to withdraw from the European project, it should certainly raise concerns and inspire a commitment to reform certain institutional arrangements. What motivates these countries to sign on to the MP framework – and how do they manage to navigate the hidden imbalances? Exploring these questions presents a chance to address an empirical challenge and, more significantly, enhances the understanding of European

⁷The reference is here to Article V of the SSM Regulation, which appoints the ECB with so-called top-up powers vis-à-vis the calibration set by national authorities.

integration, especially regarding financial supervision and the management of financial stability.

A Core-Periphery Perspective: Distributive Issues Related to Bank Foreign Ownership

While the Macprudential Triangle highlights the core policy challenges and trade-offs faced by small host countries, understanding why these issues disproportionately affect the Eurozone's peripheries requires a deeper exploration of structural conditions. Accordingly, this study adopts a core-periphery perspective drawing primarily on Dependency Theory. This section sheds light on how long-standing power imbalances and asymmetric integration processes reinforce the structural vulnerabilities captured by the Triangle.

The empirical puzzle reveals potentially “uneven socio-spatial developments” (Weissenbacher 2019, 1) between the core and the periphery in the context of the MP framework. Following the logic of the long-established Dependency School in Political Economy (see Madariaga and Palestini 2021 for a comprehensive overview), some countries qualify as peripheral – or “semi-peripheral” (see Ban and Bohle 2021) – contingent on the position they hold on a global or regional scale vis-à-vis the core countries: a position defined as *dependency*. In the words of Cardoso and Faletto (Cardoso and Faletto 1979, xxi), in the capitalist system, “some of its parts have more than their share of leadership and an almost exclusive possession of sectors crucial to production and capital accumulation, such as the technological or financial sectors”. In fact, the asymmetries revealed from this perspective are not alien to European integration. The integration process, despite its goal to generate and distribute benefits among Member States, is also a source of costs which might be allocated unevenly. The fact that European integration produces winners and losers should not surprise. A typical example in Political Economy is economic convergence and the structural bias

favouring export-led growth models over other paths for economic growth (Johnston and Regan 2021). In general, such asymmetries correlate with a combination of structural features of both the EU polity and its Member States. More than a decade ago, Enderlein and Verdun (2009) reminded us of the highly pessimistic views around the establishment of the EMU (see also Scharpf 2016). Among other concerns, questions about the distributive consequences of the EMU were very much recurrent since before its launch (Verdun 1998).⁸ Such issues have been progressively conceptualised as asymmetries (Howarth and Verdun 2020; Scharpf 2010) and addressed by Political Economy and EU Integration Studies. In particular, the analyses deploying the core-periphery framework contend that peripheral countries, both before and after the GFC, have found themselves in a disadvantageous position of dependency which would decrease the gains from integration and create sources of vulnerabilities (among others, Ban and Bohle 2021; Bonizzi 2013; Bortz and Kaltenbrunner 2018; Dumičić 2018; Madariaga and Palestini 2021; Nelson 2020; Piroska et al. 2021).

Debates in Political Economy regarding different growth models across the peripheries typically understand dependency as a function of a specific type of capital flows, namely Foreign Direct Investments (FDIs) (among others, Bruszt and Vukov 2017; Medve-Bálint 2014). Regardless of the portrayal of FDIs as having a lesser impact on vulnerability compared to other growth models (Bruszt and Vukov 2024), they fail to accurately reflect the extent of dependency experienced by the CEE region. Other impactful forms of dependency are analysed in the literature addressing specifically financial integration and the banking system (Epstein 2017; Fontán et al. 2019; Grittersová 2014; Piroska and Epstein 2023; Piroska et al. 2021). This scholarship identifies particularly two parallel dynamics that, along the years, have contributed significantly to the asymmetries characterising the relation between core and periphery. First, the EU has undergone substantial transformation of its financial markets –

⁸ Such concerns were mainly premised in the potential effects of the primacy of the real interest rate over the real exchange rate, which could delay – or prevent – economic convergence across EMU countries.

including the banking sector. As far as regulation is concerned, in the decades preceding the GFC, the EU had already become a central player in financial regulation (Mügge 2013). The prolific regulatory activity has progressively reshaped the field in which national and international financial institutions operate. One turning point in financial supervision occurred with the enactment of the *Second Banking Directive* in 1989 (Brenner 2021). This implied the transition from non-discrimination and host-country control to minimum harmonization, mutual recognition, single passporting and the home-country principle. The consequence for the cases under examination is well captured by Brenner, who argues that the *Second Banking Directive* “opened up the black box of national financial supervision” (2021, 26), resulting into the necessity of higher trust-based cooperation between national supervisors.

This project centres on a different process that has equally influenced the equilibrium between relative winners and losers of European financial integration in a more direct manner. This is the privatisation of the banking sector, notably the extent of foreign capital involvement in bank ownership. The same years of regulatory reforms coincided with the privatisation of the banking sector in the CEE region, as part of a broader dynamic that brought foreign capital into these countries: national varieties of capitalism were being restructured and prepared for transnational integration, including a necessary liberalisation of capital movements – which contributed to mould the region’s growth regimes (Bohle and Greskovits 2012; Bruszt and Vukov 2017; Bohle in Johnston and Regan 2021).⁹ As examined in the previous section, research indicates that the high share of foreign bank ownership represents a potential vulnerability for the so-called *small host countries*. According to Feyen and his colleagues at the World Bank (2014), reliance on foreign funding is a major driver of private credit growth in the CEE region. Due to dependence on foreign capital, as both bank ownership and bank

⁹ To be sure, banking reforms in the region started in the early ‘90s, but a different, Western-like model of commercial banking – as well as credit growth – are a phenomenon of the 2000s (Spendzharova 2014a).

funding, credit growth becomes very sensitive to cross-border funding shocks.¹⁰ For instance, during the GFC, a massive “cut and run” on banks from the CEE region was expected (Epstein 2014; Popov and Udell 2012). Both the Vienna initiative and the unique expansionary model employed by Western banks have mitigated the risk of a financial run (Dal Maso 2022; Epstein 2014; Feyen et al. 2014; Fontán et al. 2019). Consequently, nations that were overly reliant on parent funding, as well as those depending significantly on direct borrowing from abroad, have been restructuring their financing systems. This restructuring is evidenced by a decrease in loan-to-deposit ratios and the proportion of foreign liabilities to total liabilities (Feyen et al. 2014, 29). Moreover, the penetration of foreign capital – via bank ownership – in the CEE region has not resulted in increased financing of the local non-financial firms (mostly SMEs), but rather pro-cyclical consumer and mortgage lending (Ban and Bohle 2021).

European Integration and the Public Good of Financial Stability

Having contextualised the vulnerabilities of peripheral economies, it becomes crucial to contextualise the Triangle within the broader goals of European integration – particularly the provision of public goods. To this purpose, the section explores the political implications of conceptualising financial stability as a public good. By locating macroprudential policy within these debates, the dissertation clarifies why the provision of financial stability cannot be simply understood as a technical matter, but rather as deeply embedded in the political-economic purpose of European integration – namely the “well-being” of European peoples, as affirmed in Article 3 (1) TEU. Article 3 (3) clarifies that the internal market – in its broad meaning that include financial services – “shall work for the sustainable development of Europe”. These

¹⁰ To be clear, foreign ownership per se does not explain the different credit responses across CEE countries: stronger responses occur in countries with high loan-to-deposit ratios and stronger reliance on foreign funding (Feyen et al. 2014).

objectives imply a commitment to addressing common challenges and ensuring the provision of goods and services that benefit the entire society, thereby becoming vital for understanding the puzzle under examination.

The MP framework was established in the aftermath of the GFC, when it became clear that, due to deep interconnectedness and consequential systemic risk, supervisory authorities could not be concerned exclusively with prudential regulation at the micro-level – if the goal was to secure the benefits of financial integration for all (Baker 2013; Kranke and Yarrow 2019; Lombardi and Moschella 2017; Piroska et al. 2021; Stellinga 2021; Thiemann et al. 2021). Thus, different regulatory attempts were made at the regional level in order to establish the desired MP system – meaning the appropriate governance and policy-process. The greatest efforts were put by the countries with largest financial markets, namely the US, the UK and the EU, but these have resulted in a variety of outcomes (Masciandaro and Quintyn 2016; see also Lombardi and Moschella 2017). Importantly, there is no actual institution capable of enforcing MP policy in the interest common to all the Member States. In his speech as Governor of the Bank of Japan, Masaaki Shirakawa stated explicitly the conundrum of MP supervision in the EU: only some elements of the public good can be produced at the nation-level; while those elements to be provided by supranational institutions should not augment the democratic deficit (Shirakawa 2012).

As recalled by Wyplosz, the Bank of International Settlement (BIS), already in 1996, made clear that efforts to secure international financial cooperation in the postwar world are only possible “under the pressure of some kind of financial crisis” (Kaul et al. 1999, 152). Indeed, it was in the aftermath of the GFC that many nations’ leaders, summoned to global fora (G20, Financial Stability Board and BIS), decided to shift their attention to MP policy. Such efforts were soon incorporated into EU legislation, and both existing and new-born institutions were appointed to the task of maintaining financial stability. Behind this process of institutional

change there has always been the intention of delivering “the public good of financial stability” (De Larosi re 2009, 21). Indeed, establishing an institutional setting for the maintenance of financial stability ideally corresponds to “common interest regulation” (Bruszt and McDermott 2014), whereby transnational rules are adopted and enforced in order to benefit a broader constituency of actors: countries should be willing to seek mutually beneficial solutions in order to prevent mutually disruptive outcomes (Bruszt and McDermott 2014) – a description that echoes well with both the general goal of post-GFC financial regulation and the specific objective of MP policy, namely protecting markets from the financial instability naturally engendered by financial-integration processes.¹⁷

The production of financial stability as a public good implies specific costs. In principle, all the beneficiaries must contribute to the production of the good, although some actors may well free ride. In this sense, public goods are widely acknowledged for their extensive externalities and widespread benefits. According to a stringent definition based on consumption, these goods are both non-excludable and non-rival: no one can be excluded from using it; it can be consumed by many individuals without being diminished. Pure public goods, which are uncommon, display both of these characteristics, while impure public goods have them to a lower extent or exhibit a mix of the two (Kaul et al. 1999).¹⁸ Political economy scholarship has dealt with these qualities extensively, and it generally agrees that financial stability is a (global) public good (Kaul et al. 1999).¹⁹ According to Schoenmaker, the extent to which “the public good of international financial stability” can be produced at the national level is one paramount question (Schoenmaker 2013, 19). The author argues that, as a matter of fact, financial stability, financial integration and national financial policies are incompatible with each other, for not all the three objectives can be combined at once (Schoenmaker 2011). In his simple model of the financial trilemma, financial stability equals the successful attempt at keeping systemic risk at bay.²⁰ In principle, a bank can make significant profits from risky

lending, risking only its capital in case of failure. However, in a complex and interdependent financial system, the costs of a single institution defaulting are significantly higher – often multiple times – as one default can trigger many more.²¹ To prevent this from happening, according to Schoenmaker, coordination on bank resolution – precisely recapitalisation – is necessary, but nation-states have no incentive to share the common costs, while preferring to act independently (2013). Thus, the public good – financial stability – cannot not be produced.

Although the financial trilemma does not explicitly contemplate MP policy, it implicitly reckons in all the potential actions targeting financial stability, even beyond bank resolution, thereby assuming significance relevance to this investigation. It is important to note that financial integration could be read as free movement of capital, which is typically allowed by the eradication of capital controls within the EU. As Pistor (2009) explains, capital controls are among the tools controlling the money supply, which is generally the number one factor influencing the likelihood of financial crises – thereby requiring the national financial policies mentioned in the Trilemma. A similar understanding is adopted by Underhill and Jones (2023). Also these authors maintain that the current EU governance is incapable of delivering financial stability as a public good. To be clear, they argue that financial stability is currently supplied as an excludable good, precisely a “club good” that is often provided for a few insiders with vested interests (*ibidem*). What prevents financial stability from being a public good is precisely the absence of an Optimum Financial Area (OFA), that is a system where financial stability is non-excludable, and the risk of financial market disintegration is contained (*ibidem*). The solution proposed by the authors is an institutional setting that be able to guarantee stable capital mobility – ultimately eradicating discrimination between same units from different jurisdictions (*ibidem*).

As clarified earlier, the purpose of MP policy is not directly to increase exchanges across borders or to make prices equal, which is what market integration is according to the

official indicators of the ECB,²² but rather to prevent systemic risk from poisoning capital mobility. This ultimate goal makes MP policy profoundly intermingled with both financial stability and, as a consequence, European integration. However, as just illustrated, the literature is pessimistic on the chances to deliver such a public good within the suboptimal European setting. For this reason, the MP framework is expected to elicit political contestation. As a matter of fact, this has not been the case. Whereas the MP framework does not achieve more integration due to all the incongruencies of the “Single Financial Market” in which it is deeply incorporated (Piroska and Epstein 2023), it maintains the *status quo* and even increases the chances to rendering MP policy a positive-sum game.

Methodology

To address the research question of why peripheral countries within the Eurozone pledge allegiance to the existing MP framework despite evident structural disadvantages, this dissertation adopts a qualitative, comparative, and case-oriented methodological approach. The choice of a small-N comparative research design is not merely justified by practical as well as personal considerations regarding ontology and epistemology. Rather, it is inherently functional to the analytical needs of the research question itself. Understanding the intricate political-economic motivations behind the absence of explicit contestation or opposition requires an in-depth exploration of actors’ subjective perceptions, the institutional contexts in which these are shaped, and the country-specific conditions that serve as a test of appropriateness. By selecting a limited number of closely comparable cases, this study can provide a reliable illustration of the causal mechanisms connecting the core hypothesis to the *explanans*.

The choice of a narrow universe of cases, as well as a restricted number of attributes is also compatible with the established guidelines for small-N comparative research designs. Focusing on the so-called *causes-of-effects*, as opposed to *effects-of-causes* (Mahoney and Goertz 2006), it shifts the purpose away from generalisation and towards in-depth understanding of complex social realities. As clarified by Della Porta, social sciences' remit includes also in-depth understanding of a context through historical comparison "*a la Weber*" (Della Porta and Keating 2008, 204). At the same time, this study does not qualify as pure *case-centered* research seeking an overly detailed explanation of a single case without the possibility of drawing conclusions applicable beyond the narrow sample (see Rohlfing 2012). In practice, it aims to identify and assess previously untheorised causal mechanisms through within-case analysis and cross-case comparison. In answering the research question, this dissertation engages with other theories – precisely EU integration theories – that struggle to account for the persistence of the *status quo*, particularly when it results in sub-optimal conditions, as highlighted by the MP Triangle. Thus, this study better qualifies as a *case-oriented* analysis (See Rohlfing 2012; Della Porta and Keating 2008 use the notion of *case-based study*) in which the small number of cases is characterised by a few attributes and operational variables. However, by indirectly testing the descriptive power of EU integration theories, it also incorporates the goals of the *theory-centered* research design.

The present analysis focuses on five countries from the CEE region which are also members of the Eurozone – Estonia, Latvia, Lithuania, Slovakia and Slovenia. Two are the fundamental attributes characterising these cases:

1. The country has *Eurozone membership*.
2. The country qualifies as a *peripheral dependent economy*.

These two attributes together define the population of cases: in total, six countries qualify under the abovementioned attributes. Out of the six countries from the population only Croatia is not included in the case-selection. The reason for its exclusion lies in the fact that Croatia experience as a Eurozone country is too short to allow meaningful observations on the explanandum. To quantify the attributes, this analysis resorts to two variables, one for each attribute:

1. The year when the country adopted the common currency.
2. The share of foreign ownership in the country's banking system.

It is important to note that the cases under examination coincide entirely with the selected countries. Beyond the illustrated fundamental attributes, the cases share several characteristics due to the common geographical belonging – Central-Eastern Europe – and to the similar process the underwent starting from the 1990s – the transition from socialism to capitalism. Therefore, these countries – or groups thereof to some extent – share certain historical traditions, cultural traits, and paths of economic development. As a consequence, the case-selection offers the advantage to “parametrising” certain variables (Della Porta and Keating 2008, 214). More importantly, they reflect the logic of the *most-similar system* design: the cases under examination are all representative of the investigated phenomenon. In other words, they all qualify as *positive cases* of the absence of contestation against the MP framework.¹¹

¹¹ Positive case are representative of the explanandum while negative cases serve to test the theory and are understood as opposite instances of any given investigates phenomenon (Goertz 2006).

Epistemological Considerations

As briefly hinted, the central puzzle underneath this investigation cannot be solved by resorting solely to material or institutional variables. While economic dependency, asymmetric governance, and policy constraints are clearly important, they do not sufficiently explain the absence of contestation or the presence of active support. To account for the persistence of loyalty, this analysis turns to constructivist epistemology. This enables the examination of loyalty not as a passive consequence of material conditions, but as an active and contingent performance justified by intersubjective meanings and epistemic alignment.

Addressing the research question requires the interpretation of a political choice, namely the will to remain loyal to a system despite its inadequacy to produce what is referred to as a public good. It is legitimate to anticipate discontent from the parties who face increasing risks and to expect them raise their *voice* in favour of institutional reforms. It may also be reasonable to expect those parties to *exit* the system, if such an option was available and not exceedingly costly. Yet, in the case of Eurozone small host countries, none of these options is observed. It is essential to note that the absence of *voice* or *exit* does not inherently imply *loyalty* (Hirschman 1970), as it may well result from a number of alternative factors. For instance, actors may choose strategic silence in order to avoid conflict with other members, or they may fear retaliation or marginalisation. Moreover, small actors like peripheral NCAs could lack confidence due to power asymmetries in the system, or they could be restrained by the absence of channels through which manifesting criticism or discontent. Some of these mechanisms will be analysed thoroughly later but none of them can individually account for the entire outcome under examination. Moreover, the evidence gathered during fieldwork indicates a clear positive sentiment of belonging to the MP framework, which extends beyond simple silence and reflects the typical dynamic of loyalty. This dissertation seeks to offer a clear and original explanation for why NCAs express loyalty to the system and how such

loyalty act as a determining factor for the absence of voice. The analysis of EU integration processes and outcomes must take this factor into account, as well as the broader constructivist dimension it is associated with.

This project establishes a clear distinction between the core elements of MP governance reality. To paraphrase Lupovici (2009), on the one hand, we come across material objects, and on the other hand, there are intersubjective understandings and subjective knowledge. This dissertation utilises qualitative data extensively, which is broadly defined as *discourses*, including interviews, speeches, and reports from NCAs and other key actors. One foundational belief of constructivist epistemology is that “the notions the actors have about their actions matter” (Della Porta and Keating 2008, 86). Therefore, qualitative data serves to capture and describe those notions. Without it, it would be impossible to dissect the entire complexity of the *explanans*, which performs as a constitutive factor of the explained phenomenon (Lupovici 2009): MP governance – particularly the autonomy peripheral NCAs enjoy – acts both as an illustration of an asymmetric MP framework and as a factor diminishing the negative impact of such asymmetry. As the Greek notion of *pharmakon* implies, something can be simultaneously understood – and utilised – as both *poison* and *cure*.

At the same time, the materiality of the phenomenon under examination cannot be dismissed if we look at the sustainability of the MP framework in spite of its distributional implications. This materiality is primarily rendered through the operationalisation of the MP Triangle, which enables us to measure the gap between the official representation of financial stability – reflected in the indicators established by EU and national institutions – and the perception held by NCAs. Furthermore, only material mechanisms are included in the alternative hypotheses. These are not entirely invalidated by the core hypothesis of this dissertation, as they possess sufficient explanatory value, particularly considering the coexistence of subjective and material drivers of loyalty. More importantly, materiality is

vividly reflected in MP governance – or the norms that dictate the roles individuals occupy within the established structure (Hooghe e Marks 2009). In the case of the MP framework, the current governance arrangement has resulted from a political process of delegation of (supervisory) powers from the national to the supranational level. While this dissertation does not delve into such a process, it illustrates how allegedly rule-taking actors – namely the NCAs from peripheral countries – utilise the existing governance structure to break down the challenges of the MP Triangle into politically manageable components to their advantage.

Structure of the Dissertation

Following this Introduction, Chapter II lays the theoretical foundation by conceptualising the MP framework and locating it within the broader context of European integration. The chapter assesses the framework's partial alignment with experimentalist governance and confronts it with mainstream integration theories. Finding these theories insufficient to explain the framework's resilience, it introduces a novel hypothesis to guide the ensuing empirical investigation. The investigation begins with the operationalisation of the MP Triangle, which entails the examination of five Eurozone peripheral host countries over a ten-year period. Through the analysis of key indicators, Chapter III portrays a context of banking sectors' resilience but also persistent credit constraints and systemic exposure to parent-bank decisions. The analysis situates peripheral NCAs within a constrained environment that both enables and limits action, preparing the ground for the following chapter's historical overview. Indeed, Chapter IV deepens the empirical context by tracing the historical evolution of banking systems in the five countries under examination. It shows how transitions from socialism to market economies led to varying patterns of privatisation, foreign ownership, and regulatory integration. Importantly, the chapter highlights how the five cases exhibit distinct trajectories,

yet they share common concerns in relation to post-crisis European integration. This background clarifies both structural vulnerabilities and national strategies, paving the way for the following chapter's examination of how regulators respond to them. Chapter V, the final empirical chapter, uses expert interviews to investigate how NCAs in peripheral countries perceive and navigate the MP framework. It finds that national authorities retain substantial *de facto* autonomy across three dimensions. This autonomy enables them to pursue domestic resilience through structural tools while engaging in EU-level cooperation, ultimately spurring loyalty to the MP framework. The meaning and relevance of these findings will be finally discussed in the Conclusion.

II. PUZZLING LOYALTY: THE MACROPRUDENTIAL FRAMEWORK AND THE LIMITS OF INTEGRATION THEORY

Introduction

In order to account for the political sustainability of the MP framework despite the challenges presented by the MP Triangle, it is first necessary to understand what the framework represents within the context of European integration. Notwithstanding the multiple goals associated with the EU, all of them valuable depending on the given standpoint, this investigation centres on the economic goal embedded in the European project. This perspective is arguably the most logical reference to analyse dynamics ultimately connected with financial stability – also understood as the maintenance of capital mobility within a non-discriminatory, harmonised market. In other words, the issue under investigation is one of equilibrium between different interests – the core and the periphery – which are tied together due to the high interdependence generated by financial integration and potentially clashing in case of market failure.

With this in mind, this chapter proceeds in three steps to that theoretical analysis is grounded in an accurate conceptualisation of the MP framework and its internal governance logic. First, it introduces a novel conceptualisation of MP policy that is not merely descriptive of the empirical reality. The suggested taxonomy defines the key aspects of the *explanans* and paves the way for a comprehensive analysis of the advantages and disadvantages of the current system – ultimately seeking an answer to the research question. Second, it tests whether MP governance aligns with the model of experimentalist governance, in order to assess its capacity to offset the challenges of the MP Triangle while simultaneously achieving further integration – which is the purpose of the European project. Third, the chapter reviews mainstream integration theories to evaluate their capacity to account for the MP framework. This step is crucial to determine whether the MP framework represents a meaningful step forward in

European integration – particularly in producing Pareto-optimal outcomes – or a fragile compromise that lacks deeper support.

The Macroprudential Framework

The MP framework constitutes a fundamental gear of the EU architecture established after the GFC, which is referred to as the European System of Financial Supervision (ESFS). This system was established in 2011 following the proposal of the European Commission and the foundational guidelines of the De Larosière Report, and consists of the three European Supervisory Authorities (ESAs) and the ESRB. The structures of the ESFS appointed to safeguard financial stability in the banking sector are here indicated as the MP framework. This consists of MP policy plus the system necessary to govern its entire policymaking process and the implementation – that is, MP governance.

Figure II.1 illustrates the multifaceted dimensions of MP policy. Each of the three dimensions – *concepts and measures*, *monitoring* and *intervention* – constitutes a necessary-but-not-sufficient condition for the existence of MP policy. In principle, all three dimensions involve both national and EU institutions, but their examination reveals a notable disproportion between the two levels. The functions composing the dimension of concepts and measures proved particularly important in the early years of the MP framework, when national, supranational and international institutions collaborated to define the goals of such policy and to design the macroprudential toolkit to achieve them. Notwithstanding extensive coordination efforts, the dimension exhibits substantial conceptual variation, as evidenced by the insufficient harmonisation of the definition – and measurement – of systemic risk (see Stellinga 2021). Although the monitoring dimension in the countries under examination has undergone consistent harmonisation resulting from European integration, the interviews highlight NCAs' hesitance to fully rely on the methodologies suggested at the EU level. The reason is that these

systemic risk monitoring methodologies reflect the structures and dynamics typical of core countries. Finally, the intervention dimension represents the domain of the national authorities *par excellence*. In spite of the coordination promoted by the ESRB and the top-up powers held by the ECB, NCAs are fully in charge of implementation. The ESFS underwent review as recently as 2019, when the ESRB's mandate to oversee systemic risk was enhanced without challenging the powers that NCAs wield.¹²

¹² Regulation (EU) 2176/2019 provided for updated accountability and transparency requirements and formalised the internal organisation of the entity – which had been previously considered temporary. In addition, the Regulation expanded the list of addressees of ESRB warnings and recommendations.

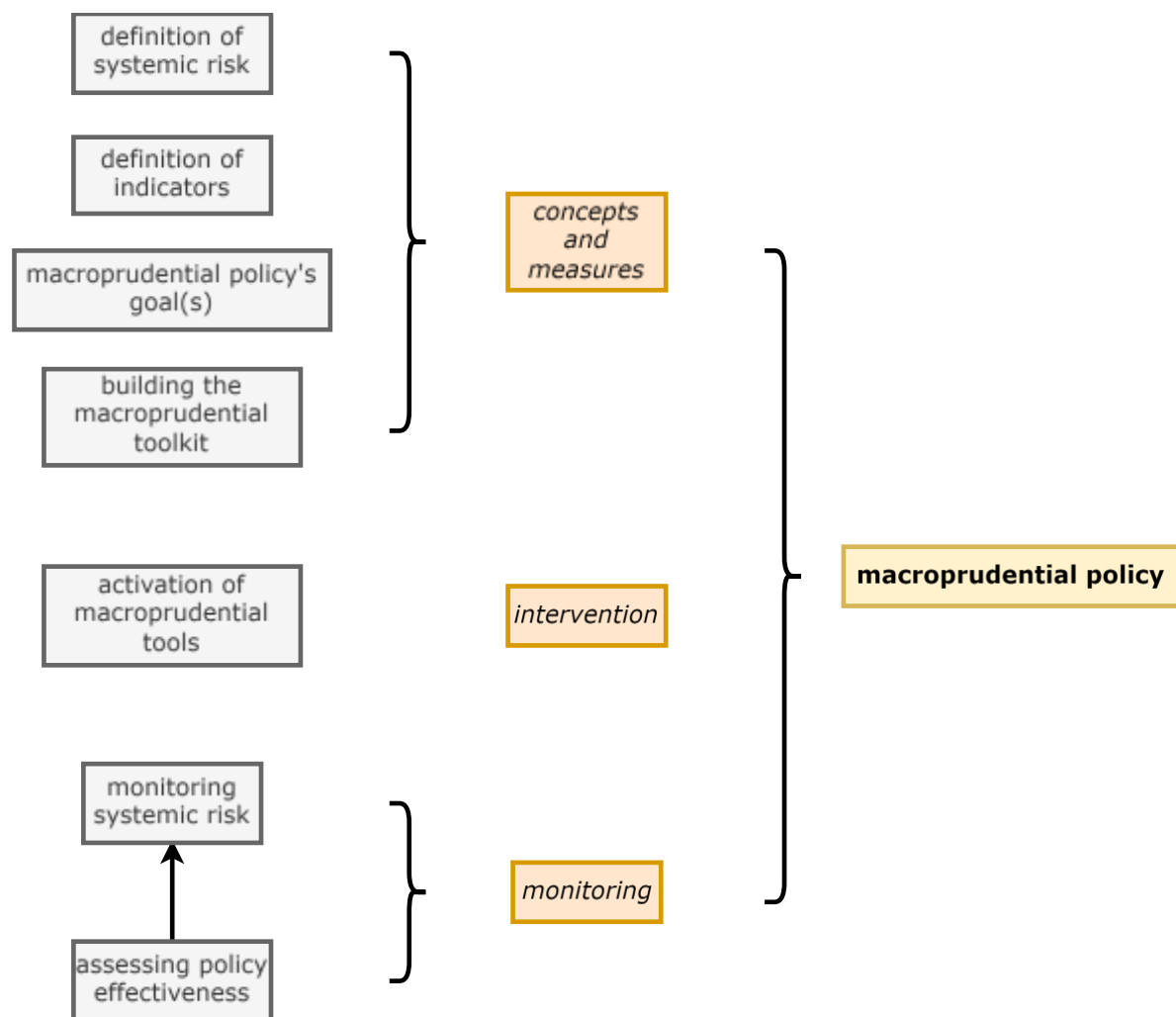


Figure II.1

Having outlined the conceptual structure of MP policy and identified the considerable autonomy retained by national authorities, we now examine whether this governance arrangement aligns with the theoretical model of experimentalist governance (XG). Testing the applicability of XG to MP governance is crucial: it helps to clarify whether the current MP framework can effectively manage the tensions embedded in the MP Triangle, or whether its *sui generis* design departs significantly from established models of flexible EU governance.

A Case of Experimentalist Governance?

The study of MP governance reveals a *sui generis* architecture that has not been comprehensively grasped. To a certain extent, this system resembles the structure of Directly Deliberative Polyarchy (DDP), a concept refined by Sabel and Zeitlin (2008) to indicate the compound of hierarchies and processes aimed at transforming the typical institutional heterogeneity of European Member States into “an asset for achieving [integration]” (*ibidem*, 276). Recently, a specific declination of DDP known as *experimentalist governance* was tested in the context of EU banking supervision – precisely the SSM. While XG does not necessarily come in its pure form, Zeitlin argues that it accounts for a considerable portion of the current setting upholding the BU – along with centralisation structures and elements of differentiated integration (Zeitlin 2022).

The primary reason for discussing XG is its relevance to the research question. Experimentalism informs the implementation of EU policy to prevent or minimise losses, thereby distinguishing itself from compensation mechanisms that intervene *ex post* to offset the imbalance ingrained in the integration process. This outcome is achieved essentially through systematic teamwork involving EU institutions, Member States and relevant stakeholders. Zeitlin and Rangoni detected such dynamics in EU banking supervision, precisely characterised by “provisional goal setting and revision, based on recursive learning from a comparative review of implementation in different local contexts” (2023, 123). Bypassing the imposition of a one-size-fits-all regulation, XG entails the recognition of interdependence between actors and the consequential joint endeavour to bring everyone closer to the Pareto frontier (see Bruszt and McDermott 2014). In this sense, experimentalist settings should not offset the challenges of the MP Triangle but rather avert them altogether.

It is worth noting that the applicability of XG to the case of the MP framework has been taken somewhat for granted, due to the capacity of this concept to recall the peculiar

combination of common monitoring and national discretion that characterises MP governance (Lepers and Thiemann 2024). As a matter of fact, XG may not be the perfect fit for the MP framework. While it is true that, as noted by Zeitlin, the EU and the national level are “ineluctably ‘condemned to cooperate’ with one another” (2022, 18), Chapter V will show the alternative face of the MP polyarchic framework, where cooperation assumes a different meaning. Firstly, *recursive learning*, a vital feature of XG, is not a necessary outcome of MP policy but rather an incidental consequence – or even a byproduct – of the discussions taking place within the ESRB working groups. The interviews show that there is no conscious effort to develop common solutions, but rather an unconscious, reciprocal influence driven by a shared sense of belonging to the same epistemic community. Secondly, XG presumes the existence of *penalty defaults*, notably escalating mechanisms designed to keep reluctant actors within the process (Zeitlin 2022). In MP governance, by contrast, such penalties are either weak or absent: the system tolerates functional differentiation, enabling national authorities to adapt common tools to local conditions without full convergence.

More importantly, the sole existence of the MP Triangle questions the applicability of XG to MP governance. As observed, an experimental setting is ultimately devoted to the advancement of European integration. Its transformative power should turn institutional heterogeneity into an asset against fragmentation and leverage it to establish a European level playing field.

Dual Lens on European Integration

Having defined the conceptual architecture of MP policy and assessed its partial alignment with the model of experimentalist governance, it is now necessary to situate the MP framework within the broader trajectory of European integration. This chapter adopts a dual analytical lens

– *economic* and *institutional* integration – to evaluate how MP governance responds to the persistent asymmetries between core and peripheral Member States, particularly in the domain of cross-border banking. This approach is essential for addressing the central puzzle: why does a governance framework that appears suboptimal, especially for small host countries, persist without visible contestation? By assessing whether the MP framework contributes to the production of collective goods or merely stabilises fragmented interdependence, we can better understand both its political sustainability and its implications for the future of integration. The MP framework plays both a symbolic and a practical role within such context, since it regulates the monitoring and management of systemic risk, which is the natural byproduct of financial interdependence (Mehrling 1999).¹³ Importantly, such interdependence is not symmetrical between the core and the periphery, whereby the latter is disproportionately dependent on capital inflows coming from the core countries – particularly in the form of bank ownership (Fontán et al. 2019).

Defining precisely how the MP framework fits within mainstream integration theories allows us to clarify how this framework remains politically sustainable despite the tensions identified by the MP Triangle. While the purpose of European integration is not fixed, especially given historical contingencies and shifting political preferences (van der Veen in Jones and Verdun 2005), integration typically involves balancing collective EU interests with the interests of individual Member States. The EU Treaties reflect this dynamic by aiming to foster cooperation through common policies and institutions, ultimately creating a more integrated political and economic union. Evaluating the MP framework from both economic and institutional integration perspectives thus becomes necessary to determine whether it truly

¹³ As explained by Minsky, the business cycle is essentially a continuum disequilibrium that is sometimes brought to equilibrium, whereby credit is the actual stabilising force of the cycle (Mehrling 1999). Failure depends on the imbalance between cash flows (both inward and outward) and cash commitments, which play a crucial role in all the relations characterizing the banking sector – both between banks and their clients and among banks themselves (*ibidem*).

represents progress towards integration or is merely a fragile compromise tolerating uneven distributional outcomes.

In order to answer this question, the present section analyses the relevant literature from two different perspectives, namely *economic integration* and *institutional integration*. A similar analytical distinction was already advanced by Hooghe and Marks, who posited that “European integration over the past decade [had] been a polity-creating as well as a market-deepening process” (1997, 1). A similar understanding can also be found in Balassa's renowned *Theory of Economic Integration* (1969), who break integration up into its dynamic and static components – respectively the *process* and the *state of affairs*. Although each of these conceptualisations differ in some of its analytical elements, the common idea behind them is that markets do not exist in a vacuum (Polanyi 2001). Their existence depends on institutions – in a broad sense – and multiple levels of governance, which have been – and will be – negotiated over many decades. This aspect is here defined as *institutional integration*: it involves both regulatory actions in the form of harmonisation or standardisation and the pooling of regulatory sovereignty at the EU level, which frequently leads to the creation of new regulatory bodies, as seen in the financial sector.¹⁴ The result of this process is defined as *economic integration*, which largely coincides with the state of affairs described by Balassa in terms of “absence of various forms of discrimination” between “economic units” from different Member States (Balassa 1969, 1).

In reality, both *institutional* and *economic* forces compose a single process – that of European integration – and their unity and complementarity is typically not challenged in EU Integration Studies. In fact, virtually all studies cited in the following sections can belong simultaneously to both categories. However, for analytical purposes, it is reasonable to consider the two elements separately.

¹⁴ For a comprehensive analysis of the relation between harmonization and standardization read Tay and Parker (1990).

Economic Integration: Making the Market (and Watching over it)?

It is first necessary to answer a fundamental question: what type of economic integration does the MP framework precisely represent? The process of economic integration has undergone significant transformation since the GFC (Parsons and Matthijs in Matthijs and Blyth 2015) and there is reason to believe that existing analyses may have not fully captured the complexity of the European response to the crisis: the political-economy debate on economic integration within the EU provides only a partial explanation of the role played by the MP framework in the broader contest between market-enforcing and market-correcting strategies. Determining whether the MP framework falls under one of those categories will enhance the understanding of the puzzle as well as the reasons for its persistence.

The fundamental concept of “eradication of discrimination” (Balassa 1969) implies that fully integrated markets achieve formal equality by means of uniform rules and practices across heterogeneous political economies (Bruszt and McDermott 2014). The historical process to establish such a state of affairs has shaped the relation between the *state* and the *market* (see Seikel 2019). A crucial moment in this process was the elevation of economic integration to the European level – with the Single European Act and the Treaty of Maastricht (Hooghe and Marks 1997). Since then, policymaking has been tasked with striking a balance between *positive* and *negative* integration strategies. The latter involves the removal of barriers and obstacles to free trade and perfect competition; the former entails the reconstruction of regulatory protection at the EU level (Scharpf 1999). These regulatory strategies correspond to two different objectives – *market-enforcing* and *market-correcting* integration – which, in turn,

align with two competing projects – *neoliberal* and *regulated capitalism* (Hooghe and Marks 1997).¹⁵

The study of such dynamics has yielded important findings, as the balance between the competing projects has changed over the course of European integration.¹⁶ While a comprehensive review of these findings is beyond the scope of this dissertation, their relevance cannot be overlooked. In particular, the prevailing interpretation suggests that European integration, until the GFC, was largely dominated by market-enforcing policies – owing also to the support of the European Court of Justice (Höpner and Schäfer 2012a; 2012b; Scharpf 2010). Over time, the European project shifted its approach from valuing institutional diversity to reshaping national institutions around a single, market-liberal model. This shift marked a transition from the principle of *non-discrimination* to that of *non-restriction* (Höpner and Schäfer 2010). Whereas the former aligns with Balassa’s proposition that foreign units should not face discrimination by domestic regulation, the latter enforces the implementation of the common market’s four freedoms even at the expense of domestic economic units (Höpner and Schäfer 2012b). Put simply, national regulation can be found in violation of European law even when it is applied equally on both nationals and non-nationals – a possibility that is often considerable unacceptable.

As for the applicability of such theses to the case of the MP framework, the literature offers few useful insights, as if the clash between market-enforcing and market-correcting

¹⁵ While it is reasonable to categorize all measures of negative integration as market-enforcing, measures of positive integration can belong to either market-enforcing action – such as when divergent national product standards are harmonized to remove existing non-tariff trade barriers – or market-correcting action – such as regulations addressing working conditions or pollution control (Scharpf 1999).

¹⁶ The literature presents different conceptualizations of the same issue. The conflict between the aforementioned goals and projects is framed in various ways: Lucia Quaglia’s *advocacy coalition framework* (2010) describes it as a clash between “market-making” and “market-shaping” forces, while Höpner and Schäfer characterize it as a struggle between “market-enforcing” and “market-restricting” integration – adding the third category of “European non-discrimination area” (Höpner and Schäfer 2010; 2012a; 2012b). Despite these differences, these analyses share a common narrative: European integration has been shaped by both an ideational and material conflict between competing projects. An insightful, alternative interpretation is the concept of “liberal developmental state”, a unified European model that somewhat diverges from the purely market-making focus of the European project. Importantly, it incorporates significant counterbalances to mitigate the negative externalities of economic integration (Bruszt and Vukov 2017).

integration strategies had reached an “end of history” moment. Höpner and Schäfer (2010) describe this shift as the “third phase” of European integration, during which the two principles of *non-restriction* and *mutual recognition* – first established during the “second phase” – now directly shape national “varieties of capitalism”. Rather than fostering the construction of a level playing field, EU policies compel Member States to converge their institutional setting towards a single model (Höpner and Schäfer 2010). In fact, a systematic interpretation of what the MP framework represents in the contest between market-enforcing and market-correcting institutions remains absent. Recent scholarship continues to underscore the victories of market-enforcing integration also in the financial field and, particularly, the banking sector. As maintained by Jones, Kelemen and Meunier (2016), European policymakers chose to disregard historical concerns about the negative externalities of financial integration and instead invested heavily in financial liberalisation. Rather than establishing an EU-wide system of banking regulation, they relied on mutual recognition and national responsibility. This left financial institutions engaged in cross-border activities to be governed by market forces (Jones et al. 2016). As a consequence, cross-country interdependence among financial institutions increased significantly and, as a result, the failure of any major bank in one country could threaten the stability of banks in other countries (Epstein and Rhodes 2014). These tensions eventually led to the establishment of the BU – with the SSM representing “the clearest abdication of national sovereignty and the greatest transfer of authority to the European authorities” (Epstein and Rhodes 2018, 215). However, the functionalist pressures behind the BU did not suffice to institutionalise wide-range mechanisms to correct for market failures: without mutualised deposit insurance and with national vetoes on common resolution funds, sovereigns remain fiscally liable for failing domestic banks (Piroska and Epstein 2023).

The prevailing emphasis on the victories of market-enforcing policies, alongside the lack of further analysis on the role of the MP framework, is not wrongly put. However, it

suggests that the literature implicitly interprets the post-GFC institutions as an extension of the same trajectory characterising overall EU integration and, more specifically, financial markets integration. To be fair, Schelkle (2017) represents a partial exception to this trend: she argues that the EMU project has always included the ingredients for “monetary solidarity” – that is, the recipe to correct for the negative consequences of market integration. Schelke (2017) provides an insightful interpretation of the issue of “monetary solidarity” through the analytical categories of the theory of *collective action* and the *tragedy of the commons* (Olson 2009; Ostrom 1990). In her interpretation, the common good is a hard, stable currency, while the tragic mismanagement is represented by moral hazard bringing to excessive issuing of Euro-denominated debt instruments (Schelke 2017). According to the author, political-economic diversity across Member States should be reconsidered as a key asset to sustain the single currency and the union built around it, rather than its insurmountable nemesis. The paradox, however, lies in the fact that diversity also complicates efforts to agree on risk-sharing institutions (Schelkle 2017), *de facto* hindering an upswing in market-correcting initiatives.

While recognising the enlightening value of these accounts, the present study aims to establish stronger connections between European integration of banking supervision and resolution, MP policy, and the broader debate on market-correcting and market-enforcing policies. A similar endeavour is undertaken by Seikel (2019), whose recent work competently integrates the perspectives of institutional and economic integration proposed in this chapter – although his analysis is based on a distinct interpretation of pooling and delegation mechanisms, which only partially aligns with their use in this dissertation.¹⁷ Its significance, however, lies in the fact that the author resorts to the distinction between *risk sharing* and *risk reduction* – an analytical framework that is essential for understanding MP policy – and contextualises its relevance in the aftermath of the GFC. While risk sharing is a well-

¹⁷ Seikel (2019) considers the unlikely scenario of supranational pooling, in which the traditional intergovernmental logic could persist even under the primacy of supranational institutions.

established concept in EU studies, both from legal and political economy perspectives, the definition of risk reduction remains largely implicit. Risk sharing is traditionally linked to solidarity within an Optimum Currency Area (OCA) and is highly politicised in debates on how to improve the EMU – as exemplified by the work of Schelkle (2017). By contrast, risk reduction refers to policies aimed at lowering systemic risks in the banking sector, including MP tools. The concept has an inherently preventive nature: "reducing" is always associated with containing the level of risk in financial markets to prevent excessive distress in the event of financial shocks. In 2018, the then President of the ECB – Mario Draghi – implied that, essentially, risk reduction involves measures designed to mitigate financial vulnerabilities before risks materialise, thereby reducing overall economic exposure to adverse shocks (Draghi 2018).¹⁸

With that distinction in mind, it is important to clarify what is ultimately at stake with financial stability. In the financial realm, Balassa's notion of "non-discrimination" coincides with capital mobility what the "different national states" wish not to be discriminated about is, essentially, the circulation of capital – which is only maintained as long as there are liquid debt-credit relations (see Jones and Underhill 2014). Initially, the establishment of free movement of capital was attained through negative market-making integration: policymakers lifted the restrictions hindering the freedom of establishment and provision of financial services. This strategy of national deregulation and reduction of barriers was marked by the *First Banking Directive* in 1977, with the introduction of the principle of non-discrimination. Subsequently, a "second phase" – of non-restriction and mutual recognition – started with the European Commission's *White Paper on the completion of the single market* in 1985. In the financial sector, that was translated in 1989 into the *Second Banking Directive*, which introduced the

¹⁸ To be clear, Draghi maintained that "the dichotomy between risk-reduction and risk-sharing that characterises the debate today is, in many ways, artificial", for "with the right policy framework, these two goals are mutually reinforcing" (Draghi 2018). The argument was made to promote the establishment of a common bank-deposit scheme (EDIS), which was opposed at the time – and partly still is at present.

principle of the “single passport” (Teixeira in Chiti and Santoro 2019). This allowed financial institutions to engage in more cross-border activities and transactions, further integrating national markets and increasing the interconnectedness of the European financial system. Integrated financial markets became a real priority, as proved by the Financial Service Action Plan (FSAP) in 1999 and the Lamfalussy Process in 2001, which started the “third phase” of financial integration (Teixeira in Chiti and Santoro 2019).

The resulting increase in interdependence created a mismatch between the potential outreach of European financial integration’s negative effects and the market-correcting regulatory framework, which was still massively dependent on national institutional settings. The imbalance between the achievements of market-enforcing integration and underdeveloped market-correcting institutions at the European level amplified the effects of the Eurozone crisis, as national governments struggled to contain the cross-border effects of banking crises (Epstein and Rhodes 2014; Mérő and Piroska 2018). It is only at that moment that European policymakers heeded concerns that had been raised even in less vulnerable times: the absence of adequate risk-sharing mechanisms was, once again, the subject of extensive debate. And yet, the efforts did not solve the issue adequately: while the outcome of the ensuing negotiations integrates and centralises banking supervision, its risk-sharing elements continue to fall short of the expectations. The positive potential of the Single Resolution Fund (SRF) is biased by the bargaining power of large economies (Seikel 2019), and the European Deposit Insurance Scheme (EDIS) is object of continuous political debate (Piroska and Epstein 2023). On the contrary, risk reduction has seemingly gained more terrain in the last decade. The Single Rulebook and the ESFS – including the SSM and its Supervisory Review and Evaluation Process (SREP), the Single Resolution Board (SRB), and the ESRB – represent a large-scale institutionalisation of risk reduction. What are the implications on the balance between market-enforcing and market-correcting strategies?

Seikel (2019) associates risk reduction with market-enforcing measures and risk sharing with market-correcting policies, demonstrating that *creditor countries* tend to favour the former, while *debtor countries* advocate for the latter. Most importantly, after examining specific instances of post-crises integration, the author finds a persistent tendency among Member States to retain control over any new instruments that entail risk-sharing and market-correcting effects (Seikel 2019). Therefore, the following question arises: considering how distinct MP governance is, with NCAs wielding substantial power, does the MP framework qualify as an instance of risk sharing? The straightforward answer is *no*. The very foundation of MP thinking is rooted in enhancing financial market resilience to shocks, rather than redistributing risk. It adopts a holistic approach to the relationship between the resilience of individual market actors and their interconnectedness at the transnational level, while acknowledging the endogeneity of financial risk (Baker 2013b; Stellinga 2020). However, the core characteristic of risk sharing – namely, redistribution – is absent from MP policy. The rationale behind the inception of the MP framework was that of containing the accumulation of systemic risk in a preventive way: it was established in complementarity with the BU, in order to support the insufficient risk management of individual institutions, precisely the micro-prudential approach characterising banking supervision before the Eurozone (De Larosière 2009). In this sense, MP policy is intimately linked with the making of the common market, in that it aims at preventing fragmentation – that is discrimination – by protecting capital mobility from financial instability (see Jones and Underhill 2014).

The competition between the integration strategies examined so far – market enforcement and market correction – has always centred on the establishment and maintenance of markets. In this sense, *economic integration* and *institutional integration* are complementary. However, singling out the perspective highlighted in this section enables us to understand the specific contribution of each component to the broader integration process,

particularly in terms of its impact on the core-periphery divide – which, in this context, is represented by the home-host relationship. On the one hand, we have observed the tendency of market-enforcing strategies to carry greater weight in shaping European integration. This tendency is, in principle, reaffirmed by the successful establishment and persistence of the MP framework: as a risk-reducing institution, MP policy represents yet another instance of market enforcement, only it qualifies as *positive* rather than the *negative* integration traditionally predicted by the literature (Höpner and Schäfer 2012a; 2012b; Scharpf 2010).¹⁹ On the other hand, the MP framework – especially MP policy – signals a crucial step away from fundamentalist market enforcement. Although its establishment came after significant losses, as the Eurozone crisis had far-reaching consequences, it represents a meaningful change of perspective (Baker 2015) – at least in theory (Thiemann 2024). Moreover, although MP policy constitutes positive integration as an effort to re-build crucial supervisory function at the EU level, it does not represent the typical case of positive integration through harmonisation (see Scharpf 1999). In fact, its implementation has been hindered by the lack of common answers to very practical issues, as evidence by the absence of agreement on a common definition – and measurement – of systemic risk (see Stellinga 2021). In addition, the MP framework challenges Seikel’s (2019) definition of risk reduction, which typically implies a stronger role for supranational institutions.

The presented perspective highlights how the MP framework navigates between market-enforcing and market-correcting strategies, clarifying its ambiguous position within post-crisis financial integration. However, to fully understand why such ambiguity requires examining the underlying dynamics of institutional evolution at the EU level.

¹⁹ As described by Scharpf (1997), the years ensuing the Single European Act of 1986 were marked by intense *negative* integration aimed at establishing the four freedoms underpinning the common market, which received significant support from the European Commission and the Court of Justice. At the same time, Member States were losing hope that the necessary market-correcting capacities lost at the national level could be re-built at the European level thanks to *positive* integration (Scharpf 1997).

Creating Political Arenas: Institutional Integration

When examining European integration from an institutional perspective, it is necessary to acknowledge the substantial differences between the various approaches composing it – particularly between the two “grand theories”. However, it is also analytically helpful to detect similarities across them. Looking for common denominators to most analyses of the integration process allows us to establish a consensus definition that enables the researcher to address numerous questions related to the process. Although any attempt to establish such a unifying concept will inevitably face exceptions, this study suggests a simple abstract definition of European integration as institutional evolution: drawing from textbooks and integrating insights from more recent analysis, I contend that the process refers to the increasing institutional cooperation among states, on various issues, which is achieved through both *pooling* and *delegation* of regulatory competences.²⁰

European integration is undoubtedly a complex phenomenon which cannot be comprehensively described by exclusive resort to its grand theories. However, the attempt at incorporating the MP framework into the integration debate should start with the fundamentals. Being the MP framework part of EU integration, it should respond to the mechanisms theorised by the literature to explain how integration occurs and where is supposed to head – at least in principle. Therefore, it is necessary to assess the capacity of the mainstream theoretical frameworks to account for the integration of the MP framework. Starting with the concept of *delegation*, it is worth noting how European-integration literature often understands the movement from the *intergovernmental* to the *supranational* dimension as a measurement of

²⁰ This synthesis is based on two key sources – plus my own interpretation: first, it draws from a textbook often referenced in courses about European integration – namely *European Integration Theory* (Wiener et al. 2019); second, it integrates insights from a recent study that encapsulates important dynamics of integration after the crisis – “Patterns of Pooling and Delegation After the Crisis: old and new asymmetries” (Seikel 2019).

European integration.²¹ In particular, it is typical for EU studies to understand European integration as *supranationalisation* (E. B. Haas 2004; Moravcsik 1993; Stone-Sweet and Sandholtz 1997) – or even *Europeanisation* (Richardson 2012).²² This interpretation assumes that integration occurs through increasing coordination of national policies, and this would only be possible when a certain amount of authority is delegated from the national to the supranational level.²³

To be clear, supranationalization is frequently considered an exclusive epistemological property the functionalist approaches but it actually represents the ontological position of a majoritarian portion of the literature. From the perspective of the present study, the traditional dichotomy between the classic theories of European integration is in reality only apparent at a low level of abstraction. The so-called “grand theories” of European integration – neofunctionalism, supranationalism and the various declinations of intergovernmentalism – have indeed conceptualised alternative mechanisms that account for European integration: these alternative visions have rivalled against each other in the attempt to provide the best – and most generalisable – prediction of how Member States deliver European integration. However, as put by Genschel and Jachtenfuchs, those theories share a “remarkable functional optimism towards the supply of integration”. This desire springs from the necessity to explain the prevailing purpose of the European project, namely market integration (2018, 181). In this sense, the two theories have more in common with each other: they both think of supranationalisation as a response to interdependence (Hooghe and Marks 2019). What is

²¹ The work of Stone-Sweet and Sandholtz (1997) is an essential reference to understand movements along the continuum of European integration, although the authors’ conceptualization is less abstract than the one proposed in this study.

²² To be clear, “Europeanization” is also often understood as the effects of European integration on domestic politics and institution-building (Arató et al. 2021). However, this is not the notion adopted in this study.

²³ Although institutional integration is often pursued through supranationalization, coordinated policy-making could be carried out also in intergovernmental mode, that is without full delegation of powers from the national to the supranational level, as it is the case for various examples of transnational integration (Bruszt and Langbein 2020; Bruszt and McDermott 2014; Eberlein and Grande 2005). A similar distinction is also proposed by Scharpf, who speaks of intergovernmental negotiations”, on the one side, and “joint decision-making” and “hierarchical direction” on the other side (Scharpf 2001).

different between the two schools, instead, refers to the question as to who rules in such supranational fora. The concept of *pooling* – namely the fact that Member States control the exercise of crucial competences at the EU level – is the answer the intergovernmental approach gives to that question. In other words, the dichotomy is about who controls the integration process (Seikel 2019) rather than what constitutes European integration.

Thus, it is common for European integration theories to measure integration by its capacity to create a new institutional – technocratic or political – community. Whereas the functionalist logic highlights a *shift in the focus of loyalty* (E. B. Haas 2004), the optimal outcome of intergovernmental policymaking is to take the discussion to a *new locus* – which stands above the national level and serves to attain otherwise unachievable goals (Moravcsik 1993).²⁴ Whereas the former sees the creation of supranational institutions as resulting from the interactions among societal actors, the latter understands the same outcome as the result of interactions among national governments (Hooghe and Marks 2019). Therefore, European integration is bound to create new institutional arenas, also through – and for – intergovernmental bargaining.²⁵ This purpose has eventually become an accepted benchmark for the entire discipline – even beyond the specific research agenda proposed by the grand theories. Hence, it is reasonable and necessary to interpret the MP framework in terms of supranationalisation.

When doing so, it should first be observed that the establishment of the MP framework has not resulted in what Haas would call a “shift in the focus of loyalty” towards the supranational level (E. B. Haas 2004): MP policy continues to rely primarily on the action of national authorities, whose role differs from the simple promotion of *the interest of*

²⁴ The idea of a shifted arena, which is implicitly present in Moravcsik’s work (1993), is originally from Jeremy Richardson’s work on “Europeanization” (2012).

²⁵ Neofunctionalism itself does not reject the role played by intergovernmental bargaining, but it rather stresses the fact that this is embedded in the integration process: integration relies on the interplay between three forces, namely transnational exchange, the demand for common rules and the establishment of organizations appointed to negotiation and adoption of such rules (Stone-Sweet and Sandholtz 1997).

transnational society characterising the functionalist logic (see Stone-Sweet and Sandholtz 1997) – here represented as financial stability.²⁶ Not only may the new arenas designated to promote intergovernmental bargaining fail to serve as the actual *locus* of MP policymaking, but also they may not attain the higher goal of financial stability as a public good – as we shall see in the next chapters. Then how should the recent developments in the governance of financial stability be evaluated according to the analytical categories of European integration? If the post-GFC institutional change is not an instance of further integration by to the logic of supranationalisation, could it be an instance of disintegration? While this question is legit, I argue that the notion of disintegration should not be associated with the condition of the MP framework. Rather, the current situation is that of a *status quo* maintained despite its sub-optimality. Can such a persistence still be described as movements along the continuum between national and supranational politics?

The original version of intergovernmentalism proposed by Hoffman encourages to consider also the reversal of the process – a sort of motion away from integration (Verdun in Verdun et al. 2023). This approach supports the functionalist notion of *spillovers* by introducing the complementary concept of *spillbacks* thereby elucidating the reasons behind countries' decisions to cooperate or not. The two categories are employed by the literature to predict and qualify integration outcomes, and yet the issue of disintegration has not been adequately addressed – or conceptualised – within the existing frameworks. Vollaard argues that disintegration should not be viewed solely as the opposite of integration (2014). He critiques the neofunctionalist concept of spillback for its nation-state bias, which implies a linear movement between intergovernmental and supranational politics; this perspective may not be the most effective way to address the issue of disintegration (*ibidem*). Rather, Vollaard advocates for a closer look at the expression of dissatisfaction with the EU and the management

²⁶ The concept is used by Stone-Sweet and Sandholtz to describe the reason behind supranationalization, namely promoting the interests of those actors who “transact across borders” (1997, 299).

of discontent to avert accelerated disintegration (*ibidem*). Importantly, dissatisfaction is more closely aligned with this study's research question, which investigates the lack of contestation for the current MP institutional setting. Hence, the legitimate question: how can dissatisfaction and dissent be incorporated into the theoretical framework?

Provided that neofunctionalism and intergovernmentalism – precisely their logic of delegation/supranationalisation – cannot account for the integration of MP policy, we should inquire other approaches to explain the puzzling absence of contestation of the MP framework. The first one to be considered is the so-called “integration of core state powers” (CSP) (Genschel and Jachtenfuchs 2014), as it may be better-suited to describe the fundamental nature of MP policy. This framework reflects on the supply of European integration while introducing novel, relevant nuances: according to Genschel and Jachtenfuchs, the grand theories interpret the supply of integration as “pooling regulatory sovereignty” (2018, 180) – rather than supranationalisation. The framework reacts to the notion of the EU as a “regulatory state” (Majone 1994) by spotlighting the increasing involvement of the European polity into core areas of typical statehood, such as taxation and borrowing – or, more specifically, the capacity to provide the “public policy good of macroeconomic stabilisation” (Braun and Hübner 2018, 5). In doing so, CSP proposes an alternative interpretation of the abovementioned dynamics of pooling and delegation: it argues that, depending on the conditions of the demand for integration, core state powers are incorporated into the EU polity through either *regulation* or *capacity building*, the latter being far under-developed than the former (Genschel and Jachtenfuchs 2014).

Although CSP's interpretation does not understand such an involvement exactly as the creation of a European federal state, as supranationalism would like to argue, it does not reduce the process to mere intergovernmental dynamics either (Genschel and Jachtenfuchs 2014). Instead, it clarifies that the typical issue-areas considered as core state powers are much more

conflictual than classical market integration which Member States fight over (Genschel and Jachtenfuchs 2016).²⁷ As a consequence, the integration of core state powers encounters less obstacles when it proceeds through the regulation of national capacities – rather than building capacities at the European level. In the case of the MP framework, whose core purpose arguably belongs to core state powers, conflict was evident during the negotiations for its establishment.²⁸ The most controversial step was to determine to what extent MP policymaking should be harmonised across the EU – as well as which EU institutions would have a voice into policymaking (McPhilemy 2016). These tensions eventually may have led to what the literature has already called the “stall of EU macro-prudential policy” (Stellinga 2021) – which is complementary to the problem represented in the MP Triangle. Such a sub-optimal situation, in CSP’s perspective, is the necessary condition to then demand further integration – understood as “means of collective problem-solving under conditions of complex interdependence” (2018, 180). And yet, for over a decade, the MP framework has not met the opposition of those Member States that face disproportionate challenges, as it is the case for Eurozone small host countries.

An additional source of puzzlement arises from the “failing forward” thesis (Jones et al. 2016), a theoretical framework that helps connect the various points discussed in this section. Jones, Kelemen and Meunier (2016) describe their theory as a blend of intergovernmentalism and neofunctionalism. While the former suggests to focus on lowest-common-denominator bargaining, the latter draws attention on functional pressures for deeper integration. The integration of these two perspectives divides the dynamics of European

²⁷ In this field, unlike in traditional market integration, conflicts over scarce resources imply zero-sum games that cannot be easily solved by implementing a regulation that incorporates all the (different) preferences of the Member States, thereby raising questions about the conditions under which further integration can happen (Genschel and Jachtenfuchs 2018).

²⁸ Recent studies focusing on European financial integration from a political-economy perspective have successfully applied the state-building framework to it (Braun and Hübner 2018; Epstein and Rhodes 2018; Genschel and Jachtenfuchs 2014, 87–104). This approach has been particularly successful in the area of financial supervision, which is a super-set to the MP policy framework (Braun and Hübner 2018). MP policy, in particular, is intimately connected with the financial health of the economy, thereby becoming a core issue.

integration into two temporal dimensions (Jones et al. 2021): on the one hand, integration advances through short-term intergovernmental bargaining aimed at mitigating the negative consequences of policy failures; on the other hand, the long-term evolution of this cycle of crises and temporary solutions gradually leads to a functionalist deepening of integration. The concept of *failing* generally refers to a policy failure occurring at a particular point in time (Jones et al. 2021), such as the collective action problem inherent in maintaining financial stability as a public good. Moreover, although it encourages a broad understanding of *moving forward*, the framework recognises *delegation* of authority as the ideal-typical measure of further integration (Jones et al. 2021). Along these lines, it interprets the recent responses to the Eurozone crisis as “minimal, stopgap reforms to hold together the Eurozone, despite the fact that [...] these stopgaps would be unsustainable” – yet moving consistently towards deeper integration (Jones et al. 2021, 1520).

The framework bears significant descriptive power relative to post-GFC European integration. However, it seems not applicable to the case of the MP framework. The thesis anticipates subsequent rounds of bargaining following an initial crisis, but no such second step appears in the case of the MP framework. While we cannot rule out the hypothesis that the initial round of intergovernmental bargaining to establish the MP framework already classified as “failing forward”, it is evident that no further integration has occurred since. Perhaps the absence of further integration may be attributed to the fact that an impactful crisis threatening the MP framework has not yet occurred, as implied by one of the three scope conditions of the failing forward thesis (Jones et al. 2021).²⁹ In this context, however, the simple collective action

²⁹ The authors describe three scope conditions necessary to speak of a case of failing forward: 1) the likelihood of the failing-forward dynamic increases with the severity of the policy crisis caused by the failure; 2) the extent to which EU institutions are already competent in the relevant policy area influences their ability to perceive the crisis as an opportunity to push for further integration; 3) the relative cost of unwinding the incomplete EU arrangements compared to the cost of moving forward by granting more authority to those arrangements (Jones et al. 2021).

problem inherent in maintaining financial stability as a public good may already constitute a policy failure worth the reform attempt.

In sum, applying the reviewed theories and theoretical approaches to the MP framework proves challenging. The logic of pooling and delegation, central to intergovernmental and functionalist approaches, may at best explain the creation of the ESRB. However, the ESRB functions primarily as a platform for information exchange and pertains only to one dimension of MP policy – concepts and measures – rather than its actual implementation. The regulatory framework outlined by CSP is undoubtedly relevant, as it describes how NCAs have been integrated into the MP framework. However, it primarily accounts for the suboptimality of the *status quo* rather than its sustainability. Finally, if the MP Triangle represents a case of failing-forward, then it is reasonable to expect further integration – or at least contestation. While the present study does not argue that the MP framework will not integrate further in the time to come, the absence of contestation over the past decade warrants a deeper investigation into its underlying stability. As observed by Stellinga, “[a]lthough policymakers agreed that the extant MPP framework was flawed, subsequent reforms have changed it only marginally” (2021, 1449). To be fair, the extant literature sheds partial lights on relevant issues that practically thwart the attempts at going beyond the current setting – which may be “stalled by design” (Piroska and Epstein 2023) or too delicate a compromise to be upset (Stellinga 2021) – but it does not explain under what condition such a stall is sustainable.

These theoretical gaps are particularly striking in light of the puzzle at the heart of this dissertation: Existing integration theories clarify how the MP framework may have emerged and why it has not progressed, but they offer little insight into its continued acceptance by the countries most constrained by it. The next section turns to the argument of this dissertation, which seeks to answer this question by advancing a novel hypothesis grounded in the institutional autonomy embedded within MP governance.

The Argument

As put forward in the Introduction, the literature on European integration has repeatedly highlighted the twofold implications of this process: on one hand, integration, is supposed to generate and distributes benefits evenly among participating Member States; on the other hand, it may impose disproportionate costs only upon certain actors. Generally speaking, these distributional effects stem from a combination of structural characteristics inherent to both the EU polity and its Member States. Key sources of these disparities include the asymmetric design of the EMU (Howarth and Verdun 2020), which features centralised monetary policy alongside decentralised fiscal policy. Other possible causes relate directly to intergovernmental bargaining between countries with different capacities and interests (Moravcsik 1998), which do not derive the same benefits from similar European policies (Bruszt and Langbein 2020). In the context of financial market integration – particularly the banking system – one key determinant of imbalances is the degree of foreign capital penetration through bank ownership. Compelling research indicates that a high share of foreign-owned banks can represent a potential vulnerability for so-called *small host countries* (among others, Fontán et al. 2019). Furthermore, the absence of a fully-fledged supranational governance for financial stability exacerbates the challenges associated with the MP Triangle.

These structural conditions were laid out in detail in the Introduction. Here, it is important to highlight that these countries not only support the *status quo* but also actively defend it against reforms and, generally, institutional change. Alongside the evidence extrapolated from the interviews, which will be analysed in Chapter V, the attachment to the current setting emerges also from certain statements made by key experts working in the field of financial stability and banking prudential supervision during international gatherings. For instance, at the *Eurofi* Financial Forum in 2024, a Slovenian official argued that the European

Commission's proposal to introduce capital and liquidity waivers at the consolidated level – as well as the option to set capital floors at the same level – risks creating an uneven playing field (Truchet et al. 2024). The concern is that multinational banks would gain greater flexibility to reallocate resources between home and host countries, potentially disadvantaging smaller host economies. While small host countries' officials opposing reforms that could tweak supervision in favour of parent banks should not surprise, it also gives a sense of the advantages the system is able to supply despite the MP Triangle. If anything, such declarations raise even more puzzlement about the MP Triangle and the loyalty pledged by NCAs.

This project hypothesises that Eurozone small host countries' loyalty to the MP framework can be explained by the autonomy they still retain within it. In particular, the core hypothesis argues the following: **NCAs from Eurozone small host countries pledge allegiance to the existing macroprudential framework due to the considerable autonomy provided by its governance structures, which allows for the customisation of prudential policies to align with national priorities.** This space partially compensates for the autonomy they had progressively lost over the years – starting with the centralisation of monetary policy and culminating in the wave of institutional integration that followed the great financial crisis, of which the BU is the most relevant example. The autonomy NCAs enjoy is grounded in three specific sources related to the national and supranational dimensions of governance:

- 1) *Decentralised decision-making*: Contrary to more centralised frameworks, such as the BU (including the SSM and the European Banking Authority (EBA)), macroprudential departments within small host countries' central banks retain significant policymaking authority and influence over domestic financial stability.
- 2) *Prominence of national governance structures*: Macroprudential departments of national central banks benefit from substantial operational autonomy and oversee each stage of

policy implementation – although the level of autonomy varies somewhat according to institutional size and resources.

3) *Limited supranational constraint*: EU institutions primarily hold advisory rather than binding powers over national macroprudential authorities, significantly restricting their ability to enforce a specific policy agenda.

Crucially, the high level of autonomy described above enables NCAs in Eurozone small host countries to deploy a dual approach. In continuity with policies implemented before the GFC, NCAs apply MP policy domestically with a predominantly micro-prudential orientation, thus maintaining a strong focus on individual credit institutions and domestic financial resilience. Simultaneously, at the international level, the limited power of supranational bodies motivates NCAs to actively endorse the EU-wide MP framework. As a consequence, NCAs achieve several interconnected objectives:

- a) On the domestic front, ensuring the resilience of national credit institutions.
- b) On the international stage, securing membership within the transnational epistemic community committed to financial stability.
- c) Within the Single Market, effectively managing the negative externalities associated with financial integration, particularly cross-border spillovers of macroprudential policies.

Through these achievements, NCAs in Eurozone small host countries effectively mitigate the challenges of the MP Triangle. Although the evidence supporting the components of the Triangle is substantial and corroborated by expert interviews, the findings indicate that the MP Triangle primarily exists as a hypothetical threat that remains only latent. To be clear, the threat

exists beyond its theoretical conceptualisation, as largely confirmed by the interviews. The logic lies in the inherently countercyclical nature of MP policy, which is supposed to contain credit growth rather than stimulating it. As a consequence, credit provision – a vital ingredient of economic development – could be unnecessarily depressed in the name of financial stability. This outcome might result from the host country's own MP policy, which is tightened according to domestic conditions – including the dependence on foreign-owned banks. However, it might also materialise as a cross-border spillover of the home country's MP policy, which compels parent banks to allocate more resources to their own balance sheet.

Although these considerations have never been formulated with regard to MP policy and, specifically, the core-periphery relations, they are grounded in widely accepted economic principles and literature findings. However, through the exploration of the interviews, this dissertation draws different conclusions than what logic and literature suggest. One important reason for such a mismatch lies in the absence of a comprehensive conceptualisation of the MP framework within the context of European integration, as illustrated in this chapter. The core hypothesis enunciated at the beginning serves to develop this argument, which will be completed in the Conclusion.

Conclusion

This chapter has set out to clarify the puzzle underlying the political sustainability of the MP framework by analysing its conceptual architecture and theoretical position within European integration scholarship. First, it defined MP policy conceptually, emphasising national autonomy and limited supranational control, and tested its partial resemblance to the model of experimentalist governance. Next, it evaluated mainstream theories of economic and institutional integration, revealing their limitations in explaining the persistent political

acceptance of a seemingly suboptimal governance structure, particularly among small host countries facing asymmetric risks. To address this explanatory gap, the chapter advanced a core hypothesis: the substantial institutional autonomy embedded within the MP framework provides small host countries with sufficient flexibility and incentives to maintain loyalty to the system. The empirical chapters that follow test this proposition rigorously, seeking to shed new light on the nuanced relationship between national autonomy, supranational coordination, and the governance of financial stability within the Eurozone.

III. MACROPRUDENTIAL TRIANGLE IN NUMBERS

Introduction

The operationalisation of the MP Triangle involves the collection and analysis of data over approximately ten years. This time frame is defined by the emergence and development of the MP institutional framework, consisting of entities and rules established during the GFC and its aftermath to manage financial risk. Although the steps that led to the completion of the MP framework are unambiguously clear, this study relies on existing timelines and accounts, particularly the works by Stellinga (2021) and McPhilemy (2016), to ground the methodological choice into the literature on the topic.

The story begins with the establishment of the ESRB in 2010. This decision responded to the report commissioned by the Commission President Barroso in 2008: the High-Level Group led by the former Governor of the central bank of France Jacques De Larosière explored ways to enhance European cooperation on financial stability oversight, early warning systems, and crisis management, including the handling of cross-border and cross-sectoral risks (McPhilemy 2016). The original idea of a European Systemic Risk Committee (De Larosière 2009) was then put into a legislative proposal by the Commission, which led to the adoption of Regulation 1092/2010 establishing the ESRB. When the crisis escalated in 2012, Eurozone Member States agreed on centralising banking supervision by appointing the ECB responsible for micro-prudential supervision (Stellinga 2021). Meanwhile, two important legislations were drafted and adopted: the Capital Requirements Directive (CRD IV) and the Capital Requirements Regulation (CRR), in 2013 – Directive 2013/36/EU and Regulation (EU) No 575/2013. These incorporated into EU law the principles of capital adequacy agreed internationally in the context of Basel III (McPhilemy 2016), thereby providing for the MP tools that Member States can use with a certain degree of discretion. However, the ultimate completion of the MP framework occurred with the establishment of the BU. Under the so-

called SSM regulation (Regulation (EU) No 1024/2013), the ECB is also entitled with top-up powers for the imposition of capital buffers under specific conditions as a last resort in case of Member States' MP inaction (Stellinga 2021).

The MP framework has been refined and reformed in the ensuing years, but the resulting changes have been only marginal (Stellinga 2021). Accordingly, this study sets the beginning of the observation period in 2012, when financial turmoil prompted Member States to devise common solutions. While the MP framework was formally established in 2014, the MP Triangle includes financial stability variables that are heavily influenced by the length of the financial cycle (interview MP official from ESRB 4/12/2024), thus encompassing the earlier peak of the Eurozone crisis.

Methodological Notes

As elaborated in detail in the Introduction to this dissertation, the MP Triangle raises critical questions about the suitability of the current MP framework for small host countries in the Eurozone. The underlying puzzle illustrates how peripheral countries, despite confronting unique challenges within the MP Triangle, decide to support the existing framework instead of pursuing institutional changes. My central hypothesis asserts that **NCAAs from Eurozone small host countries pledge allegiance to the existing macroprudential framework due to the considerable autonomy provided by its governance structures, which allows for the customisation of prudential policies to align with national priorities.**

In this chapter, the MP Triangle will be explored in its empirical dimension. To that end, it is first necessary to clarify that peripheral Eurozone countries, especially those in Central-Eastern Europe, face structural disadvantages stemming from two main conditions:

1) These countries exhibit a significant presence of foreign-owned banks, rendering them susceptible to external financial shocks and cross-border spillovers.

2) The absence of robust supranational governance that actually handles financial stability as a public good exacerbates these vulnerabilities.

These structural factors place peripheral countries precariously within the MP Triangle, requiring a careful balance among financial stability, containment of negative spillovers, and the provision of adequate credit to the real economy. Accordingly, this dissertation examines the puzzling phenomenon of the enduring loyalty of small Eurozone host countries to the MP framework.

The following sections fulfil two functions specifically. First, the analysis of the selected indicators supplies a basic understanding of the management of financial stability in the countries under examination, for which the Triangle served as fundamental dialectical tool during fieldwork, as the findings presented here were utilised to engage in technical conversations with the interviewed experts. While various other variables exert a great influence on the three core elements of the MP Triangle, the few selected indicators can simply facilitate the examination of the research question by providing an empirical contextualisation of the phenomena object of this study. Secondly, the purpose of the following evaluation is not to demonstrate the causal mechanisms connecting MP policy and financial stability. Rather, by correlating widely accepted financial stability indicators and outcomes, the following operationalisation sets the stage for the empirical test of the hypothesis conducted in Chapter V. The causal validity of the *explanans* – that is, autonomy in MP governance – can be fully grasped only after highlighting the gap between the institutional functioning of the three dimensions of MP policy (see graph in the Introduction) and their actual interpretation by NCAs.

Foreign Capital in the Banking Sector

The first structural condition in detriment of small host countries' financial stability is the interdependence characterising financial integration, specifically the relationships between core-home countries and peripheral-host countries. The definition of *small host country* adopted here is directly derived from a World Bank's working paper. This defines small host countries as economies characterised for hosting subsidiaries of multinational parent banks that "are of systemic importance" for the domestic economy, under the condition that "the foreign operation is not material for the parent bank and thus for the home country authority" (Fontán et al. 2019, 6). Adding on the fact that they are structural borrowers at the aggregate level on the Euro money market (Badarau et al. 2020), the study showed that small host countries suffer from a specific vulnerability, which potentially generates negative cross-border externalities travelling along inter-bank channels: this vulnerability consists of the high share of foreign ownership in the banking sector (Fontán et al. 2019).³⁰ Besides, the European Central Bank (ECB) has recently clarified that the activities related to cross-border spillovers are concentrated in specific areas of the EU, and the potential for such effects may be greater in banking sectors with strong presence of foreign banks (ECB Financial Stability Committee 2020a). Importantly, both studies explicitly list CEE countries among the economies most affected by such externalities.

As clarified by the ECB, "domestically oriented macroprudential policies have the potential to create material cross-border spillover effects" (ECB Financial Stability Committee 2020a), which occur "either through bank ownership or through exposures" (ECB Financial

³⁰ In turn, *foreign ownership* is defined as "a banking institution with at least 50% ownership stake held by a non-domestic parent bank" (Fontán et al. 2019, 7).

Stability Committee 2020b). All MP measures have the potential to produce such effects, which should be distinguished based on the jurisdiction in which they are felt. Although these effects may well be positive, Member States are nevertheless encouraged to implement national frameworks for the assessment of the negative unintended consequences. The ESRB clarifies that a conscious choice of the measure, the evaluation of the potential spillover, and reciprocity, are key to achieve the ultimate goal of financial stability (European Systemic Risk Board 2018). In fact, concerns about cross-border spillovers result directly from financial interconnectedness and, in principle, do not refer only to small host countries. The latter, however, face additional challenges due to the systemic importance of foreign credit institutions to the domestic economy, which is not counteracted by an EU-wide mechanisms to rebalance the relationship between home and host countries.

Governance

The second factor contributing to the increased pressure that small host countries face refers to MP governance. As discussed in Chapter II, the integration of MP policy within the EU is part of a broader process of institutionalisation, which is also inseparable from the economic idea of integrated financial markets – and its main principle, capital mobility. These two parts incorporate and realise the Balassian idea of non-discrimination in the financial realm. However, this study notices that the institutionalisation of financial stability remains incomplete, as financial stability is not produced as a public good at the supranational level, with potentially material consequences on the distribution of benefits within the Eurozone. This deficiency proves more impactful for small host countries, where the high share of foreign-owned banks adds additional challenges to the management of financial stability.

The literature maintains that national MP policies focused on the credit supply in individual countries are better at addressing financial stability than using a one-size-fits-all federal policy (Poutineau and Vermandel 2017). The reason for this is that financial cycles and credit conditions vary significantly across core and peripheral countries in the Eurozone. A one-size-fits-all approach, such as using federal buffers based on EU-wide metrics, can lead to ineffective or even counterproductive outcomes (Poutineau and Vermandel 2017); while a country-targeted policy can smoothen the complications of a common monetary policy (Dehmej and Gambacorta 2019). However, studies conducted at the ECB and the Bank of International Settlement (BIS) show that there are significant gains to policy coordination in a monetary union with international trade and cross-border lending (Darracq Paries et al. 2019), and specifically when the peripheries are overly dependent on core countries (Agénor et al. 2017). Moreover, in the plausible case of symmetric shocks, as the event of a synchronised boom across the home and the host countries, national MP policy can produce potentially destabilising cross-border spillovers (Badarau et al. 2020).

According to an ESRB official, the main reason why countries with higher shares of foreign banks register an above-average MP action is because “they are afraid that foreign-owned banks will repatriate their capital when a crisis bursts, thereby closing their business there and generating a procyclical effect on the crisis” (interview MP official from ECB 21/11/2023). Moreover, the lack of coercive powers in the hands of the supranational institutions does not allow for a compelling protection of host countries’ interests (*ibidem*). In other words, host countries are relatively more exposed in case of home countries’ inadequate action, and the academic support for policy coordination (see Singh 2020) does not surprise. Even less so when we consider the broader governance setting in which MP policy is implemented, namely the Banking Union (BU). Post-crisis integration of banking supervision and resolution has significantly altered the relationships between home and host supervisors by

making successful action depend on cooperation and coordination. While this model brings in the advantages of polyarchic modes of governance (see Zeitlin 2015), including great autonomy, such leeway may leave the power asymmetries unresolved – or even feeding into them. As compellingly illustrated by Woll (2014), such setting may witness a strategic use of inaction, which would then have consequences on financial stability in the entire EU (Lepers and Thiemann 2024).

Macroprudential Tools and their Effects

MP policy consists of a set of tools all aimed at “safeguarding the stability of the financial system as a whole” (ESRB 2018, 5).³¹ In principle, it maintains financial stability in two ways: first and foremost, it seeks to curb the credit cycle in order to safeguard financial markets – and the real economy – from widespread crises; additionally, macroprudential measures contribute to the increasing resilience of credit institutions – and borrowers as well.³² There exists a broad range of implications associated with MP policy which could account for the challenges faced by Eurozone small host countries. Generally, such implications are related to the aforementioned objectives of MP policy, namely taming the financial cycle and improving the resilience of the financial system. As we shall see, some of these effects are independent of the position of any given country relative to the international flows of capital, while others are specifically associated with the peripheral rank.

Typically, we can distinguish between the implications that MP policy has on credit growth and those impinging on other macroeconomic variables. The literature speaks of the “costs of macroprudential policy”, a formulation borrowed from the study by Richter,

³¹ It is important to note that the macroprudential toolkit includes also instruments that technically qualifies as *micro-prudential*.

³² The question as to what MP policy is in fact, and how should it be in principle, is a complex one and part of ongoing debate (see Thiemann 2019).

Schularick and Shim (2019), who show relatively modest effects of certain measures on inflation and GDP (see also Ampudia et al. 2021; De Schryder and Opitz 2021). At the same time, researchers provide evidence of a statistically significant impact on credit growth, through households' credit and private consumption in both advanced economies and emerging markets (Alam et al. 2019; Ampudia et al. 2021; Andrieş et al. 2022; De Schryder and Opitz 2021; Eller et al. 2020; Poghosyan 2019). The cited studies focus on both capital-based measures (CBMs) and borrower-based measures (BBMs) – with the actual impact depending on the specific tool deployed.³³ However, beyond the typical distinction between credit-related effects and other variables, MP policy is practically utilised by NCAs to increase the resilience of their banking systems. This aspect will be explored thoroughly in Chapter V, as it pertains to the subjective understanding of financial stability and is a crucial element of this dissertation's core hypothesis. Conversely, this chapter focuses on the mainstream interpretation of financial stability, as it results from the application of the indicators agreed-upon by EU and national institutions.

Within such a scope, the impact on credit growth is particularly relevant for two reasons: *a)* credit growth is indeed one of the most accepted measures of systemic risk employed in MP policymaking; *b)* the counter-cyclical reduction of credit provision usually caused by MP tools, and the consequential credit crunch, may be either desirable or undesirable depending on the perspective. Indeed, due to the reduction in the volume of credit, MP policy is considered “more explicitly and conspicuously distributional” than monetary policy (Baker 2015, 2), particularly as far as BBMs are concerned.³⁴ When the country seeks to constrain

³³ CBMs have gained importance after the GFC (Ampudia et al. 2021), encompassing instruments that ultimately alter banks' cost of capital, ideally with a counter-cyclical attitude. BBMs, instead, have more direct effects on lenders' leeway to provide credit, by putting limits to the supply. These are used more by some countries than others (Cerutti et al. 2017), but they robustly affect households and businesses' access to credit in both advanced economies and emerging markets (Alam et al. 2019). However, it is important to note that the line between advanced and developing economies is not the same across all the studies.

³⁴ Recently, Anat Keller has highlighted that BBMs are so inherently distributional that a cost-benefit analysis should be mandatory before their activation (Central Bank of Italy 2022).

risky credit expansion, a typical goal of MP policy, it will likely pursue negative credit growth. From the perspective of market participants, however, the credit crunch could mean unwanted distributive effects: for those who rely on credit for consumption and investment – namely households and businesses. And this is why the management of credit growth is a crucial dimension of the MP Triangle. But MP policy is also associated with unintended consequences beyond the national jurisdiction where the policy is activated (ESRB 2018), namely *cross-border spillovers* – the third and most characterising element of the MP Triangle analysed at the end of this chapter.

Financial Stability

The first element of the MP Triangle, financial stability, is central to the European integration project. Over the course of many years, the EU has regulated various aspects of capital mobility, with a great attention paid to the banking sector. However, the resulting economic integration has created financial interdependencies that can undermine stability, particularly in small-host countries with large shares of foreign bank ownership in their banking systems. As clarified earlier, financial stability is supposed to be delivered as a public good, but the current MP governance falls short of the necessary means. While the prominent role of individual countries' policy choices may translate into the opportunity to address specific needs, the absence of a neutral centre of coordination – with effective powers – could discriminate smaller economies lacking the leverage to shape EU-wide financial stability policies.

That said, it is important to note that financial stability cannot be actually chosen but the conditions for it can be implemented (Stellinga 2021). It is not merely a product of MP policy, as it is also influenced by broader economic forces. On the one hand, monetary policy plays a significant role in shaping the environment in which MP measures operate. Central

banks, through their control of interest rates, inflation, and liquidity, influence credit conditions. In this sense, periods of low interest rates can increase borrowing thereby necessitating tighter macroprudential controls to prevent financial overheating. On the other hand, the observation of two decades of single currency and centralised monetary policy has shown that the latter does not necessarily foster economic convergence across the Eurozone, thereby suggesting the use of MP policy as a complementary instrument to fill the gaps (Dehmej and Gambacorta 2019) or even to offset negative externalities of financial integration (Fontán et al. 2019; Piroška et al. 2021). In this context, with centralised monetary policy, autonomously set MP measures appear as one necessary condition for a fine management of financial stability (Brzoza-Brzezina et al. 2015; Dehmej and Gambacorta 2019; Fontán et al. 2019). Brzoza-Brzezina, Kolasa and Makarski (2015) suggest that de-centralisation of MP policy, and its adaptation to the specific needs of each country, is a guarantee for its effectiveness. Even more so when we consider that financial stability is also affected by the broader economic environment, including factors such as GDP growth, investment opportunities, and demand for credit.

In the Eurozone, disruptions to financial stability are detected and measured through specific indicators employed by both Member States and EU institutions – with some differences in the respective methodologies. The development of such indicators has taken long time and is still a work in progress. As clarified by Thiemann (2024), the choice of systemic risk indicators evolved through a combination of events and actions, including early advocacy and empirical research by BIS economists, responses to financial crises, institutional support at both the national and international levels, and the need to overcome significant challenges in measurement and implementation. Moreover, this process has been influenced by the double-faced nature of MP thinking: the notion of endogenous risk is composed of two dimensions, namely a *time-varying* dimension and a *structural* one – the former tackling pro-

cyclicalities and the latter focusing on the interconnectedness of financial institutions and markets (Galati and Moessner 2017). To some extent, these two dimensions ended up generating two different regulatory stances, *resiliency* and *anti-cyclicalities*, which display their own specific features in terms of focus, forms of regulatory intervention, metrics of systemic risk, and political exposure (Thiemann 2019). Notwithstanding such differences, the two regulatory stances share common roots, namely the enduring micro-prudential mentality that still characterises MP action; a mentality that is reflected in the indicators and measurements commonly employed by supervisory authorities at both the national and the supranational level (Kranke and Yarrow 2019).

It is important to clarify that the indicators selected in this chapter are not by themselves reflecting the fundamentally collective interest behind the maintenance of financial stability. In fact, they rather incorporate a national perspective. Despite the collective effort at the international level to develop a framework for the assessment and containment of systemic risk, showing the necessity to address the procyclical tendencies of the financial system, the measures eventually implemented after the GFC have focused more on resilience (Thiemann 2024). In addition, the debate over financial cycles indicators has yielded different evidenced opinions on the actual utility of the most applied measurements of systemic risk and the general build-up of dangerous imbalances and weaknesses (see Schüller et al. 2020 for a comprehensive review). Whereas this study does not take a stance vis-à-vis this complex debate, it sheds light on an additional aspect of the bias towards the nationalisation of financial stability policy. As Chapter V will illustrate, not only are the indicators deployed by the following sections deeply influenced by resilience-oriented perspective, as they are nevertheless criticised by NCAs for their inadequacy to effectively capture country-specific conditions.

With that given, all the *financial stability reports* issued by the country in the sample during the observed period present a similar analytical blueprint to assess the major risks in the

banking sector. These risks also coincide with the “main figures” reported by the ECB’s statistics under *supervisory banking data* as well as with the main issues highlighted in the ERSB Risk Dashboard. Specifically, both national and EU-level data refer to the following four categories of banking issues: *capital adequacy*; *leverage*; *liquidity*; *asset quality*. This suggests a common conceptual understanding of the health of the banking system. However, the composition of such indicators may have varied over the years. Above all, the most characterising difference refers to the population of banks included in the data. Whenever possible, this study resorts to national statistics owing to the larger population of banks taken into consideration – versus the focus on Systemically Important (SI) institutions characterising EU data.³⁵

Cross-country comparison

By and large, systemic risk indicators reflect vulnerabilities that could produce and spread systemic risk, while resilience indicators show the ability of the banking system to withstand shocks, absorb losses and maintain the system stable under conditions of prolonged stress. Resilience-oriented indicators is the category most deployed at the national level, as autonomous NCAs have always been concerned with the health of their national financial systems. Among the indicators proposed in this section, only the non-performing (NPL) loans ratio and credit-to-GDP gaps are able to signal potential threats that can lead to widespread disruptions in the financial system and the broader economy. The remaining indicators, instead, primarily proxy for the resilience of the banking sector.

The capital adequacy ratio (CAR) – or total capital ratio – refers to the bank’s own funds expressed as a percentage of the total risk exposure amount, which, pursuant to Article

³⁵ To be clear, national statistics often do not include data on foreign branches, which are usually collected and detained by multinational banks themselves.

92 CRR, cannot be lower than 8%. In this sense, CAR is crucial to the resilience of the banking sector, and it is rated among the key indicators in the *supervisory banking data* collected by the ECB, as well as widely used by NCAs. This indicator compares all types of banks' capital to the risk weighted assets held by all banks in a given country. Although the guidelines provided by the ESRB encourages the use of the Common Equity Tier1 (CET1) capital ratio, since this applies a stricter definition of bank capital that is more readily available (European Systemic Risk Board 2018), CAR allows us to run a consistent comparison across countries over the entire observation period.

When examining the aggregate capital adequacy of Eurozone Systemically Important (SI) institutions (see *Figure III.1*), we notice that they have all maintained good levels of total capital – well above the minimum requirement set at 8%. However, their ratio is evidently lower than what registered in the banking systems of the examined countries. This may reflect the fact that such credit institutions are often more diversified and do not need the same amount of capital relative to their risk-weighted assets, owing also to the easier access to assistance from national governments and central banks in light of their systemic importance. Regardless, the figures suggest that these institutions show an overall low risk profile and are unlikely to face solvency issues in the future – at the aggregate level, of course.

Although the respective data is only available until 2019, Estonia stands out for registering higher levels of bank capital, with a sharp increase from 25% in 2013 to a peak of over 35% in 2017. While such a trend is not exclusively due to MP policy, as other macroeconomic and financial-sector-specific factors may have an impact, the country's risk-management policy seems to yields positive results.³⁶ The current profile suggests that banks

³⁶ Estonia started tightening its capital requirements already in the late '90s, in order to strengthen the resilience of its banking sector in response to both speculative attacks on its currency and the consequences of Russia's financial crisis (Eller et al. 2020). The increase in capital requirements continued in 2006 and was followed by the implementation of further capital buffers in 2014, although minimum reserve requirements were relaxed in order to approach the rate set by the ECB (Eller et al. 2020).

continue to operate with substantial capital reserves, the highest values across the Eurozone peripheries, which reduces the risk of insolvency during financial downturns. Although at a lower level than Estonia, Latvia also shows high CAR ratios over the entire observation period, following an upward trajectory, with some fluctuations around 2016 and 2020. The gradual upward trend suggests that Latvian banks have made consistent efforts to strengthen their financial stability, while they have incurred a few adjustments along the way in response to changing market conditions, thereby reflecting a proactive risk management.

On the contrary, Slovenia's lower capital levels reflect the hardship the country faced in the immediate aftermath of the GFC – from 2010 to 2013 and beyond – to recapitalise its banks (see Piroška and Podvršič 2020; Tajnikar et al. in Arató et al. 2021). After reaching higher levels of total capital, the Slovenian banking sector registered considerable fluctuations – especially in recent years. The current trend suggests a low-risk profile that should provide a strong cushion against financial shocks: overall, banks remain well-capitalised. A similar conclusion can be drawn for Lithuania and Slovakia, as both countries show CAR levels well above the regulatory minimum. Slovakia's overall curve is upward-looking. Small spikes suggest that banks have increased capital to face heightened contingent risk during the pandemic, while they have generally strengthened their capital positions over the entire period. Lithuania shows a relatively bumpier trend, with more extremes spikes around 2014 and 2020, probably to tackle specific risk events. The ensuing drops demonstrate a return to normal operation. This implies a balanced approach to risk.

Capital Adequacy Ratio by Country

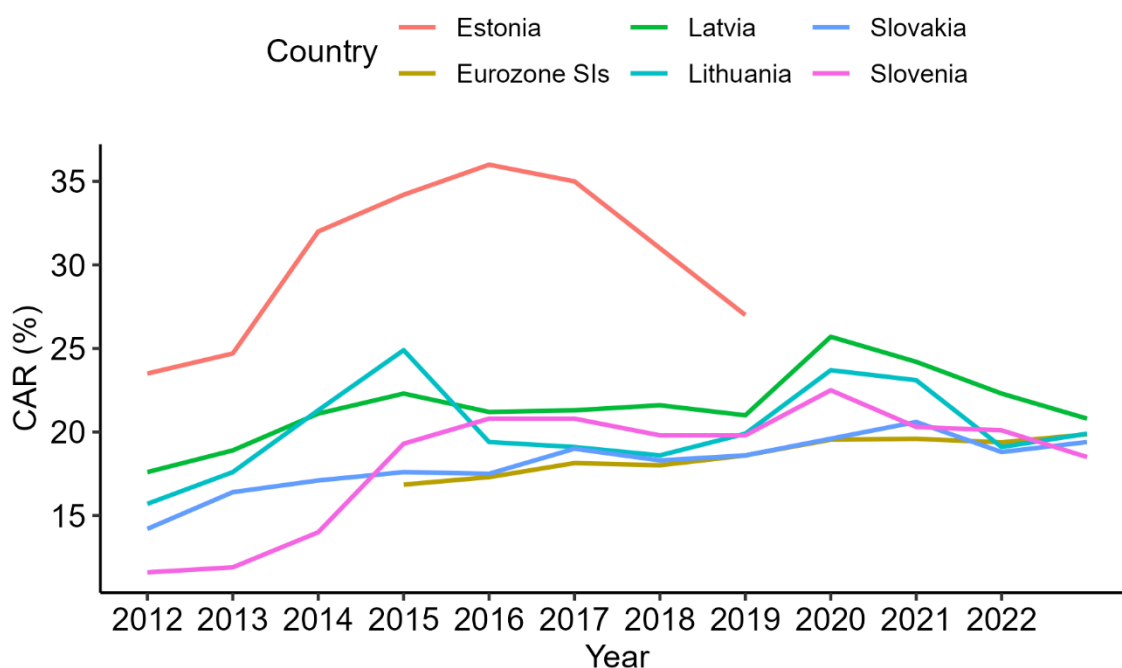


Figure III.1

Leverage is a measure of a bank's capital relative to its total exposure (both on and off-balance-sheet items). It serves as a non-risk-based complement to risk-based capital adequacy measures. This means that it does not consider the riskiness of the assets but only plots capital and assets together. The CRR, Recital 18, provided that NCAs would set the minimum requirement according to their autonomous evaluation until the harmonisation of the leverage ratio in 2018. For this reason, the data merges indicators with different names to the extent their definition – as provided by the respective central bank – corresponds to the definition of the leverage ratio harmonised at the EU level and enforced starting from 2018. However, it is not possible to consider one single minimum level for the leverage ratio over the entire observation period: an EU-wide minimum leverage ratio – 3% – had not been set until 2021, even later than the enforcement of the harmonised indicator in 2018.

With that given, the cross-country comparison shows a picture somewhat compatible to the scenario observed for capital adequacy, as the respective policies interact with each other: an upward-looking CAR curve – meaning an increase in CAR – should correspond to a downward-looking leverage curve – meaning a decrease of the leverage ratio. Taking the now binding 3% leverage ratio as reference, all five countries have maintained their ratios well above the minimum for the entire time frame of the observation (see *Figure III.2*). Not surprisingly, Eurozone SI institutions consistently maintain the lowest leverage ratios, indicating a highly conservative and stable risk management approach. This is typical for systemically important institutions, which are heavily regulated and monitored because their failure could have wide-reaching impacts on the broader economy, as the GFC taught.

Estonia has progressively reduced its risk exposure after 2015, thereby moving towards a more stable and conservative financial environment. The continuous drop in leverage makes Estonia's banks less vulnerable to shocks, as lower leverage generally indicates stronger capital buffers (see *Figure III.1*). However, a rapid decline could also suggest potential constraints on credit growth, impacting economic expansion. Latvia's stable leverage ratio suggests that banks have managed to maintain a balance between growth and risk management. Overall, the country's banking sector shows a low-risk profile, and its stability points to predictable financial conditions and controlled risk-taking, thereby reducing the likelihood of financial instability as well as vulnerability to market crises. Similar to Latvia, Slovakia's banking sector also shows a low-risk and stable profile. The minimal fluctuation in leverage ratios suggests that banks are financially sound and that build-up of risk has been minimal. Such an outlook foresees confidence in the banking sector, with likely sustainable growth and resilience to external shocks. On the contrary, Lithuania registers a more fluctuating leverage ratio: the upward spikes indicate higher risk taking in 2016, 2018, and again 2022. Such events are a potential signal that banks were expanding aggressively their asset-base, owing also to looser

capital requirements policy (see *Figure III.1*), thereby increasing their vulnerability to market downturns. A similar – but slightly less volatile scenario – is registered for Slovenia. The peaks in 2017 and 2022, followed by noticeable declines, indicate possible over-expansion in lending or exposure to unstable assets. Such fluctuations make banking sectors in both countries appear more fragile – especially due to a potentially less controlled risk-taking.

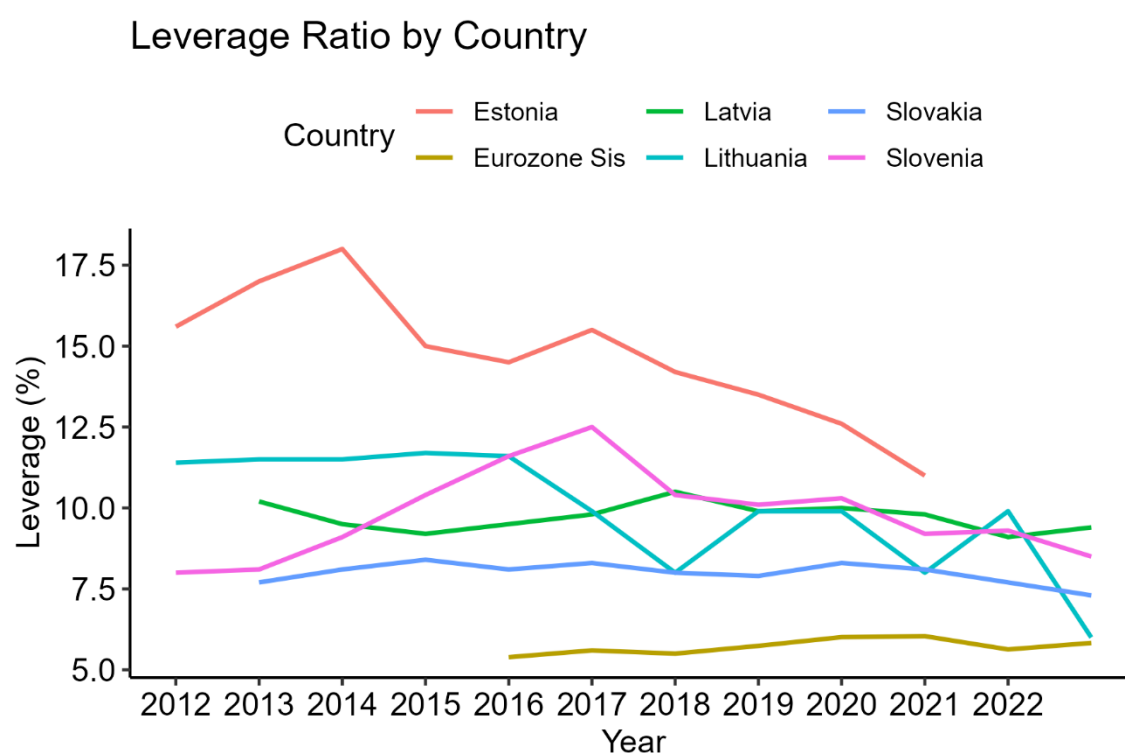


Figure III.2

Liquidity management is a cornerstone of banking stability, ensuring that institutions can meet their short-term obligations without incurring significant losses. As banks play a fundamental role in the maturity transformation of short-term deposits into long-term loans, liquidity risk management is crucial to avoid that the distress of the single institution can have system-wide repercussions (Basel Committee on Banking Supervision 2008). Even before its harmonisation at the European level, the liquidity coverage ratio (LCR) was proposed as part of the Basel III

framework as the standard measurement of liquidity risks (Basel Committee on Banking Supervision 2013). However, the analysis of the *financial stability reports* issued by central banks of the countries under examination shows that the LCR was introduced only later in the observation period. NCAs, instead, would apply their own indicators, which focused on specific time buckets and direct coverage of short-term liabilities, without incorporating a stress-testing component. Despite the specificities of each country's definitions, the calculation methodologies of the selected indicators appear consistent to each other – precisely by measuring the proportion of a bank's liquid assets relative to its short-term liabilities. However, in order to strengthen the cross-country comparison, and to avoid underestimation/overestimation of liquidity risk, the plot below (see *Figure III.3*) considers only the available timeseries for the LCR – from 2016 to 2023.

It is worth noting how Eurozone SIs register virtually the lowest liquidity ratio throughout the observed period. Regardless, their performance appears relatively more stable than the rest of the cases. This stability reflects a low-risk profile in terms of liquidity management, as well as confidence in their risk-management choices. Moreover, systemically important institutions have strong access to funding, thereby reducing the need for higher liquidity ratios. On top of that, their systemic importance translates into a stricter focus on capital adequacy and stress testing.

Estonian and Slovakian banks both operate with lower liquidity ratios, which could indicate higher reliance on stable funding sources or at least tighter liquidity management. Estonia's ratio remains steadily flat over the observation period, indicating stable levels of liquid assets yet signalling that banks might have less flexibility in responding to short-term funding needs. This could imply higher vulnerability to liquidity crunches during times of financial distress or unexpected market shocks. Slovakia, on the other hand, registers a steady decline of the liquidity ratio until 2019, followed by a mild recovery afterwards. Current

liquidity levels indicate a moderate risk profile, as the relatively low liquidity ratio could leave banks more exposed to liquidity shortages compared to countries like Latvia or Lithuania. The latter, however, both show substantial volatility. In particular, Lithuania dramatically increased the liquidity ratio starting from 2020, before dropping back down in 2022 – still above the post-GFC levels. This suggests that banks may have responded to crises by increasing their liquid assets. In any case, the significantly volatile pattern raises questions about the stability of liquidity management.

A similar situation characterises the Latvian case, with liquidity ratios ranging from around 310% in 2016 to about 270% in 2023. Banks in Latvia have undoubtedly gone through several adjustments in liquidity management. These do not necessarily signal an inadequate risk profile, as adjustments mean adaptation to changing market conditions, but they may raise concerns about potential liquidity management inconsistencies. On the contrary, the Slovenian case is characterised by a more stable pattern, registering a moderate yet steady decline in liquidity ratios over the observed period. Half of the observation frame coincides with the years of the great privatisation and restructuring of the Slovenian banking system, which may have meant the reallocation of resources to less liquid assets, thereby decreasing the liquidity levels. While the overall picture suggests a moderate risk profile, if the trend continues, it could lead to increased liquidity risks in the future, especially if banks face a sudden rise in demand for liquid assets.

When it comes to systemic risk, the NPL ratio is a crucial indicator for risk assessment within the banking sector and the broader economy. It measures the percentage of a bank's total loans that are classified as *non-performing*, meaning the borrower has either stopped making payments or is significantly behind on them (typically 90 days overdue). In other words, the ratio shows the extent of loans likely to result in losses. For this reason, it proves particularly important in signalling stress in the financial system and heightened risks of bank failures,

which can spill over into the broader economy. For example, during the GFC and the consequential contagion within the EU, NPL ratios surged in many countries, indicating severe financial stress that required systemic intervention (Huljak et al. 2022). To be clear, the ratio commonly referred to as NPLs is relatively new in the MP toolkit. In the years preceding and ensuing the GFC, NCAs would use their own ratios – such as non-performing-loans-to-total-loans, non-performing-exposures, and non-performing-claims – whose composition substantially coincides with the NPL ratio: whereas the national criterion differs slightly, as in the case of non-performing exposures, this proves even more useful for a holistic assessment of the bank's asset quality and overall credit risk exposure – rather than focusing exclusively on the loan portfolio. Accordingly, this study plots all the national indicators together under the label of NPL ratio (see *Figure III.4*).

Liquidity Ratio by Country

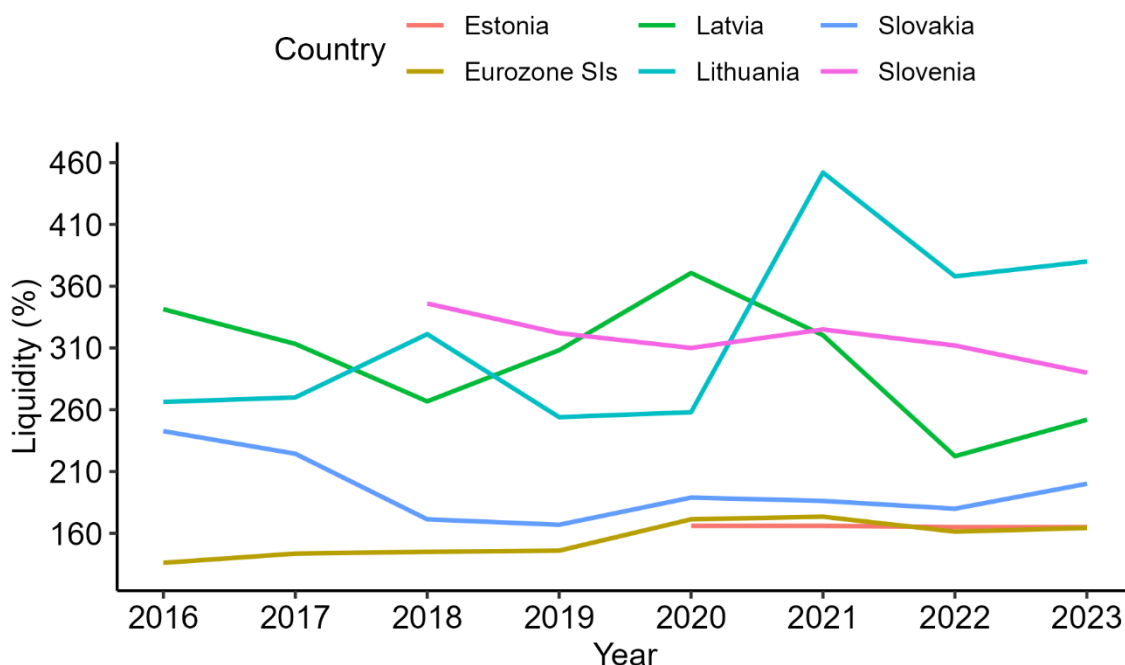


Figure III.3

Estonia shows a consistently low NPL ratio throughout the entire period, ranging between 1,5% and 3%. Albeit NPLs are not exclusively a bad-management issue, this hypothesis is the most validated in the literature (Huljak et al. 2022), thereby lending credibility to Estonian banks' risk management. The absence of significant fluctuations and the overall low levels of NPLs clearly point to a low-risk profile of the banking sector. Moreover, the downward trend suggests that Estonian banks are well-insulated from potential credit-related shocks in the future. Overall, the country shows an excellent loan performance with minimal exposure to bad loans, even when compared to the aggregate data for Eurozone SIs. A similar pattern emerges from the case of Lithuania, which registers a steeper decline of NPLs ratio over the years but it shows tantamount low levels in recent years – at below 1%. Starting from a ratio of 5% in 2015, its decline suggests that Lithuanian banks have been effective in improving loan quality and today locate themselves in the range of low-risk profiles.

Latvia's NPL ratios started high – at around 9% in 2012 – but showed a sharp decline to around 2% by 2022. This significant improvement reflects also this country's efforts to restructure loans and enhance credit policies. During the observation period, Latvia transitioned from a high-risk profile to a lower-risk one, signalling a successful reduction in credit risk and a healthier loan portfolio by 2022. Slovakia, by contrast, maintained a relatively stable NPL ratio around 5% between 2012 and 2018, with a relatively more pronounced decline starting in 2019, reaching 2% by 2022. The slower rate of reduction compared to other countries indicates that Slovak banks faced persistent credit risk for much of the decade. However, the recent improvements in loan recovery and credit standards have reduced Slovakia's risk profile, bringing it closer to lower-risk territory in recent years. Finally, Slovenia's banking sector started the period with the highest NPL ratio, peaking at 15% in 2013, likely due to the Eurozone debt crisis. However, it saw a dramatic reduction in bad loans, declining to 2% by 2022. Judging from the outstanding decline in the ensuing years, Slovenian banks decisively

addressed their credit issues, using restructuring and recovery efforts to restore loan quality besides the ambitious banking privatisation program carried out after 2012. Consequently, Slovenia shifted from a high-risk profile to a much lower-risk one, reflecting a significantly healthier financial sector.

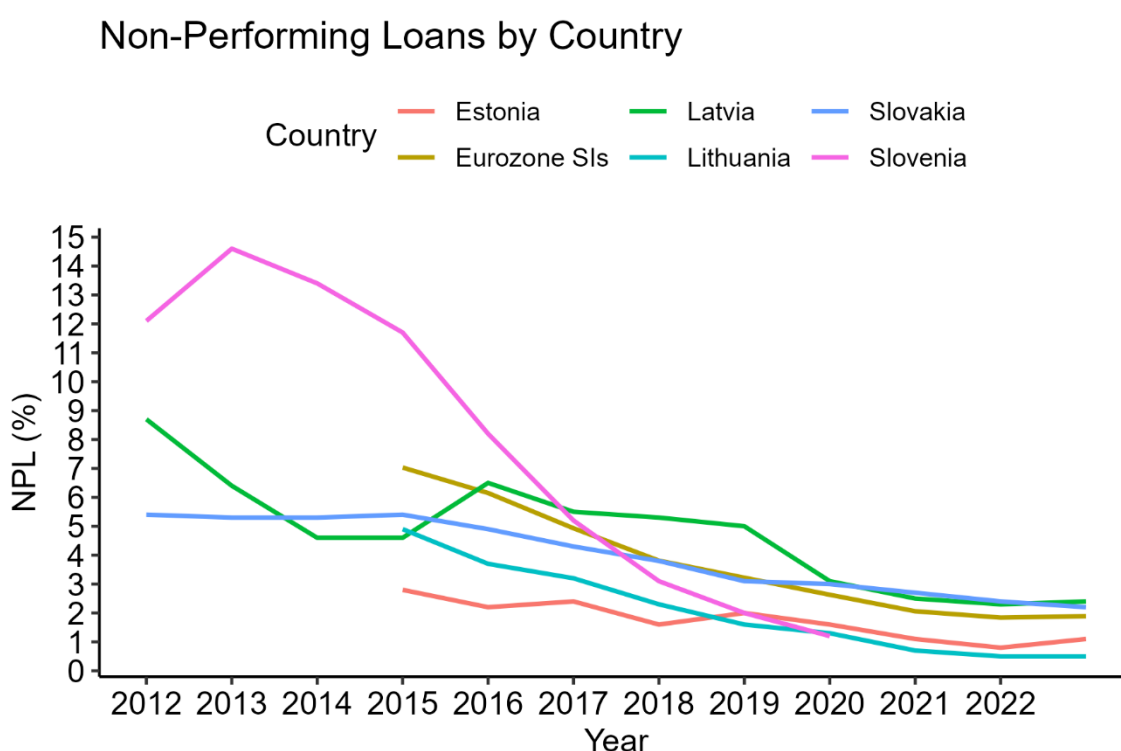


Figure III.4

Failing – or likely to fail – banks

The comparative evaluation of financial stability across the five case-studies should also be complemented with the analysis of material cases of financial turmoil regarding specific credit institutions. These occur when systemically important banks fail or are likely to fail – so-called FOLTF banks. Such events – and the risk thereof – are usually tracked at the EU level by the

institutions that are involved in monitoring and resolving bank failures and the resulting financial instability. Firstly, the Single Resolution Board (SRB) holds a database for FOLTF banks as part of its role in the resolution process, thereby watching over the resilience of the banking system. Secondly, the ESRB issues warnings and recommendations addressing vulnerabilities across EU financial markets, spotlighting those countries that should act counter-cyclically in order to prevent the materialisation of systemic risk.

The two aspects are analysed separately. When it comes to warning and recommendations regarding systemic risk, the data show that the countries under examination have not faced particular challenges since the establishment of the MP framework – clearly to a lesser extent than core countries. The only country from the sample addressed with a warning by the ESRB is Slovakia, and the case is quite recent in time. In a nutshell, the ESRB drew attention on four issues: rapid house price growth; high mortgage credit growth; rising households indebtedness; structural issues in the tax regime. The aspect related to FOLTF banks, instead, is examined in detail in the next chapter, alongside the historical evolution of the case-studies' banking systems. To that end, an overview of the banking crises experienced by the Eurozone small host countries will be provided.

Finally, the issue of failing banks, and more generally the risk of insolvency of credit institutions, should also be evaluated through the Z-score indicator. The Z-score is a measure of financial stability used in the *Global Financial Development Database* (GFDD) of the World Bank. Despite being criticised for its backward-looking composition, since it only takes account of past events, it is well established among academics and still relevant in evaluating banking stability – especially in small or developing economies (see Hafeez et al. 2022). The indicator is designed to assess the risk of insolvency of financial institutions, typically banks. A higher Z-score indicates greater financial stability and lower risk of insolvency – suggesting the bank has higher returns, more capital, or less volatile returns – while a lower Z-score

indicates a higher risk of insolvency. It is a broader measure of banks' stability compared to more credit-risk-specific indicators like the NPL ratio. Thus, a banking sector could register a worse result on the Z-score while still exhibiting relatively low credit risk. Moreover, foreign banks in the CEE region may have more conservative lending practices, resulting in lower non-performing loans and thus lower credit risk, despite the broader risk measures captured by the Z-score (Škrabić Perić et al. 2018).

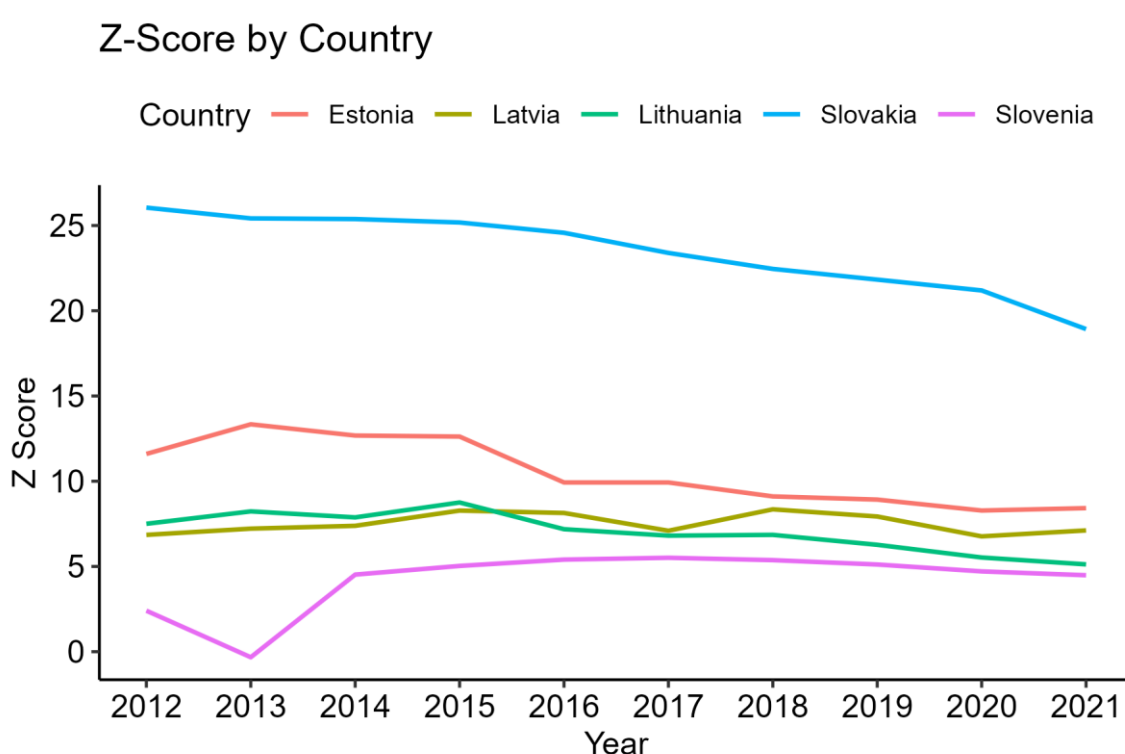


Figure III.5

The charts (*Figure III.5*; *Figure III.6*) show how the five case-studies perform on the Z-score. In order to evaluate the actual meaning of the data, the studied sample is compared with a sample of core home countries where banking capital comes from.³⁷ To this purpose, *Figure*

³⁷ The Global Financial Development Database does not provide data for the EU – or Eurozone – average.

III.5 isolate the five case-studies, while *Figure III.6* plots them together with the second sample. Several key trends emerge from the comparative analysis. Nordic and Western European home countries – Norway, Sweden, Denmark, Austria, Belgium – exhibit consistently higher Z-scores. The only home country showing lower levels is Italy, which underwent major bank crises in the years of the GFC and afterwards. The Baltic States display moderate banking sector stability, with Estonia leading the region. However, the downward trends in Z-scores for these countries highlight increasing risks, possibly linked to broader macroeconomic challenges or slower regulatory advancements. A similar downward trend is registered by Slovakia, which started with the highest Z-score in the sample – of 26.05 in 2012 – but by 2021 it had fallen to 18.93, which places it close to the top-performing group of home countries. Conversely, Slovenia exhibits the lowest Z-score pattern in the dataset: starting at a low of 2.41 in 2012, Slovenia's banking sector hits a negative score of -0.33 in 2013, indicating severe instability. Despite the ensuing improvement, Slovenia's banking sector remains relatively fragile according to this indicator, with a score of 4.49 in 2021.

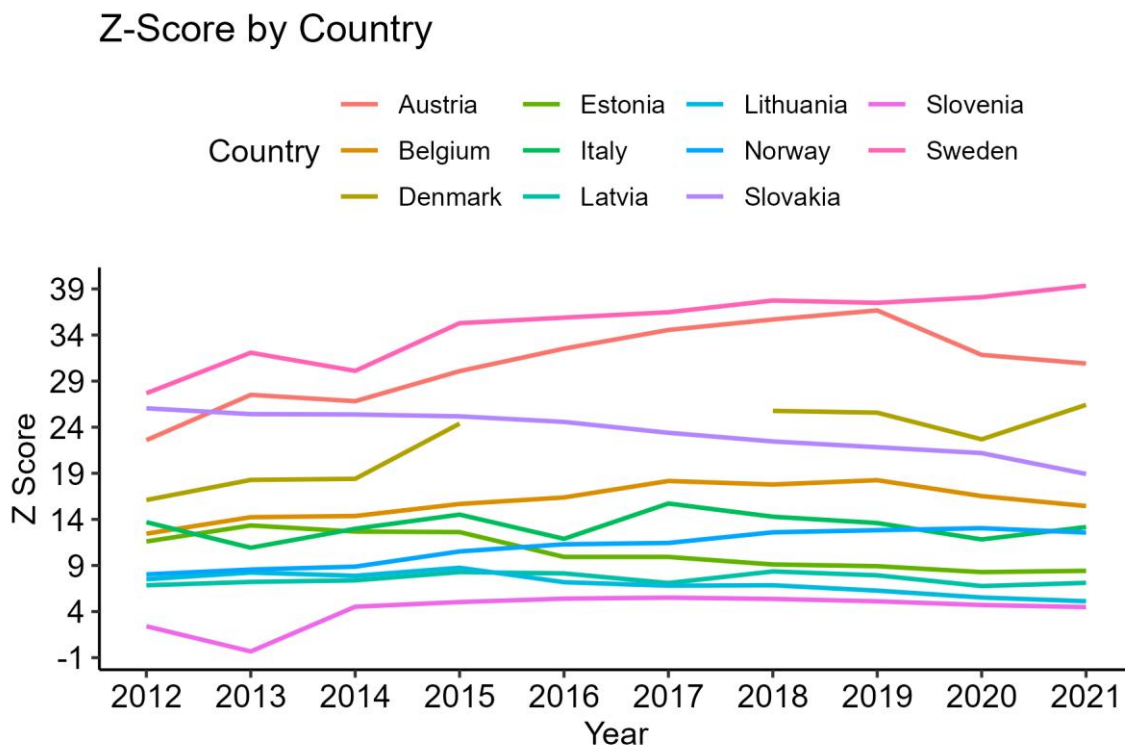


Figure III.6

Credit provision

The conundrum of credit provision, and its relation to the other elements of the MP Triangle, is complex: while the real economy needs credit, credit expansion is a source of systemic risk. This risk is typically measured by the credit-to-GDP gap indicator. Although the success of this indicator has been questioned on several occasions by experts in the field (interview economist Slovakia 14/01/2025), the ESRB employs it in its *Risk Dashboard* – which is a set of quantitative indicators, and their measurements, published regularly 2012. While a higher gap often indicates increasing financial instability, a negative gap suggests that credit is growing more slowly than the economy, which may reduce the risks of credit bubbles, excessive leverage, or financial crises. Moreover, an economy expanding steadily without counting excessively on credit expansion is assumed to be a good sign, as households and firms may be

better positioned to handle economic downturns – since they are not overburdened by debt. On the other hand, significant or prolonged negative gaps may suggest underinvestment, credit constraints, or weak economic demand, which could hinder economic growth.

To evaluate the supply of credit, instead, we can look at the amount of loans provided to households and firms per year – focusing on aggregate figures of the entire private sector. A first general picture is again provided by the World Bank's GFDD, which supplies data on total domestic credit to private sector as a percentage of GDP – including not only loans, but also purchases of nonequity securities, and trade credits and other accounts receivable.³⁸ As the chart shows (*Figure III.7*), all countries except for Slovakia exhibit a downward trend during the observation period, signalling a constant contraction of credit provision in relation to their GDP. Slovakia's credit relative to GDP, instead, increase steadily from around 45% in 2012 to over 60% by 2020. Estonia ratio exhibits a relatively flat trend over time, with the highest level at around 75% and the lowest level at about 60%. However, Lithuania's ratio is overall more stable, making it the flattest curve in the sample, fluctuating around 40%. Conversely, Latvia shows the sharpest contraction of credit among the countries in the sample, from around 55% in 2012 to just over 35% by 2020. Only Slovenia registers a sharper decline in credit provision, yet only in the immediate aftermath of the GFC, with stabilisation and flatter of the curve at around 45% in more recent years.

³⁸ It is worth mentioning again that the World Bank's dataset in use does not provide data on the EU average that is used as comparator in the remaining graphs.

Domestic Credit to Private Sector (% of GDP)

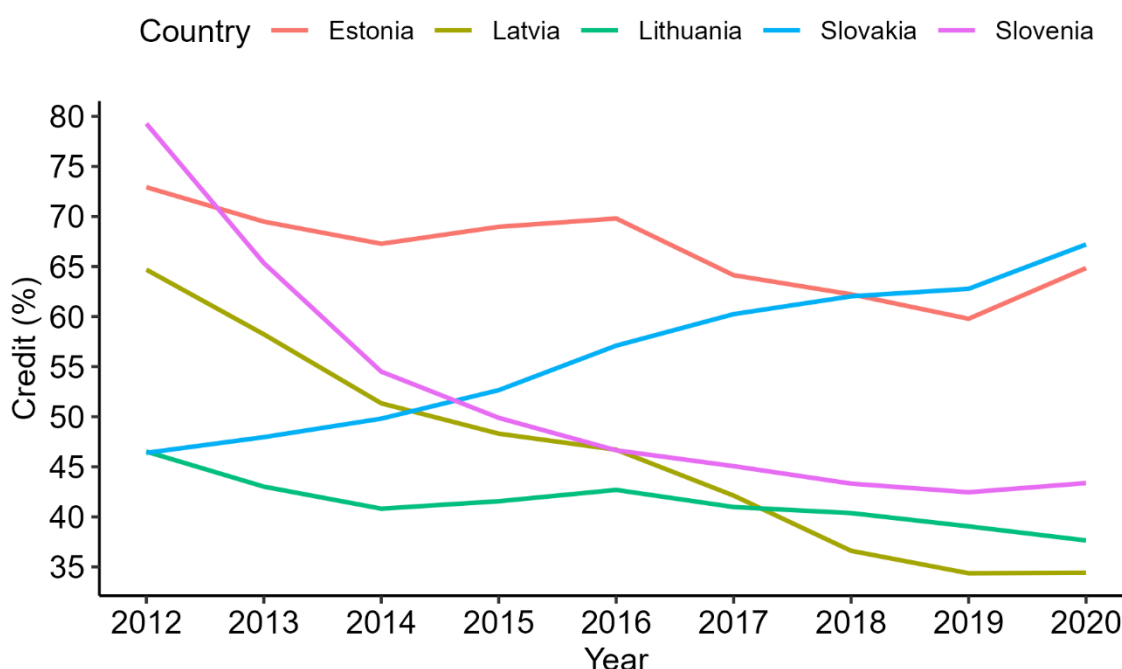


Figure III.7

The values above can provide a deeper understanding of credit dynamics when combined with credit-to-GDP gaps for each country (*Figure III.8*). In particular, the comparative analysis of the two indicators allows us to shed lights on the trade-off between credit provision and systemic risk. Countries with deeply negative credit gaps, like Latvia and Slovenia, show that credit provision has been significantly below historical norms. While this likely reflects efforts to reduce systemic risk, it may also indicate that the real economy's need for credit is not being fully met, potentially harnessing growth. Latvia's persistent shortfall suggests tight credit conditions, while Slovenia shows signs of recovery but still struggles with a substantial gap. Countries like Estonia and Lithuania are closer to balance, with moderately negative credit gaps. Their credit-to-GDP ratios are lower or flat, but they do not appear to be constraining credit excessively. Estonia's slightly negative gap suggests it could expand credit to support growth without adding significant systemic risk, while Lithuania's gap has narrowed to near

zero, indicating a good balance. Finally, the unique case of Slovakia, with rising credit levels and a gap fluctuating around 0%, may indicate that the credit growth has been mostly in line with the economy's real needs, without creating substantial systemic risks yet.

Credit-to-GDP Gap by Country

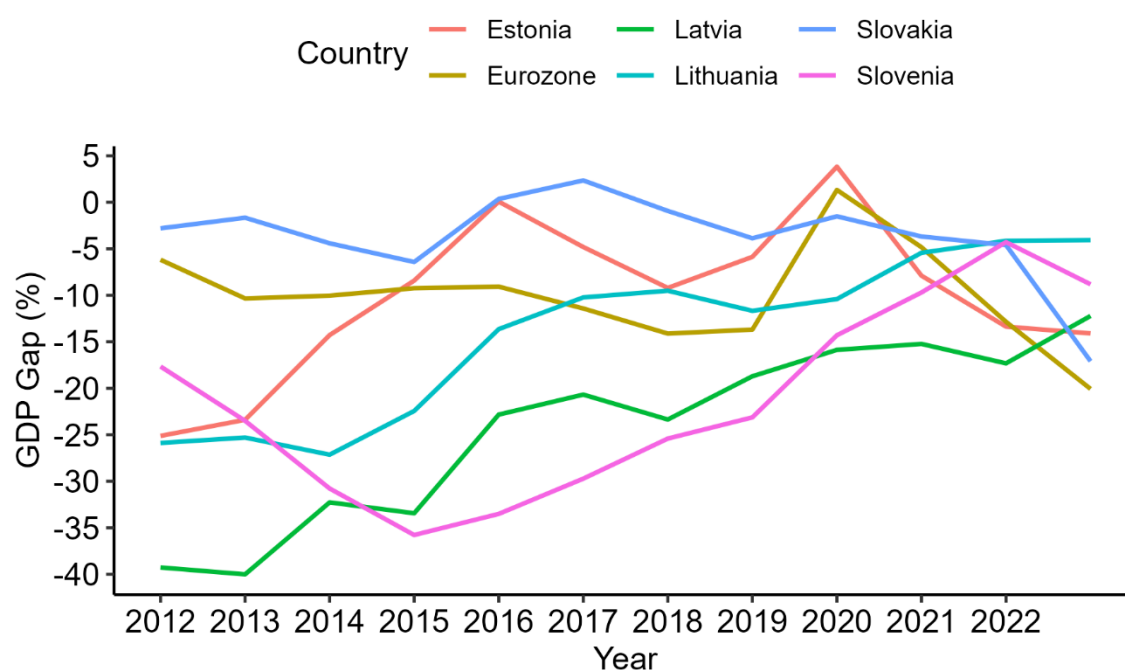


Figure III.8

The ECB collects sectorial data for both firms and households, relative to consumption and house purchases. The charts below (*Figure III.9*; *Figure III.10*) illustrate the rate of growth (or decline) in the total amount of adjusted loans over time, expressed as a percentage, reflecting the change in loan activity over a specific period.³⁹ Through the introduction of such data, we can gain a more comprehensive understanding of the friction between the containment of excessive credit growth and the real economy's needs. Thus, Slovakia and Lithuania stand out

³⁹ Adjusted loans refer to loan data that has been modified to account for seasonal effects or other adjustments. This helps to make the figures comparable over time by removing irregularities.

for their strong credit growth in both sectors, although the former country faced a period of sharp decline in the growth of credit to firms between 2017 and 2020. Overall, these trends suggest that the two countries could strike a balance between growth and risks. Estonia and Slovenia show more moderate credit growth in both sectors, reflecting a more cautious approach to credit expansion while still providing adequate support to the real economy. Latvia, on the contrary, stands out for its lack of credit growth in the business sector until 202, and very little growth in credit to households.

It is useful to read these observations in comparison with the aggregate credit-growth rate registered in the Eurozone for both sectors. In particular, the Eurozone curve appears fairly flat in both cases, with a slightly upward trend over the years. The absence of major fluctuations suggests that the region as a whole is providing consistent support for both household consumption and business investment without creating excess credit growth. In addition, the credit-to-GDP gap exhibits an overall downward trend, except of the spike in the years of the pandemic, suggesting that credit provision across the Euro area has been conservative but not drastically out of line with historical trends.

Credit to Firms by Country

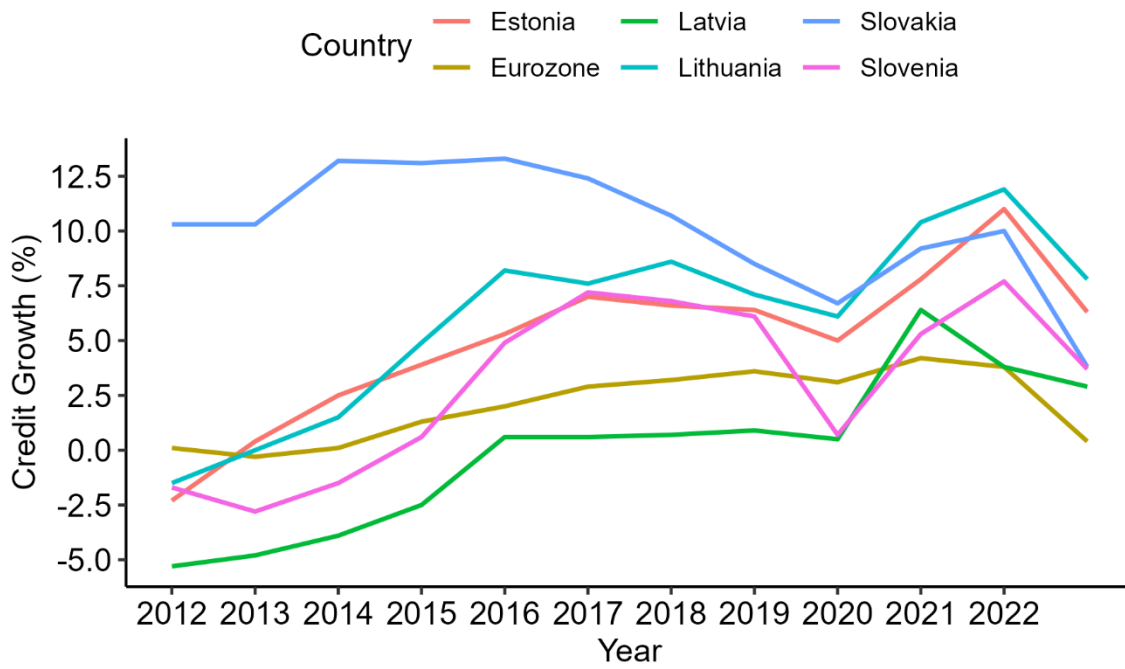


Figure III.9

Credit to Households by Country

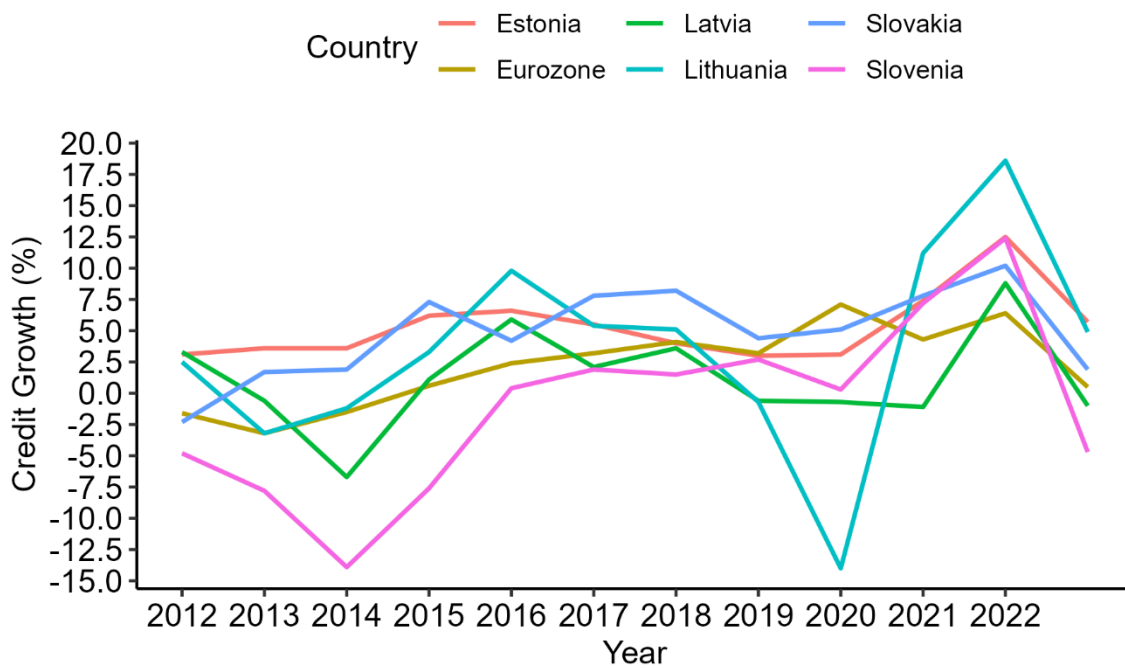


Figure III.10

Cross-border Spillovers from Foreign Banks

The data illustrated so far should only be interpreted in the context of specific challenges that small host countries face due to the foreign ownership of the banking sector. Foreign ownership is a by-product of *cross-border banking*, a characterising phenomenon of European financial markets integration. Its magnitude has intensified over the last several decades, translating in both advantages and disadvantages. In principle, international banking can lead to increased competition in the banking sector, which diminishes the costs of borrowing and improves the capacity to withstand international financial shocks – mainly due to the diversification of funding sources (Singh 2020).⁴⁰ However, a larger presence of foreign banks means a greater chance of cross-border shocks (Song and Zhang 2021).⁴¹ Such opposite effects are possible as the result of financial interconnectedness, which is naturally fostered by international banking.

Although international banking is a global phenomenon, whereby ties between banks' balance sheets have been built across continental boundaries, this study focuses exclusively on the dynamics taking place within the Eurozone – precisely between core countries and Central-Eastern peripheries. Here a small number of foreign credit institutions dominate the banking scene. The World Bank defines such institutions as banks with at least 50% ownership held by a non-domestic parent bank (Fontán et al. 2019, 7). Their activity mostly plays out through banks' subsidiaries – although a number of branches is still present in the region.⁴² The distinction between the two entities is relevant in that only subsidiaries fall under the supervisory jurisdiction of the host country.⁴³

⁴⁰ For instance, research shows that foreign banks are less likely to cut credit to the private sector during domestic banking crises in comparison to domestic banks (R. de Haas and van Lelyveld 2010).

⁴¹ The authors distinguish between *cross-risk* and *inherent risk*, both linked to financial networks' structure (Song and Zhang 2021). Simplifying, the former is the risk that depends on the connections among countries' financial systems, while the latter is the risk arising in each country's banking system independently of interconnectedness.

⁴² Luminor Bank AS, one of the largest credit institutions operating in the Baltic countries and headquartered in Estonia, converted its individual offices into branches both in Latvia and Lithuania starting from 2018. This moved served the centralization of management and a better allocation of capital (Central Bank of Latvia 2018).

⁴³ To be clear, supervision of branches within the Banking Union is exercised by the ECB under specific conditions.

The actual impact on the domestic economy of high shares of foreign banks is still controversial, but it can be maintained that these entities sometimes prove dangerous to financial stability. Among others, Škrabić Perić, Rimac Smiljanić and Aljinović (2018) found that financial stability in CEE countries is closely tied to the health and behaviour of foreign parent banks, which in turn depends on the macroeconomics of the home country – with GDP growth having a negative effect on the credit risk of the subsidiary banks. It is generally assumed that higher ratios of foreign banks result into a decrease of credit risk in the host country, where larger and more profitable parent banks make subsidiaries more risk averse. However, risk can increase through flows within the interbank markets, especially high liquidity in the parent bank can lead to excessive risk-taking by its subsidiaries (Škrabić Perić et al. 2018). Generally, phenomena like over-borrowing, credit bubbles and general financial instability are created during “good years” (Škrabić Perić et al. 2018). Moreover, even if recent scholarship has shown that international banks did not “cut and run” as a consequence of the financial crisis (Dal Maso 2022; R. A. Epstein 2014), the risk of negative spillovers and consequential economic decline in the host country should not be underestimated (ECB Financial Stability Committee 2020a) – and deeply localised funding sources are to be desirable (Singh 2020).

Badarau, Carias and Figuet (2020) explain that interbank flows between the core and the periphery are one-sided: parent banks finance peripheral institutions but not vice versa. Thus, at the aggregate level, peripheral countries tend to be “structural borrowers” on the Euro money market (Badarau et al. 2020). During booms, multinational credit institutions loan funds to peripheral banks through the interbank market. After economic busts, instead, when the private sector no longer has confidence in lending (because of higher risk or market collapse), liquidity moves towards the periphery in the form of official funds through TARGET 2

imbalances (Badarau et al. 2020).⁴⁴ However, the negative externalities considered by this study consist of either direct or indirect consequences of MP policy, as we shall see. In a nutshell, foreign banks enact specific *lending and investment strategies* as a *reaction* to either domestic or host-country policy. These mechanisms are made possible by consolidated cross-border capital flows between the home and the host country, whereby their effects are defined as *negative cross-border spillovers*. The concept is widely used in the literature (among others, Cerutti and Zhou 2018; Covi et al. 2021), which also refers to “unintended consequences” whose impact – and perilousness – actually depends on case by case, precisely on what goals the country is pursuing (Carpantier et al. 2018; European Systemic Risk Board 2018, 192).⁴⁵ Although these effects may well be positive, Member States are nevertheless encouraged to implement national frameworks for their assessment and prevention (European Systemic Risk Board 2018).

Mechanisms and Channels of Transmission

The literature on cross-border spillovers is vast, encompassing issues that go beyond the scope of this study. An example of such complexity is the classification proposed by the ESRB, which identifies five economic and financial channels for potential spillovers: 1) cross-border risk adjustments; 2) network formation and potential for contagion; 3) regulatory arbitrage; 4) altering credit conditions through the relative cost of lending; 5) trade effects (European Systemic Risk Board 2018). This chapter re-classifies spillovers along two main categories,

⁴⁴ Financial interdependence and its asymmetry are also reflected by other dynamics broadly related to the high share of foreign banks in the domestic economy. For instance, the penetration of foreign capital in the CEE region has not meant an increased financing of the local non-financial firms (mostly SMEs), but rather pro-cyclical consumer and mortgage lending (Ban and Bohle 2021). Moreover, research showed that EU’s peripheral countries have been particularly vulnerable to housing and mortgage booms both before and after the GFC (Bohle 2018).

⁴⁵ To be clear, spillovers are not necessarily negative, but they can be. The ESRB suggest that countries “favour instruments for which negative cross-border spillovers are limited” (European Systemic Risk Board 2018, 19). Moreover, it is worth emphasizing that, however negative or positive, spillovers are assessed as consequences of “sound policy decisions” (European Systemic Risk Board 2018, 180). Hence, additional spillovers may derive from sub-optimal policy action.

namely the *withdrawal of capital and liquidity* from the peripheral subsidiaries and the potential *increase in systemic risk* in the host country. Importantly, these dynamics involve both CBMs and BBMs, with the actual effect being instrument-specific.

Furthermore, a third – less relevant – category refers to MP inaction. Due to the inherent risks of financial interconnectedness, timely and consistent application of MP policy is paramount to financial stability. In fact, macroprudential inaction is deemed highly dangerous by European and national authorities in charge of financial supervision (interview MP official from ESRB 04/12/2024). The issue is usually referred to as the *inaction bias*, and it has multiple causes – such as systemic risk’s endogeneity (Stellinga 2020), the micro-prudential mentality still informing MP thinking (Kranke and Yarrow 2019), the institutional features of both national MP frameworks (Thiemann 2019) and the BU (Piroska et al. 2021), and even trade-offs between different (at times, incompatible) objectives (White 2020). Here the issue is relevant inasmuch as it highlights the weaknesses of the current MP governance, which is not capable of imposing financial stability from above, thereby counting exclusively on Member States’ autonomous and timely action.

Negative cross-border spillovers are related to subsidiaries’ banking, branches’ banking, and direct cross-border lending. The ECB has recently made a conceptual effort to clarify the functioning of these dynamics (ECB Financial Stability Committee 2020a). Thus, spillovers are generally transmitted through two channels, namely *inward* and *outward* channels. These refer to the direction in which domestic macroprudential policies interact with foreign countries: inward transmission captures the effects of domestic MP policy on the domestic economy through the impact on foreign entities operating there; outward transmission, instead, refers to the effects of foreign MP policy on the domestic economy, including through direct cross-border lending.

For instance, raising counter-cyclical capital buffers (CCyBs) in the home country can lead parent banks to repatriate capital from the peripheral subsidiaries, thereby producing a reduction of lending in the host country (Poutineau and Vermandel 2017).⁴⁶ This is due to the need of parent banks to allocate more capital to meet the stricter requirements. Out of the same necessity, these banks may alternatively decide to reduce exposures to foreign economies (European Systemic Risk Board 2018), thereby causing a contraction of credit.⁴⁷ In this sense, the ESRB considers the withdrawal of funds from the subsidiary as one of the main “cross-border negative spillovers” of MP policy. On the other hand, tighter MP policy in the home countries may shift more funds – and lending – to the host countries, thereby fuelling credit expansion and consequential risk (Badarau et al. 2020). As clarified by the ESRB (2018), multinational banks tend to evade capital buffers and loan-to-value ratios in the home country by shifting towards risky profits across borders – where lending is less constrained.

Causal Pathways to Spillovers

The dynamics described above can be illustrated through concrete stylised pathways. While this analysis does not claim a direct causal link between MP policy and observed financial stability outcomes, the examination of Financial Stability Reports (FSRs) issued by NCAs, alongside literature and analysis from European institutions, reveals two common mechanisms accounting for cross-border spillovers: first, the increase in the home country’s CCyB rate and consequential repatriation of capital; second, regulatory arbitrage leading to excessive credit growth.

⁴⁶ To be clear, this effect does not exclude a reduction of lending in the home country itself as a direct consequence of higher capital buffers.

⁴⁷ In the wording of the ESRB, “[a] change in the [MP tool’s] rate on exposures in a certain country may have spillover effects on all countries where a bank operates. For example, banks may choose to scale down all of their exposures regardless of the jurisdiction of their borrowers in order to meet a higher buffer rate in a [home] country” (European Systemic Risk Board 2018, 33).

When a home-country authority raises CCyBs – a common capital-based measure – in response to perceived systemic risk, it requires parent banks to hold additional capital to absorb potential losses at the consolidated group level (ECB Financial Stability Committee 2020a; ESRB 2018). Owing to the fact that parent banks must promptly meet higher capital adequacy demands, they may choose to repatriate capital from their foreign subsidiaries to consolidate their resources in the home jurisdiction (Poutineau and Vermandel 2017). Since subsidiaries in small host countries have limited sources of local funding, this repatriation directly reduces their capital buffers and lending capacities, tightening credit availability in the local economy (Cantone et al. 2019). Consequently, the credit crunch triggered by the home country's policy decision not only curtails economic activity in the host country, but also raises systemic risk precisely in economies where foreign-owned banks are systemically important, yet regulatory safeguards and supranational backstops remain insufficient (Fontán et al. 2019; Badarau et al. 2020).

Alternatively, tightening MP measures in home countries – particularly borrower-based measures like stricter LTV limits – often incentivises regulatory arbitrage (European Systemic Risk Board 2018). Facing constraints at home, parent banks shift lending operations toward subsidiaries in host jurisdictions where regulatory demands are relatively less stringent, or enforcement is weaker. Due to these lower regulatory hurdles, subsidiaries in small host countries witness increased capital inflows from parent banks seeking profitable jurisdictions for their surplus liquidity (Badarau et al. 2020). Although this inflow might initially boost local credit markets, it can also cause unsustainable credit growth, leading to the accumulation of excessive private-sector debt and inflating financial bubbles (Škrabić Perić et al. 2018). The host country's NCA has limited jurisdictional power to counterbalance these inflows, especially through branches or direct lending channels, exacerbating financial fragility without

appropriate supranational regulatory coordination (ECB Financial Stability Committee 2020b; Cantone et al. 2019).

The Impact on Small Host Countries

The preceding analysis sheds light on the dual role of foreign-owned banks in small Eurozone host countries. The FSRs issued by NCAs consistently highlight the stabilising effects of foreign bank presence, such as improved capital adequacy, prudent risk management practices, and enhanced liquidity management resulting from the rigorous regulatory posture of parent banks' home jurisdictions. These effects, which were widely recognised during the GFC and more recent economic distress, suggest that foreign bank can play a positive role in the examined economies – with subsidiaries generally preferred over branches (interview MP official from Central Bank Slovakia 28/11/2023).

However, the FSRs equally, albeit less vocally, acknowledge the underlying structural vulnerabilities stemming from the very same foreign banks. NCAs explicitly recognize two central risks. First, host countries' banking sectors are significantly exposed to financial conditions in home countries, meaning local financial stability can quickly worsen due to spillovers from parent banks' decisions regarding liquidity or market-based funding reliance. Moreover, many host countries' NCAs do not have enough information on the volumes from these activities, which are usually monitored by multinational banks themselves (Cantone et al. 2019). Researchers at the ECB have calculated the share of credit through cross-border lending and foreign subsidiaries for all SSM countries. The economies under examination do not stand out for high percentages compare to countries like Luxembourg (61%), Cyprus (24%), Ireland (24%), and Malta (24%), but they still register non-negligible values: Estonia at 8%, Lithuania at 12%, Latvia at 14%, Slovenia at 15%, and Slovakia at 19% (Cantone et al. 2019). The analysis also shows that a significant portion of sectoral cross-border exposures –

provided through both direct cross-border lending and lending via foreign branches – pertains to the corporate sector, which represents approximately 5% or more of total lending in 11 SSM countries. In this case, the examined sample sits on that very average – Slovenia at 4.9%, Latvia at 5.1%, Lithuania at 5.9%, Estonia at 6.1%, and Slovakia at 8% (Cantone et al. 2019).

In addition, the autonomy of local subsidiaries remains limited, especially during times of market stress, when parent banks prioritise their own domestic stability, potentially curtailing the flow of capital and liquidity to subsidiaries and intensifying the host countries' systemic risks. Thus, although FSRs generally convey confidence, a closer examination reveals continuous awareness among NCAs of their economies' structural vulnerability. This directly reflects the broader tensions within the MP Triangle and highlights the challenges of governing financial stability within an incomplete supranational structure – where coordination is ultimately reliant on NCAs' action – and against inherent asymmetries of cross-border financial integration.

Conclusion

This chapter has provided an empirical operationalisation of the MP Triangle, delineating the structural conditions under which small Eurozone host countries – Estonia, Latvia, Lithuania, Slovakia, and Slovenia – must balance financial stability, sufficient credit provision, and the containment of cross-border spillovers. By analysing key indicators – capital adequacy, leverage, liquidity, non-performing loans, Z-scores, and credit growth – the chapter has illustrated how tensions among these dimensions unfold in practice. To be clear, the purpose has not been to establish a causal relationship between specific macroprudential policies and financial stability outcomes. Rather, these indicators contextualise the structural environment within which NCAs operate, thereby making visible the inherent tensions and vulnerabilities

these countries face. These are determined by high foreign bank ownership, local subsidiaries' limited autonomy, and the absence of a supranational governance geared towards the supply of financial stability as a public good.

The descriptive statistics confirms that small host countries exhibit considerable resilience on several fronts, including robust capital adequacy ratios and improving credit quality. At the same time, structural vulnerabilities remain evident. Persistent negative credit-to-GDP gaps suggest that, in some countries, the specific conditions have resulted in under-provision of credit. While this may reflect efforts to reduce systemic risk, it also raises concerns about prolonged credit constraints that could hinder investment, consumption, and broader economic development. At the same time, volatile liquidity ratios in countries like Lithuania and Latvia may indicate changing group-level liquidity strategies or reactive adjustments to market conditions. These dynamics, when considered alongside the high share of foreign ownership and reliance on parent-bank funding, further expose small host countries to abrupt shifts in financial conditions beyond their direct control – as illustrated by stylised causal pathways. Importantly, the dual role of foreign-owned banks emerges clearly: while these institutions enhance stability through their management practices and home-country regulation, they are also sources of substantial systemic risks due to their inherent susceptibility to parent-bank financial strategies and conditions.

By rendering the conceptual claim of the MP Triangle empirically intelligible, the chapter set the stage for the empirical analysis of the interview data performed in Chapter V. Clarifying the empirical conditions shaping the MP Triangle – alongside the backstories of the evolution of Eurozone peripheries' banking sectors (see next chapter) – is necessary to examine the subjective interpretations of such conditions by the NCAs themselves. The purpose is to transition from material objects to subjective knowledge and intersubjective understanding, in order to investigate precisely how regulators understand, justify, and navigate these structural

tensions. Ultimately, this transition strengthens the dissertation's core hypothesis: it is precisely the significant autonomy embedded within the current MP governance arrangements that enables NCAs to remain committed to the existing framework despite their structural disadvantages.

IV. BANKING INTEGRATION AND CRISES IN THE PERIPHERIES OF EUROPE

Introduction

This project seeks to provide an explanation for small host countries' loyalty to the European MP framework.⁴⁸ There are valid reasons to find such loyalty puzzling, on both empirical and theoretical grounds. The MP Triangle synthesises these perspectives: its elements and their interactions offer a vivid description of how difficult it is to establish the right synergies among different factors that influence financial stability and how the task becomes particularly challenging when a significant portion of the banking system consists of foreign banks. Within the context of European integration, one might anticipate two potential outcomes: *a*) a backlash against integration due to the uneven distribution of costs and benefits; or *b*) further integration to correct for what some might label as “functional dissonances” (Brenner 2021). Despite these expectations, there is notable contentment with the current stalemate of the *status quo*. To clarify this conundrum, I propose that MP governance is a crucial yet often underestimated factor contributing to the non-contentious preservation of the *status quo*, alongside other mechanisms conceptualised as alternative hypotheses.

The present chapter builds upon the previous one to provide further contextualisation. In Chapter III, the MP Triangle was presented in its empirical dimension. This is reflected in the three elements of the Triangle – financial stability, credit provision, and cross-border spillovers – and particularly in the indicators selected to operationalise them. However, it is important to note that these three elements are insufficient for assessing financial stability in the countries under examination due to the complex causality involved, resulting from

⁴⁸ As extensively explained in the Introduction, the observations that gave rise to this investigation were originally premised on the puzzling absence of contestation against the *status quo*. Voice – that is, contestation – and loyalty should not be automatically juxtaposed. However, as clarified in the Introduction, the fieldwork I conducted provided enough evidence that NCAs from peripheral countries are eagerly loyal to the European MP framework.

numerous interacting variables - with potential equifinality and conjunctural causation. Nevertheless, Chapter III provides the first empirical contextualisation for the dynamics explored in this dissertation. The descriptive statistics presented pertain exclusively to banking, which is the sole aspect of financial integration addressed in this investigation.

In Chapter III, I demonstrated that all analysed countries have made significant progress in enhancing their financial stability in alignment with EU-level objectives. This progress is reflected in positive performance on key indicators and the absence of any formal warnings or recommendations from the ESRB. Overall, the countries exhibit more robust regulatory frameworks and prudent financial practices compared to their positions during the GFC, indicating sound risk management and economic recovery. However, the pace and extent of these improvements vary, suggesting diverse strategies and context-specific conditions. Each country's measurement is above EU averages and minimum regulatory levels. Moreover, each country outperforms Eurozone SI institutions in capital adequacy, leverage, liquidity, and asset quality. That said, Chapter III concludes that variation in small host countries' performance warrants a detailed examination.

In the following sections, I will provide further context for some country-specific conditions that contribute to account for the data illustrated in Chapter III. Specifically, I will explore the backstories of how the current banking systems evolved, including privatisation and foreign ownership as well as notable cases of FOLTF banks. This examination will focus on institutional change and/or continuity during the early years of the post-socialist transition, as well as the subsequent decade leading up to the GFC, making use of additional single-country data to complement the analysis in the previous chapter. In the second part of the chapter, I will describe the interaction between national banking systems and the EU-level framework for banking supervision, known as the Banking Union (BU). Within this framework, the chapter will compare core and peripheral countries, as well as distinctions

within the periphery. The ultimate goal is to set the stage for the empirical analysis in the subsequent chapter.

Methodological Notes

As described in the Introduction in detail, this analysis is a case study design comprising five countries selected based on the most-similar system logic. Case selection is premised on two main attributes, which are then operationalised through two key variables:

1. The country has *Eurozone membership*.
 - a. Year of Euro adoption.
2. The country qualifies as a *peripheral dependent economy*.
 - b. Share of foreign banks.

All the countries in the sample meet both conditions. In other words, the five countries under examination share structural similarities – alongside the outcome similarity – and variation in secondary conditions. This strengthens the causal claim that the autonomy granted by MP governance creates the necessary conditions for small host countries' loyalty to the MP framework. This chapter provides a detailed examination of the structural conditions and the country-specific variables mentioned in the previous chapter. A thorough exploration of these details is crucial for assessing the validity of the core hypothesis. Following the logic of the most-similar system design (MSSD), the interaction of different variables in contexts shared by countries with common structural features enhances the explanatory power of the hypothesis regarding the investigated outcome. To this purpose, the ensuing sections will deploy Comparative Historical Analysis (CHA) to provide additional details about both the structural conditions characterising all case studies – namely, the two aforementioned attributes – and the

various country-specific conditions that have shaped the evolution of each country's banking system since transitioning to a market economy – as clarified in the introductory section. Importantly, this chapter covers a time span that extends beyond the observation period. While the evidence gathered to validate the hypothesis pertains to the extended decade from the GFC to the post-COVID recovery, the historical overview in the following pages includes the post-socialist transition period.

A conclusive remark is necessary to guide the consultation of the data provided in this chapter, which includes single-country charts and graphs. First, the *stacked bar charts* presented below illustrate the cumulative intensity of structural MP tools adopted by selected small Eurozone host countries over the period 1997–2020. The underlying data originates from the macroprudential policy intensity database (MPPI Database) compiled by Eller et al. (2020), which systematically records prudential actions by national authorities and translates them into standardised index-style values. Each measure considered – capital requirements (*CAP Index*), adjustments to capital definitions (*Capital-Based Index*), reserve requirement bases (*RR_base*), liquidity rules (*LR_gen*), single-client (*SCE_limit*) and intra-group exposure limits (*IGE_limit*), sectoral exposure constraints (*SMSE Index*), and mortgage risk weights (*RW Index*) – is represented by a dedicated processed indicator from the database. These indicators reflect cumulative policy intensity, meaning they increase with policy tightening and decrease with policy loosening. The bar height for each quarter corresponds to the sum of the intensity-coded values of all included instruments active in that period. Thus, each coloured segment within the bars shows the individual contribution of a specific structural measure.

Second, it is important to note that the *single-country graphs* exhibit steeper curves compared to the comparative charts from the previous chapter. The underlying data is the same used in Chapter II, but this new plotting employs an automatically scaled y-axis to highlight within-country variation, while the comparative charts maintain a common y-axis scale across

countries. Consequently, changes in the new charts may appear steeper due to the narrower axis range, allowing for a greater emphasis on variation across the sample. Finally, it is necessary to clarify that the chapter adopts the concept of prudential policy – instead of MP policy. While the latter is the real object of study, the extended observation period of the comparative historical analysis requires a different terminology. In fact, MP policy the way we know it, did not exist until around 2010 – with the establishment of an EU-wide MP framework. To be clear, the epistemic debate about MP policy had been going on for many years – even before the GFC. However, the toolkit often referred to in this study is the one drafted by the ESRB. As a consequence, this chapter makes use of the notion of *prudential policy*. This notion is particularly helpful to highlight the policy continuity characterising the stance of the countries under examination. Moreover, it paves the way for the argument elaborated in the next chapter.

Country Profiles and Comparative Insights

The following sections explore the aspects of CEE countries' transition to a market economy that are pertinent to this dissertation's focus on the banking sector. It is important to highlight that this transition has led to a vibrant diversity of capitalism in the region. Bohle and Greskovits (2012) identified three distinct varieties of capitalism: a neoliberal order that emerged in the Baltics; a regime of embedded capitalism developing in the Visegrad states; and neo-corporatism in Slovenia. Despite significant differences among these three post-socialist regimes, they also share important commonalities relevant to this investigation. Firstly, all regimes underwent substantial economic liberalisation and progressively integrated into various aspects of European integration, including compliance with the *acquis communautaire* (EU law) and, as far as Eurozone countries are concerned, participation in the Banking Union (Bohle and Greskovits 2012). Secondly, foreign direct investments (FDIs) became a key driver of economic restructuring, technological advancement, and export-led growth. Consequently,

large-scale privatisation of state-owned enterprises took place, often guided by neoliberal principles, resulting in deindustrialisation – although to a varying degree across the region (*ibidem*).

FDIs come in various forms. One less discussed form is the foreign ownership of the banking sector, which serves as a structural condition for the MP Triangle. This particular type of FDI has resulted in what Epstein (2017) refers to as the “marketisation of banking” in the CEE region. This concept is defined as “the extent to which the banking sector is privately, as opposed to publicly, held, and the degree to which banks’ business activities are subject to diminishing home political influence” (Epstein 2017, 15). The phenomenon encompasses two core dimensions:

1. *Ownership structure*, understood as a transition from public or state ownership, or significant state control, to private (especially foreign) ownership.
2. *Political influence*, which pertains to the potential reduction in the control that national governments exert over banking operations.

According to Epstein (2017), the process of marketisation has not occurred uniformly across Central-Eastern Europe; variations exist due to differences in state power, exposure to crises, and international pressure. Despite differences, all countries under examination registered a significant increase in the share of foreign banks between the late 1990s and early 2000s – with only minimal decrease in the level of foreign penetration since that time.⁴⁹ This characteristic renders the CEE region vulnerable to events originating outside its borders. The interplay of these dynamics, along with other factors not covered in this investigation, arguably contributes

⁴⁹ The region went from a close-to-zero share to almost 100% in certain small countries – such as Croatia (Fontán et al. 2019). This transformation was part of a larger dynamic that characterized especially the transition of some former-Soviet countries in the region. In particular, the liberalization of capital movements was one of the main pillars of the state-building process occurred before and after the accession to the EU.

to the vulnerabilities faced by CEE countries as small hosts of foreign banks. At the same time, it is important to clarify that, despite the evidenced impact of foreign banks on host countries' vulnerability (Ban and Bohle 2021; Nelson 2020), it cannot be claimed that high shares of foreign ownership triggered the crisis. Although the effect of international banks varies based on the conditions of both the home and host countries' banking sectors, these banks are generally considered key nodes for the transmission of financial shocks (World Bank 2018). According to the World Bank, host countries must create the necessary conditions to maximise the benefits from foreign banks (World Bank 2018), which do not accrue by themselves.⁵⁰ The ensuing sections will elaborate on individual countries' cases to illustrate the diverse evolution of each banking sector, particularly how foreign capital entered Eurozone peripheries and what role it played during the GFC.

Early Transition and Privatisation: Shaping the Banking Sector for the New Millenium

After restoring independence from Soviet occupation in 1991, Estonia swiftly began the transition to a market economy – and a market-based banking system. The country is often depicted as the first mover in the Baltic group, as it pioneered important steps of the socio-economic transition (Feldman and Kuokštis in Arató et al. 2021). First, it introduced its national currency in 1992, establishing a hard peg in the Deutsche Mark. Secondly, it pioneered privatisations and liberalisations – compared not only to other Baltic countries but to the entire CEE region. Thirdly, it adopted an almost ideological approach to frugal public finances: its commitment to fiscal prudence and a balanced budget was so deep that it had shown the smallest public debt in the EU (*ibidem*). Finally, it was the first country in the Baltic region to

⁵⁰ A comprehensive understanding of the mechanisms linking banks' foreign ownership to the vulnerability of small host countries must also take into account how these dynamics currently operate within the general framework of the Banking Union and in the specific context of monetary policy. However, such an inquiry is beyond the scope of this dissertation.

join the Eurozone in 2011. Before the transition, the Soviet system was characterised by specialised state banks. These were initially reconstituted as state-owned commercial banks and then gradually privatised (Baudino et al. 2022). At the same time, the regulatory liberalisation ensuing the collapse of the Soviet Union spurred the establishment of numerous new private banks in the early 1990s – a total of 41 operating banks already by 1992 (IMF 2001). The explosion of banking activity proved challenging to the then-limited regulatory capacity of the country, and the rapid expansion led to instability (Baudino et al. 2022). The volatile post-Soviet economy, inexperienced bank management, weak legal frameworks, and inconvenient ties with Russian assets resulted in severe banking troubles in the first decade of the transition. In this context, the Central Bank adopted a strict policy of *no bailouts*, instead closing or merging insolvent institutions that failed to meet obligations, thereby hindering the potential recovery of the banking system (Fleming et al. 1997). Through these episodes, the banking sector underwent rapid consolidation – with the number of banks decreasing from 22 in 1994 to only 6 by 1998 (World Bank 2000). By the late 1990s, Estonia had significantly advanced the privatisation and restructuring of its banking sector, establishing a solid foundation for the upcoming European integration.

Latvia's transition to a market economy – and a market-based banking sector – was rather a tumultuous process instead. Following independence from the USSR in 1991, Latvia adopted shock therapy reforms, including rapid liberalisation, privatisation, and price deregulation. These changes caused a sudden economic collapse and the consequential implementation of tight fiscal and monetary policy (Bohle and Greskovits 2012). In the early 1990s, minimum entry hurdles resulted in an excessive proliferation of banks, with over 50 private institutions established within the initial years, frequently by entrepreneurs, and occasionally by criminals or politically connected individuals, attracted by lenient laws and the potential for high-yield schemes (OCCRP 2011). Similar to Estonia, Latvia had also inherited

some Soviet-era banking institutions: the local branch of the USSR State Bank was restructured under the newly established central bank (Bank of Latvia), while other state-owned specialty banks were merged or restructured for future privatisation (Baudino et al. 2022). However, the proliferation of new banks characterising Latvia's early transition resulted in many institutions functioning primarily as unregulated investment schemes. As a consequence, the country underwent a significant banking crisis in 1995, one of the most severe among post-Soviet governments (Fleming et al. 1997). The trigger was the collapse of Banka Baltija, at the time Latvia's largest bank: the bank had engaged in a classic Ponzi scheme – offering unsustainably high deposit rates (reportedly up to 90% returns) and speculating on a currency devaluation (OCCRP 2011). Its catastrophic failure, which costed the saving of numerous Latvian pensioners and workers due to the government decision not to bail out, revealed deep corruption and lack of effective supervision in the emerging banking system. In response, Latvian authorities strengthened banking regulations and enhanced oversight (*ibidem*). A second shock occurred shortly, with the Russian financial crisis of 1998. Latvian banks had grown reliant on the Commonwealth of Independent States, and to be rescued with help from international investors including the EBRD (*ibidem*). By the late 1990s, these crises had significantly shrunk the banking sector: the number of banks fell from 62 in 1993 to 27 by 1998 (World Bank 2000). The remaining banks from the Soviet legacy were also privatised or restructured by the state. By 2001, Latvia's banking sector was entirely in private hands (OeNB 2002).

The early years of Lithuania's transition to capitalism were fairly similar to Latvia's experience, namely swift market reforms, early stabilisation, and crisis-driven austerity (Bohle and Greskovits 2012). Similarly, the banking transition in the 1990s shares some elements with its Baltic neighbours, notably an early phase of rapid creation followed by crisis and consolidation. When gaining independence, the country inherited a number of Soviet banks

which were converted into commercial banks under state ownership (Baudino et al. 2022). In parallel, new private banks were founded by various entrepreneurs, often with minimal regulatory oversight – reaching a total of over 25 commercial banks by 1994 (*ibidem*). However, many were undercapitalised and engaged in risky lending. This was not the trigger of the crisis though. The actual trigger was a combination of the diminishing of profitable trade finance with post-Soviet countries and widespread mismanagement – including instances of politically directed lending by state banks (*ibidem*). During the resulting banking crisis, between 1995 and 1996, several banks failed or had to be rescued – including two of the largest banks, namely Lithuanian Innovation Bank and Litimpeks Bank (Fleming et al. 1997). The government and Central Bank agreed on limited intervention to protect certain depositors but generally adopted a strict stance on insolvent institutions by withdrawing licenses – thereby diminishing the number of banks from 26 to 10 by 1997 (*ibidem*). To restore stability, authorities strengthened prudential rules (e.g. stricter capital and provisioning requirements by 1996) and restructured the biggest state banks. Compared to Estonia and Latvia, Lithuania was initially slower to attract foreign strategic investors, and domestic owners remained significant a bit longer (World Bank 2000). Nevertheless, the late 1990s initiated a transformative period: following the Russian crisis of 1998, trust in domestic banks diminished, prompting the government to view foreign capital as a remedy for recapitalising the sector (Fleming et al. 1997). By 2000, Lithuania had stabilised its macroeconomy and was advancing towards EU accession, which stimulated the completion of banking reforms. All surviving state banks were designated for divestiture, and the legal and regulatory framework was reformed to comply with EU norms.

Post-socialist transformations in Slovakia occurred through gradualist and state-centric reforms which delayed macroeconomic stabilisation and limited the FDI inflows in an initial phase – until the late 1990s, when new elections brought a reform-oriented government that

pursued rapid privatisations and liberalisation (Bohle and Greskovits 2012). Unlike the Baltics, Slovakia's banking transition occurred at a more gradual pace too, facing significant challenges along the way. In the early 1990s, Slovakia's banking sector was characterised by a concentration of a few large state-owned banks, which were successors of the Soviet monobank system (Borish et al. 1997). In the mid-1990s, these banks were state-controlled and frequently experienced political interference, including directed lending to preferred enterprises. The outcome was a significant accumulation of NPLs on their balance sheets. By the late 90s, Slovakia's three largest banks – Všeobecná úverová banka (VÚB), Slovenská sporiteľňa (SLSP), and Investičná a rozvojová banka (IRB) – were technically insolvent, with NPLs reportedly between one-third to one-half of their portfolios (OECD 2002). The government delayed the tackling of these problems in the mid-90s. Actual restructuring occurred only after 1998, when thorough reforms were pipelined in light of approaching EU membership. Between 1999 and 2000, Slovakia undertook a comprehensive banking sector restructuring. The state transferred tens of billions of crowns in bad assets from the three largest banks to consolidation agencies (*ibidem*). The banks recovered some value, but the government took on the NPL load. In parallel, the state refinanced big banks with government bonds to save them (World Bank 2004). Additionally, between 1999 and 2002, a number of smaller troubled banks were resolved – some were closed and their licenses revoked, while others were merged or sold (*ibidem*). Some of these cases cost the deposit insurance fund billions of crowns, which were reimbursed by the state. Shortly after, Slovakia had dramatically transformed its banking sector: in the early 2000s, the era of state-directed banking had ended, bad debts were largely written off to the state, and the path was clear for privatisation to strategic foreign owners.

Slovenia, had more political continuity than other CEE countries, with former Yugoslav elites in power throughout the 1990s and the corporatist heritage of Yugoslav worker self-management preserved (Lindstrom and Piroška 2007). Unlike other Eurozone small hosts, the

country had a slower banking shift in the 1990s. The banking industry inherited several banks from Yugoslavia in the early 1990s, including Ljubljanska banka (later NLB) and Banka Maribor. These top Yugoslav banks initially were packed with bad debts and frozen foreign-currency reserves (Simoneti et al. in Mrak et al. 2013). The immediate reaction of the Slovenian government, in mid-1990s, was to seek recapitalisation and restructuring by issuing government bonds to cover their inherited losses (Cvikl and Gaspari in Mrak et al. 2013) – instead of swiftly opening to foreign capital. The bank privatisation was one of the most significant property transfers since Slovenia attained independence and sparked popular opposition – with successful attempts to stop privatisation of the largest state-owned banks, such as NLB (Lindstrom and Piroška 2007). Thus, private international banks entered the country in the late 1990s but remained with a very modest presence for several years. Slovenia avoided a full-blown banking crisis in the 90s (unlike other post-socialist countries), thanks to prompt government intervention and a relatively stable macroeconomic environment – although the country experienced a heated debate over the best developmental strategist between “gradualists” and “shock-therapists” (Mencinger in Mrak et al. 2013). During the 2000s, Slovenia’s banks enjoyed strong growth and high profits as the economy expanded (especially after EU accession in 2004 and euro adoption in 2007). Regardless of ownership structure, banks were heavily incentivised to source funding from abroad. As a result, in the years leading up to 2008, there was a massive inflow of foreign capital into Slovenia’s banking sector: around 10% of GDP came in the form of banking loans, either through interbank loans or direct banking loans (interview economist Slovenia 03/12/2024). Simultaneously, the banks lent extensively to Slovenian companies, accumulating credit risk (*ibidem*). Fiscal packages coordinated with the European Economic Recovery Plan, and the EC’s lowering of the Maastricht ceiling on public finances, prevented a full-blown financial crisis once again (Piroška and Podvršič 2020).

Capital Inflows in the Banking Sector and Financial Stability Policy

The arrival of foreign strategic investors in the second half of the 1990s was a major turning point for the CEE region, which witnessed what Epstein defined the “marketisation of banking” (Epstein 2017). While Western European states maintained lower levels of foreign bank ownership and more control over domestic banks, CEE countries experienced substantial foreign penetration in the banking industry, resulting in greater marketisation (*ibidem*). As seen in the previous section, marketisation was frequently the consequence of banking or financial crises, which generated a compelling need for better management practices and international credibility (Epstein 2017; Grittersová 2014). Given this, the countries under examination experienced varying levels of foreign penetration in the banking industry: Slovakia, Estonia, and Lithuania achieved the highest levels of foreign penetration at the onset of the GFC in 2008 (99%, 98%, and 92%, respectively); Latvia was in the middle (66%), and Slovenia had the lowest level in the sample (31%) (Epstein 2017).

After the 1998 crisis, Estonian authorities actively courted foreign banks – especially Scandinavian banking groups – as a source of stability and capital for the weakened system. Estonia’s banking system needed foreign banks’ experience, credibility, and financial strength during the early transition (Grittersová 2014). By 1999, two large Swedish banks – Swedbank and SEB – owned majority shares in Estonia’s main banks, which accounted for 85% of the banking sector’s assets. As a result, nearly the entire Estonian banking sector came under foreign ownership by the early 2000s, and within a few years virtually 100% of banking capital was foreign-held (Spendzharova 2014a). In practice, involvement mainly took the form of acquisitions of existing local banks, which were subsequently managed as subsidiaries of Nordic parent corporations (Baudino et al. 2022). The road to EU accession in 2004 further fueled foreign interest, since the expectation of a common EU regulatory framework and the

Baltics' rapid economic growth made Estonia an attractive market for European bank. By the mid-2000s, the Estonian banking landscape was dominated by a few large Scandinavian bank subsidiaries, resulting in a highly concentrated yet seemingly well-managed system (Spendzharova 2014). This high foreign-bank presence set Estonia apart from some other transition economies and was viewed as a strength of its banking system (World Bank 2000).

When the crisis struck, Estonia was relatively well-prepared. Evidence indicates that Estonia implemented some fundamental prudential instruments at an early stage (see Figure IV.1). By 1997, capital restrictions were established, with the *CAP Index* reaching 2.5 by the end of the year – an early indication of structural limitation. Authorities established legal restrictions on the lending capacity of banks to affiliated entities or individual clients (*IGE_limit* = 20, *SCE_limit* = 25), presumably as a reaction to the lessons learned during the 1998 crisis, and in preparation for EU admission. These regulations may have been intended to build confidence in investors and EU partners that Estonia offered the proper legal framework. While the *RW Index* shows little policy movement, the country maintained elevated mortgage risk weights since 1997 and implemented a strategic increase in 2006.⁵¹ On the other hand, liquidity tools (*LR_gen*) and sector-specific capital add-ons (*SMSE Index*) were left untouched. Similarly, the reserve requirement framework was not adjusted dynamically: *RR_base* had a minor increase in 1997 and subsequently remained stable. Overall, Estonia entered the GFC with fundamental regulations in place. Despite the absence of a comprehensive set of tools to counteract credit expansions or address escalating financial disparities, Estonia's structural policy stance appears conservative in design and cautious in its implementation over the 1997-2020 period. The analysed metrics present a consistent pattern, with a lightly rising trend following the 2008–09 crisis. This pattern reinforces the idea that Estonia adopted a “delegated” approach to financial stability, relying on the internal

⁵¹ Little policy movement is partly due to the composition of the indexes, which only reflect episodes of tightening and loosening.

governance of foreign-owned banks — especially Swedish parent companies — rather than building a robust domestic macroprudential toolkit (see Spendzharova 2014). Moreover, based on its crisis experience, the country advocated at the EU level for maintaining the ability of national regulators to impose stricter rules than those mandated by harmonised EU frameworks like CRD IV (Spendzharova 2014).

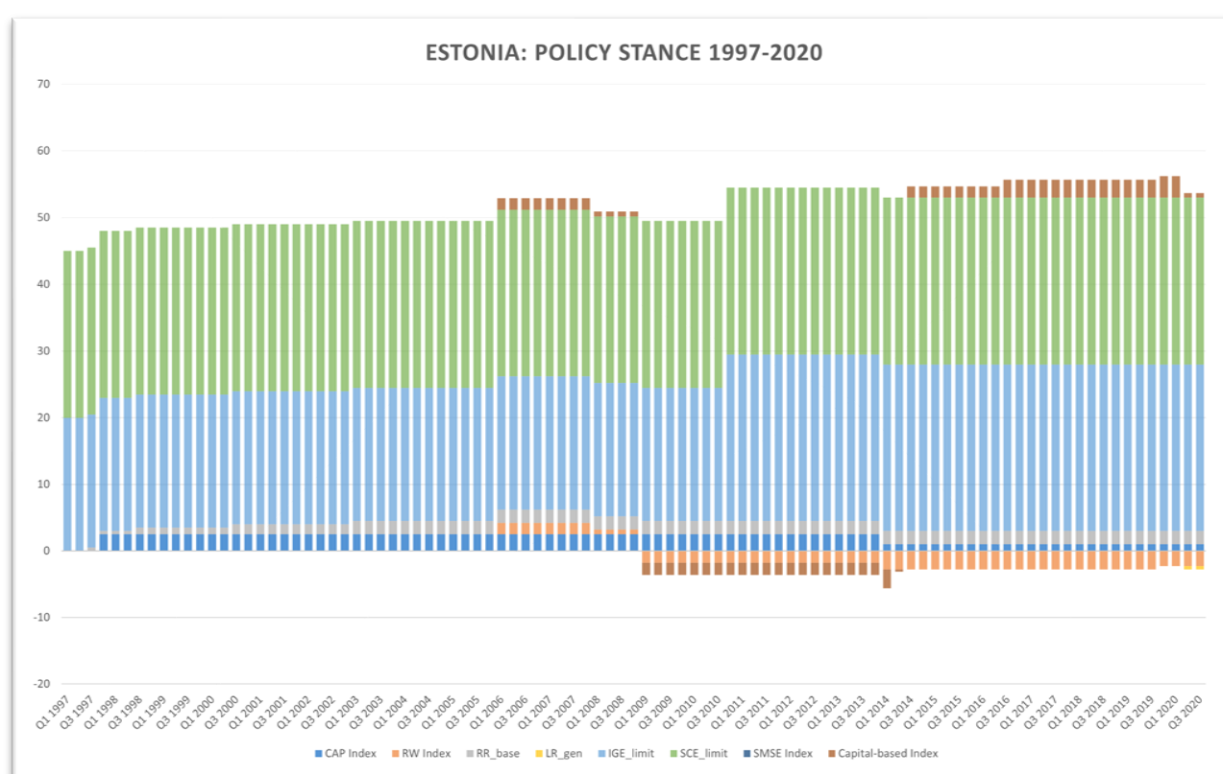


Figure IV.1

Latvia's banking sector was reshaped significantly by the wave of foreign penetration that characterised the late 1990s and early 2000s. Policymakers saw respectable international banks as a method to stabilise and modernise the industry after the 1995 crisis and especially after 1998 (Baudino et al. 2022). From about 1998 onward, Western European (especially Scandinavian) banks began acquiring Latvian banks: by end-1998, 15 of Latvia's 27 banks

were foreign-owned, and foreign-controlled banks held around 85% of total bank assets (World Bank 2000). Swedbank (via Hansabanka) and SEB purchased two of Latvia's main banks during that time. Other Nordic players including Norway's DNB, Finland's Nordea, and smaller German, Danish, and Russian banks entered (*ibidem*). An investigation assessment found that Scandinavians captured Latvia's mainstream lending and deposits in 1998 when SEB acquired Unibanka and Swedbank acquired Baltija's successor (OCCRP 2011). By the 2000s, just a few significant locally owned banks remained, including Parex Bank, which specialised on ex-Soviet clients (Baudino et al. 2022). Harmonisation with EU law anticipating the upcoming EU membership made operating in Latvia easier, and cross-border bank mergers increased consequently (*ibidem*). In the mid-2000s, Nordic banks including Swedbank, SEB, Nordea, and Danske (via Sampo) dominated Latvia's retail sector. The entrance of Scandinavian banks helped "clean up" Latvia's financial industry, and substantial foreign ownership improved monitoring and banking procedures (OCCRP 2011). During this time, conservative Nordic-owned banks served local customers, while smaller Latvian-owned banks focused on offshore deposit business (for Russian and CIS clientele) (Rupeika-Apoga et al. 2018). In the 2000s, Parex, ABLV, and Rietumu became major participants by drawing foreign deposits, a business strategy with problems that would emerge later. Despite the benefits brought by Scandinavian banks, the GFC exposed significant vulnerabilities in Latvia's banking system, which suffered one of the deepest recessions in the EU, with GDP falling by over 18% in 2009 (Spendzharova 2014).

Compared to Estonia, Latvia's pre-crisis structural configuration was relatively laxer. The country stands out for being the least active among the five economies under examination, with negligible net tightening (Eller et al. 2020). Despite the implementation of pertinent structural requirements (CAR and Tier 1) by authorities since 1997, subsequent years exhibited a slight loosening of these policies in the years immediately prior to the crisis, as evidenced by

the stable *CAP Index* (see Figure IV.2). Likewise, risk-weighting instruments (*RW Index*) have stayed unchanged during the initial transition years and subsequently relaxed. Despite the existence of exposure limitations (*SCE_limit* = 25, *IGE_limit* = 20), they remained static and did not include supplementary stabilising instruments. Similarly, liquidity-related tools (*LR_gen*), reserve requirements (*RR_base*), and the composition of capital requirements (*Capital-based Index*) were all relaxed. In summary, Latvia approached the GFC with a minimal macroprudential toolset. This was not solely due to policy inertia or a passive stance: it indicated a deliberate dependence on the perceived stability provided by foreign ownership and the eventual conformity with EU regulatory standards - as it was the case for Estonia. The banking system in Latvia was primarily controlled by Scandinavian parent banks, similarly to Estonia's situation, but missed comparable initial efforts to establish local protections.

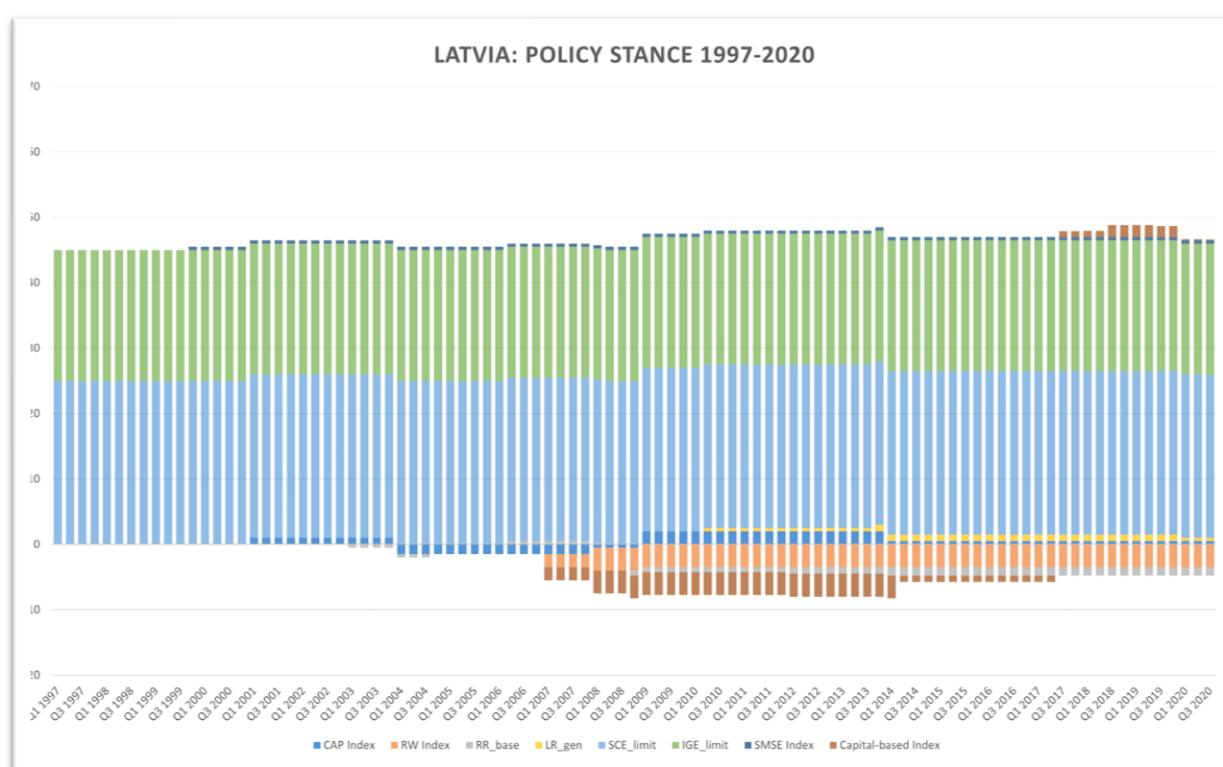


Figure IV.2

Foreign bank investment in Lithuania experienced a significant increase at the turn of the century. Bank foreign ownership surged after 1998, surpassing Estonia and Latvia in the mid-1990s (World Bank 2000). The government's privatisation of the main banks between 1999 and 2002 was crucial. The country sold Vilniaus Bankas, to Sweden's SEB in 1999, and soon after sold the second-largest, Hermis Bank, which was merged into SEB's operations (*ibidem*). In 2001, a consortium that included Estonia's Hansabank privatised the state's massive Lithuanian Savings Bank (Lietuvos taupomasis), which Swedbank later acquired (The Baltic Times 2001). Similarly to other Baltics, Swedish banks SEB and Swedbank dominated Lithuanian banking by the early 2000s thanks to these mergers. Snoras, a prominent bank with Russian shareholders, expanded quickly in the 2000s, while Ūkio Bankas, owned by a local businessman, eventually became troublesome (LRT News 2020; Reuters 2011). Overall, foreign strategic investors from Scandinavia (and to a lesser extent Germany and Poland) gained majority stakes in most of Lithuania's banking assets by the mid-2000s (Spendzharova 2014). EU accession in 2004 further cemented this trend: like the other Baltics, the expectation of uniform EU regulation and Lithuania's fast-growing credit market made it very attractive for European banks (Baudino et al. 2022). Scandinavian banks – already present – deepened their commitment and brought in know-how and funding. By the late 2000s, roughly 90% of Lithuania's banking sector was foreign-owned, chiefly by four Nordic banking groups (SEB, Swedbank, DNB/Nordea, Danske) which operated through locally incorporated subsidiaries or branches (Spendzharova 2014). The prevalence of foreign ownership was seen as a stabilising factor and helped integrate Lithuania's financial system with European markets: in the 2005-2008 boom, international parent banks offered cheap capital to their Lithuanian units, enabling tremendous credit growth (Baudino et al. 2022). However, when the cycle turned, Lithuania

faced a sudden suspension of capital inflows, as the country was heavily dependent on the strategies and liquidity decisions of foreign parent institutions (Spendzharova 2014).

Despite an early and sizeable privatisation of domestic banks to foreign strategic investors, Lithuania's pre-crisis prudential framework remained somewhat modest. Numerous fundamental prudential instruments had been established during the transition years and before the GFC, such as capital requirements, reserve ratios, and basic risk weights. Nonetheless, they remained unchanged throughout the 2000s (see Figure IV.3). The *CAP Index* did not begin to rise until 2009; similarly, risk weights were applied at a flat 100% from the late 1990s, and both local- and foreign-currency reserve requirements were set at 10%. Yet the corresponding *RW Index* and *RR_base* indicators show no movement — reflecting a broader lack of policy adjustment. Moreover, liquidity tools (*LR_gen*) made only a brief appearance in 1999, without subsequent developments. Sectoral capital requirements (*SMSE Index*) and dynamic exposure rules remained substantially at zero. The exposure limits were raised and static (*SCE_limit* = 30, *IGE_limit* = 30), indicating that Lithuania approached the global financial crisis with a technically effective yet politically passive regulatory framework. Although this static posture is particularly striking given the country's reliance on foreign credit during the boom years, the same argument is applicable to all the Baltics: cheap capital from Scandinavian parent banks enabled aggressive credit expansion and reliance on parent banks prudential strategies.

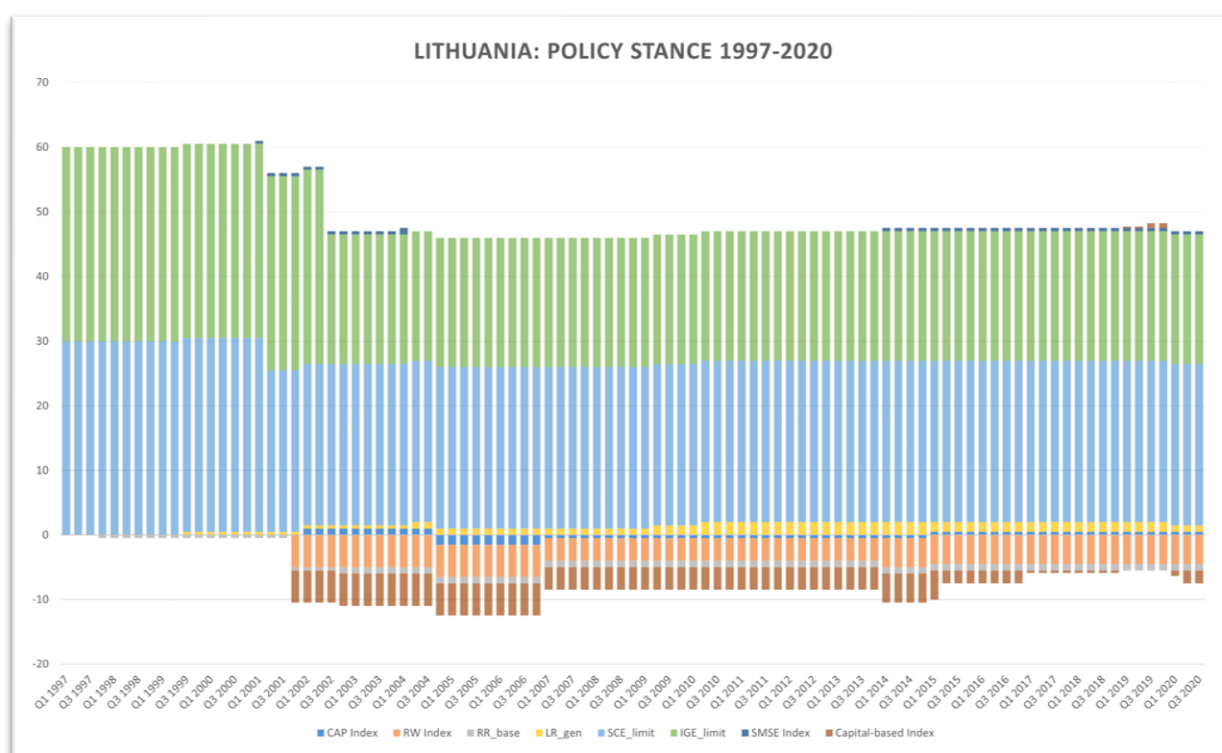


Figure IV.3

Slovakia began aggressive bank privatisation in the early 2000s after clearing its balance sheets through recapitalisation under WB and IMF supervision (Epstein 2017). The strategy encouraged by the two IOs was to bring in respectable foreign banks as owners to ensure better corporate governance and to prevent a recurrence of political lending. In 2001, the government sold SLSP mostly to the Austrian Erste Bank and VÚB to the Italian Intesa Sanpaolo (*ibidem*). By the end of that year, foreign investors controlled a dominant proportion of Slovak banks' total assets and equity – effectively taking over the sector. In early 2002, the third large bank, Investičná a rozvojová banka (IRB), was acquired by Hungary's OTP Bank. Additionally, Austria's Raiffeisen founded Tatra Banka in the 1990s, while Germany's HVB founded a bank that later merged. (*ibidem*). The figures by 2002 were striking, especially when Slovakia's late kick-off is considered: roughly 85-90% of Slovak banking assets were in foreign hands

(Šestáková and Ferenčíková 2015). Foreign owners contributed know-how, enhanced risk management, and restored worldwide confidence in Slovakia's banks; by the mid-2000s, Slovak banks were reporting healthy profits and manageable levels of bad loans, a far cry from the late 90s (World Bank 2002). The European Union accession in 2004 further reinforced stability, as Slovak banks started operating under EU banking directives and supervision standards (Epstein 2017). In 2009, Slovakia adopted the euro, eliminating currency risk and further integrating its banking system with the Eurozone – thereby accessing liquidity support and crisis mechanisms (*ibidem*). However, with nearly all major banks owned by foreign entities, Slovakia became dependent on the health and strategies of parent banks in Austria, Italy, or Hungary (*ibidem*). However, Contrary to the other case-studies, the GFC did not produce a systemic banking crisis in Slovakia, partly owing to the deep restructuring the system had undergone (Epstein 2017).

Slovak authorities implemented a variety of fundamental prudential instruments well before the GFC. The raw data shows the robustness of the initial framework. In 1997, capital requirements were set at 8%, and in 2001, they increased to 10%. By 2000, Tier 1 capital had risen from 0% to 4%, while reserve requirements for local and foreign currency were gradually reduced – from 9% in 1997 to 6.5% by 2000. Liquidity tools (*LR_gen*) appeared from the first quarter of 2000, with a weight of 0.5, while risk weights on mortgage lending were set at 50% and remained unchanged throughout the pre-crisis years (see Figure IV.4). These tools show that Slovakia entered the GFC with a reasonably well-developed regulatory base. However, as shown in Figure IV.4, most indexes — *CAP Index*, *RW Index*, *RR_base*, *SMSE Index* — remained flat before 2009. This corroborates a trend observed in the Baltics: instruments were available, yet no discretionary modifications were implemented in reaction to the boom cycle.

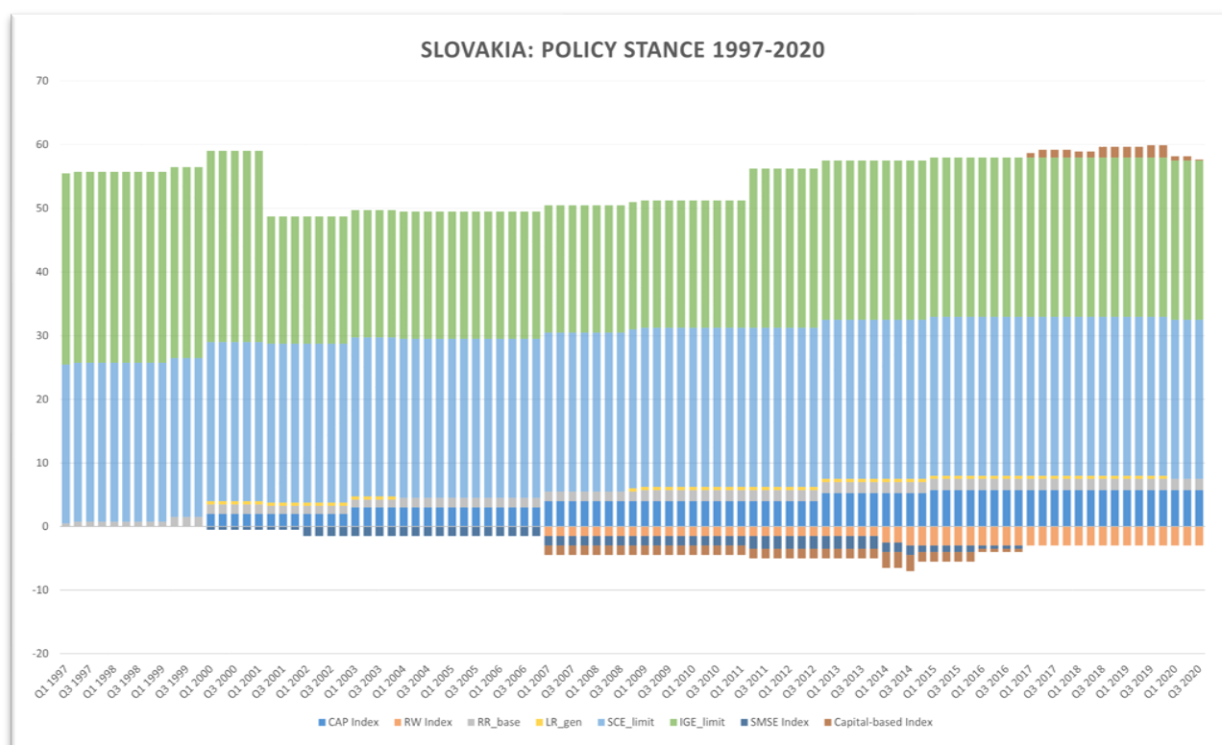


Figure IV.4

Slovenian banking system did not receive significant amounts of foreign capital until much later than other Eurozone small hosts. Actual marketisation occurred only after 2013 – notably through the post-GFC restructuring (see Piroška and Podvršič 2020 for a comprehensive account). Prior to 2013, the two largest banks (NLB and NKBM) were majority state-owned and the third (Abanka) was also locally controlled; while foreign banks held only smaller franchises.⁵² The situation changed dramatically in the aftermath of Slovenia's 2012–2013 banking crisis (see next Section). Under EU pressure, Slovenia agreed to privatise or deeply restructure its banks as a condition for approving state aid (Piroška and Podvršič 2020). Between 2014 and 2016, NKBM was sold to foreign investors: specifically, in 2016 the

⁵² In July 2001, Slovenian Minister of Finance encouraged major financial organizations to show interest in banks, leading to Belgian KBC's offer to buy 34% of NLB shares. However, only six institutions responded, with three meeting the minimum standards. In October 2001, the Minister of Finance deemed the offers too low and suggested boosting negotiations: privatization was delayed [INTERVIEW MRAK].

government sold NKBM to a U.S. private equity fund (Apollo Global) and the EBRD (*ibidem*). Likewise, Abanka was merged and later sold (in 2019, Abanka was also acquired by Apollo, which merged it into NKBM) [INTERVIEW GOLE]. Due to its systemic importance, the state recapitalised NLB, although the EU compelled Slovenia to lower its holding. Slovenia traded NLB on the public market in 2018-2019, selling 65% to a wide range of international investors, including foreign institutional investors (Piroska and Podvršič 2020). Thus, by 2019, Slovenia had finally opened the door to significant foreign ownership: NLB became majority privately (and largely foreign) owned, and NKBM and Abanka were 100% foreign-owned. Additionally, a few foreign banks had increasingly operated in the country since earlier: for instance, UniCredit of Italy and Intesa (through its subsidiary Banka Koper) had steady market shares around 5–7% each, and French-owned SKB had around 10% market share [INTERVIEW MP OFFICIAL FROM CENTRAL BANK SLOVAKIA 28/11/2023]. These players provided some competition even when NLB and NKBM were state-run (*ibidem*). Some observers note that, had Slovenia allowed more foreign investment earlier, it might have avoided some of the governance problems that led to the crisis (OECD 2013). Others note that the Slovenian case exemplifies a wider trend inside the EU, whereby financial governance transitioned from democratic oversight to technocratic management in response to crisis conditions (Piroska and Podvršič 2020).

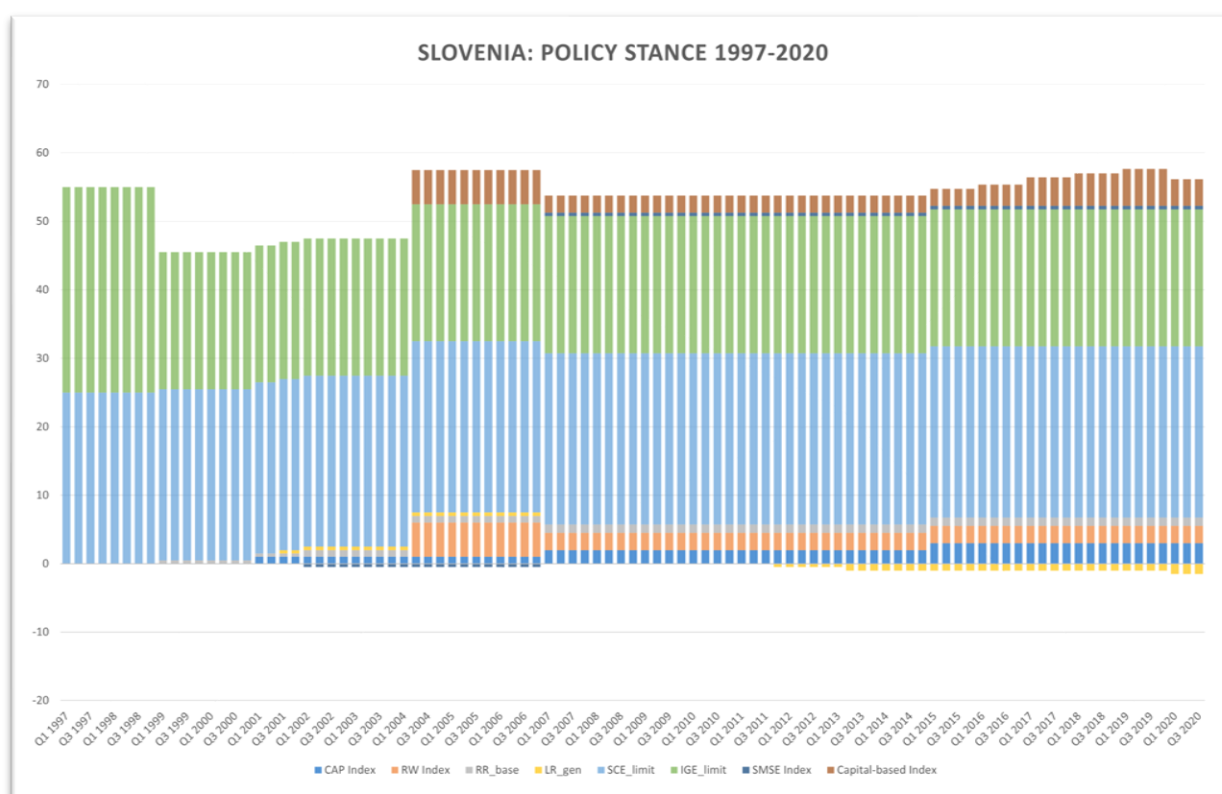


Figure IV.5

Slovenia implemented various structural prudential instruments before to 2009, although their tightening/loosening was limited, resulting in their absence from cumulative indices until the late 2000s. As early as 1997, the country applied capital adequacy rules (8%), reserve requirements (12%), and risk-weighted capital ratios tailored to domestic circumstances. These measures were not intensified during the economic boom, yet their existence evidences the presence of a fundamental regulatory framework. Nonetheless, this approach demonstrated inadequacy. Structural tools remained substantially flat, and no significant tightening occurred throughout the credit boom of the 2000s (see Figure IV.5). The RW Index and CAP Index remained flat after an initial increase, reflecting a somewhat static regulatory posture. At the same time, domestic loan classification standards were weak, and banks were under-provisioned for bad debt (Epstein 2017).

FOLTF Banks Before and After the GFC

Under foreign ownership, Estonia's banking sector enjoyed a period of stability throughout the 2000s, but it was not immune to external shocks. A substantial loan expansion, financed by parent-bank capital, resulted in an overheated economy by the mid-2000s (Spendzharova 2014). During the GFC, Estonia experienced one of the most severe recessions worldwide. Nonetheless, its banks showed resilience. No significant commercial bank failures occurred in Estonia during the 2008 crisis, mostly due to the support provided by Nordic parent banks for the liquidity and capital requirements of their Estonian subsidiaries (R. A. Epstein 2017). As noted in the previous section (see also Figure IV.1), the Bank of Estonia implemented precautionary measures, including elevated risk weights on home loans and substantial reserve requirements, to mitigate the credit boom in the years preceding the crisis (Baudino et al. 2022). These buffers were beneficial: in contrast to neighbouring Latvia, Estonia did not require any state bailouts for banks during the GFC, and its foreign-owned banks addressed liquidity deficiencies with assistance from parent institutions rather than local taxpayers (Baudino et al. 2022; Epstein 2017). In the decade ensuing the crisis, Estonia maintained a sound banking sector, as confirmed by its policy stance (see Figure IV.6): the CAR rose steadily from 24% in 2012 to a peak of 36% by 2016, before gradually declining to 27.5% by 2019. These buffers well above EU minimums were not the result of new macroprudential tools, but rather of capital accumulation at the group level. A similar trend is observed in the leverage ratio and confirmed by the declining share of NPLs. The former remained exceptionally solid during the same period, reaching over 18% in 2014 before declining to around 11% by 2022 (see Figure IV.7). Non-performing loans registered a steady decline from 2.8% in 2015 to below 1% by 2022 (see Figure IV.8).

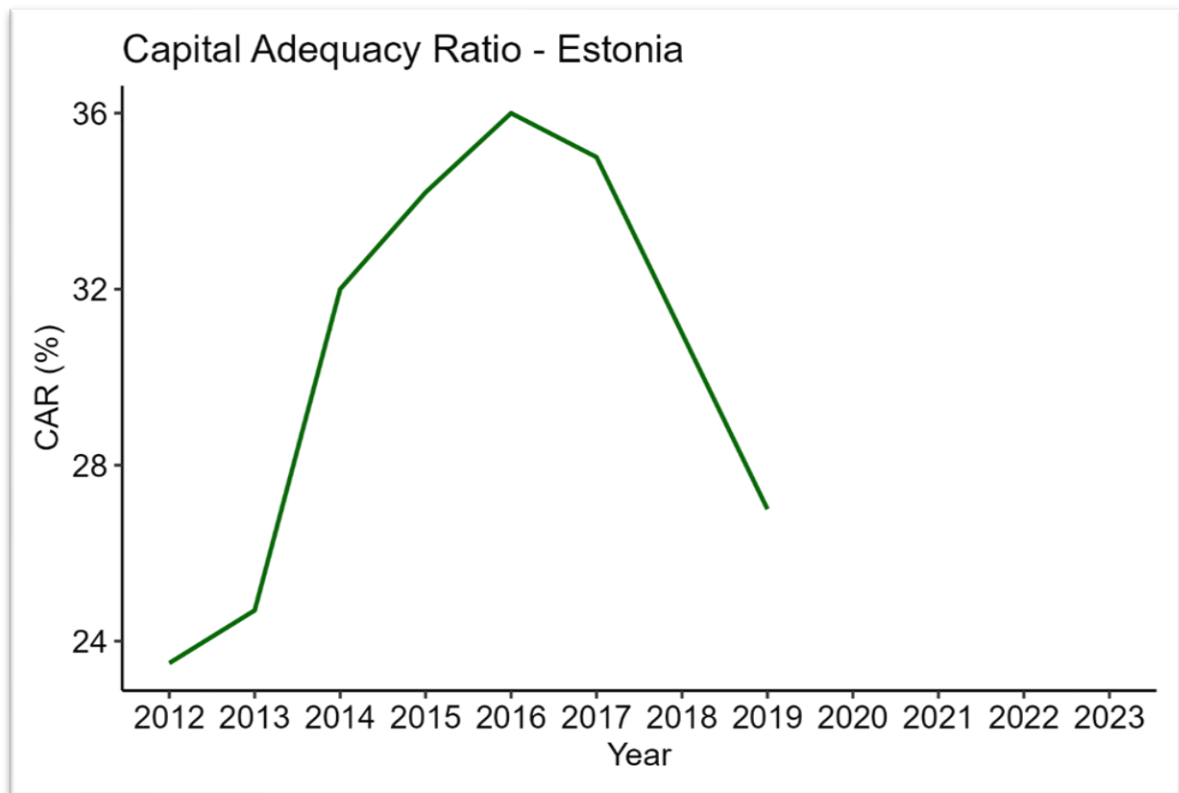


Figure IV.6

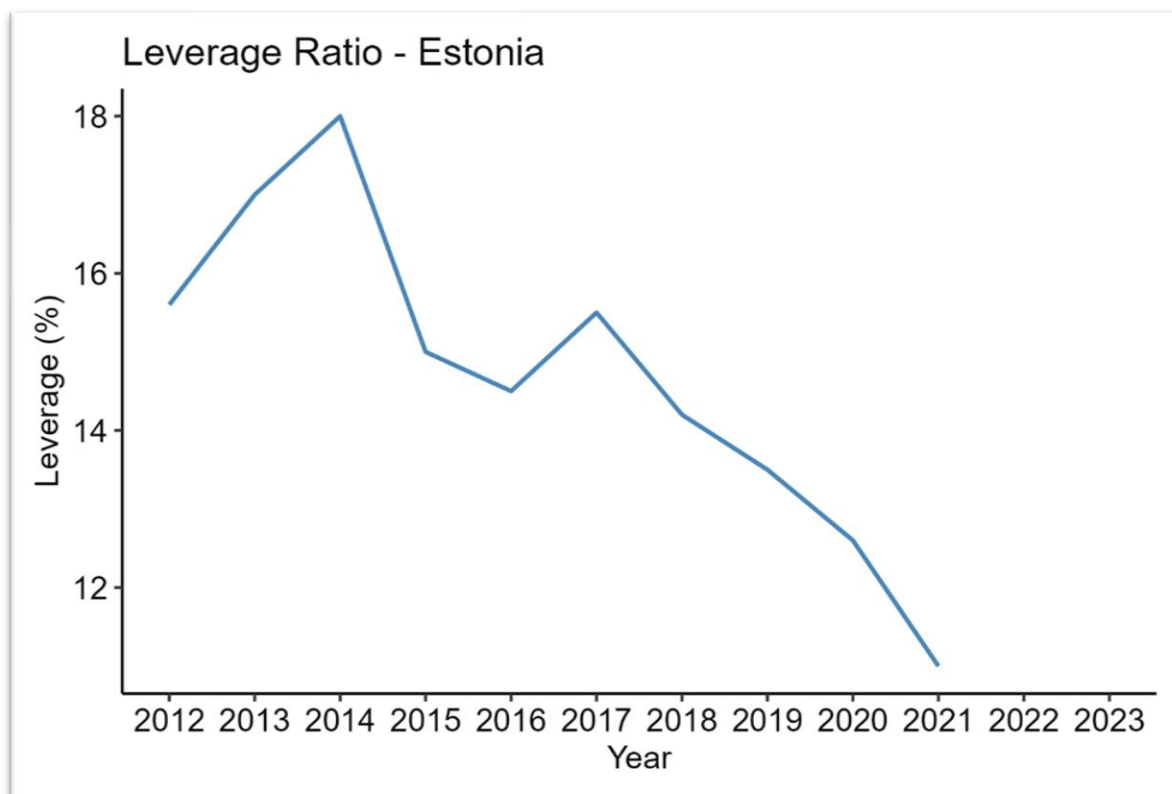


Figure IV.7

These trends suggest that, despite a static regulatory stance, Estonia’s banking system enjoyed high levels of resilience resulting from foreign banks’ consolidated balance sheets – and partly due to those banks’ business models (Dal Maso 2022; R. A. Epstein 2014). The only challenges the banking industry had to face emerged in the form of money-laundering scandals. In 2018, the European Central Bank revoked the license of Versobank – a small bank – citing “serious and long-lasting” violations of anti-money-laundering regulations (Reuters 2018). The closure of Versobank, characterised by its predominantly non-resident clientele, exemplified the Estonian regulators’ strict stance against illicit finance, without posing a risk to overall stability. Another high-profile event was the Danske Bank scandal, which involved a massive money-laundering scandal at the Estonian branch of Denmark’s Danske Bank and ultimately resulted in the branch’s closure in 2019 – although this was more of a compliance failure than an

insolvency issue (Bjerregaard and Kirchmaier 2019). Aside from these episodes, Estonia's commercial banks remained robust and profitable throughout the entire observation period.

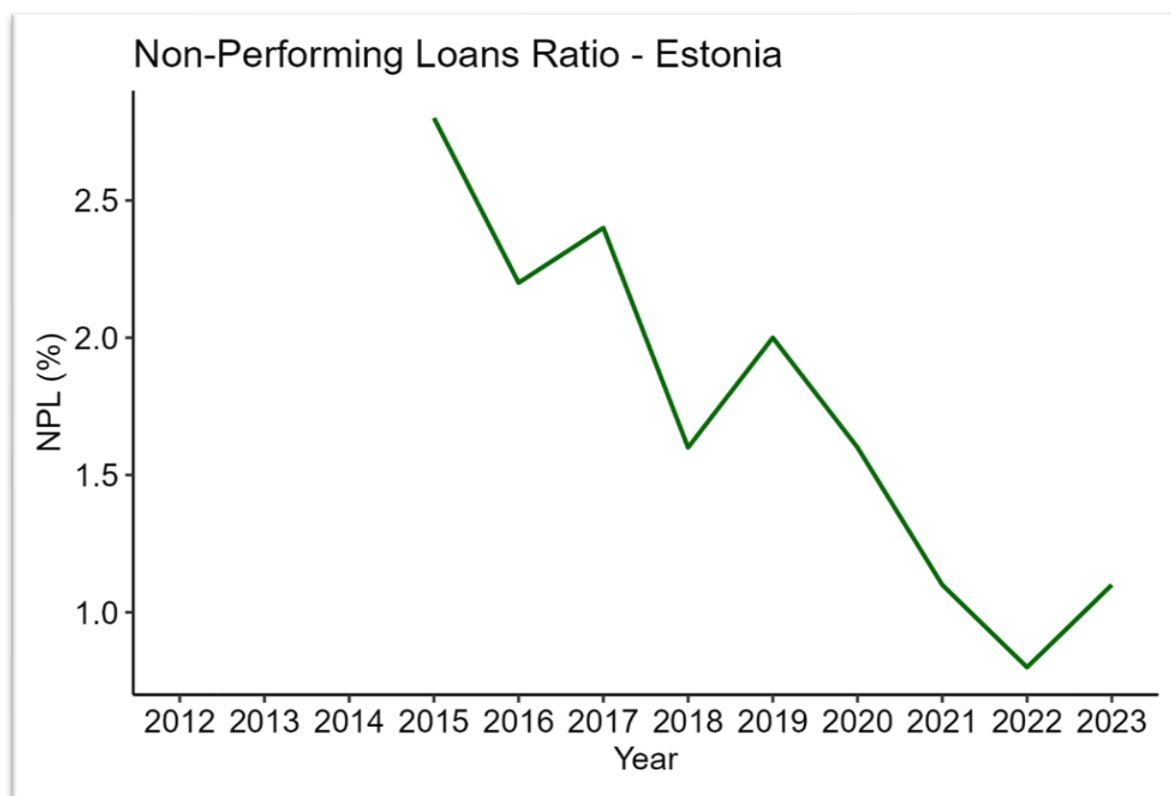


Figure IV.8

On the contrary, Latvia suffered severe banking failures in the 2000s, likely reflecting the consequences of limited domestic prudential oversight combined with an overreliance on non-resident funding and foreign banks' capital. The latter did not pull out during the crisis, but Swedbank and SEB underwent recapitalisation and restructuring (Dal Maso 2022). However, it was the bankruptcy of Parex Bank in 2008 that marked a watershed moment. As the second-largest Latvian bank, Parex had grown rapidly in the boom years but faced a run on deposits in late 2008 (Epstein 2017). As global credit tightened, depositors (many of them foreign) pulled out funds; Parex lost over a quarter of its deposits in a matter of weeks (IMF 2008). The bank

was left severely illiquid and on the brink of default, prompting the government to step in. In November 2008, the Latvian state nationalised Parex Bank to prevent its outright failure (*ibidem*). This intervention – the first major bank nationalisation in independent Latvia – triggered a broader financial crisis. In fact, the collapse of Parex was the primary reason Latvia had to seek an IMF/EU bailout at the end of 2008 (*ibidem*). The government’s initial partial takeover of Parex (buying 51% from its private owners) was not enough to restore confidence but it was necessary amid fears of financial contagion (Epstein 2017). Eventually, the government assumed nearly complete ownership and guarantee of the bank’s liabilities. The consequences were terrific: Latvia’s economy declined by approximately 18% in 2009, and the banking sector shrunk as foreign loan inflows unexpectedly ceased (Bakker and Klingen 2012). With the help of international funds, Parex was restructured, dividing it into a “good bank” – Citadele Bank, which was later sold to private investors – and an asset recovery bad bank (Bakker and Klingen 2012; Epstein 2017).

The Parex crisis revealed the fragility of banks that rely on wholesale and non-resident funding. Moreover, the policy stance before the crisis had not provided sufficient buffers (see previous section). Although core tools such as capital requirements and exposure limits were present from the early 2000s, there were no effective tightening actions – while some indexes, such as *CAP*, *Capital-based*, *RW*, *RR*, even show policy loosening (see Figure IV.2). These choices generally suggest limited risk sensitivity in regulatory design, perhaps due to political reluctance or the belief that EU harmonisation and foreign ownership provided enough protection. Although the Nordic-owned banks in Latvia remained solvent throughout this turmoil thanks to their parent banks, Latvia’s troubles did not end there. Additional bank failures occurred in the early 2010s, with the majority affecting banks that served overseas depositors. In late 2011, Latvijas Krājbanka, one of Latvia’s largest locally held banks, failed alongside its Lithuanian parent bank, Snoras. Krājbanka was shut down by regulators because

to its parent's dishonesty, resulting in huge losses for deposit insurance funds. Latvia and Lithuania discovered a major fraud scheme orchestrated by the Russian owners of Snora and Krājbanka, which cost taxpayers hundreds of millions of euros (The Baltic Times 2012). In the following years, Latvia's increased monitoring of banks handling non-resident money led to the 2018 failure of ABLV Bank, the country's third-largest bank. The US Treasury accused ABLV of money laundering, leading to a flight of depositors and a liquidity crisis. The European Central Bank declared ABLV "failing or likely to fail" (ECB 2018). The bank was liquidated under Latvian law, as it was deemed non-systemic – since its failure was not a threat to overall financial stability (*ibidem*).

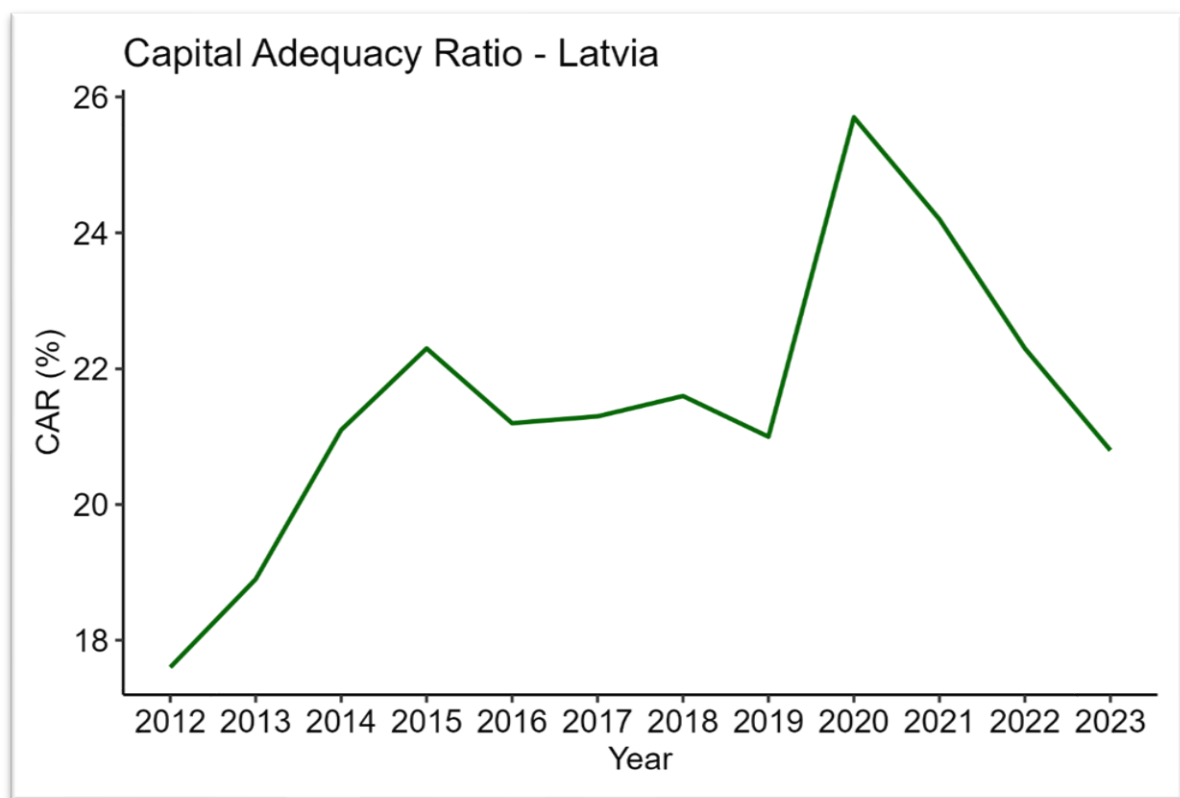


Figure IV.9

In essence, Latvia's banking evolution has been marked by significant shifts, from excesses in the 1990s to a stable boom in the mid-2000s, and the 2008-09 crisis. In 2019, the sector was smaller and more conservative, with foreign banks dominating retail markets but a decrease in high-risk non-resident banking due to regulatory pressure. The lessons of Banka Baltija (see Section: Early Transition and Privatisation) and Parex have enhanced the regulatory system, but governance concerns remained until recently. The post-GFC regulations and measures have likely put Latvia's banking sector on a firmer path, enhancing transparency and compliance with EU standards, bringing it closer to a more traditional European banking environment [INTERVIEW JG]. The CAR rose from 17.5% in 2012 to nearly 26% by 2020, despite some fluctuation afterward (see Figure IV.9), while non-performing loans declined steadily from 8.6% in 2012 to under 2.5% by 2022 (Figure IV.10) – indicating improved portfolio quality after painful restructuring and stricter compliance measures.

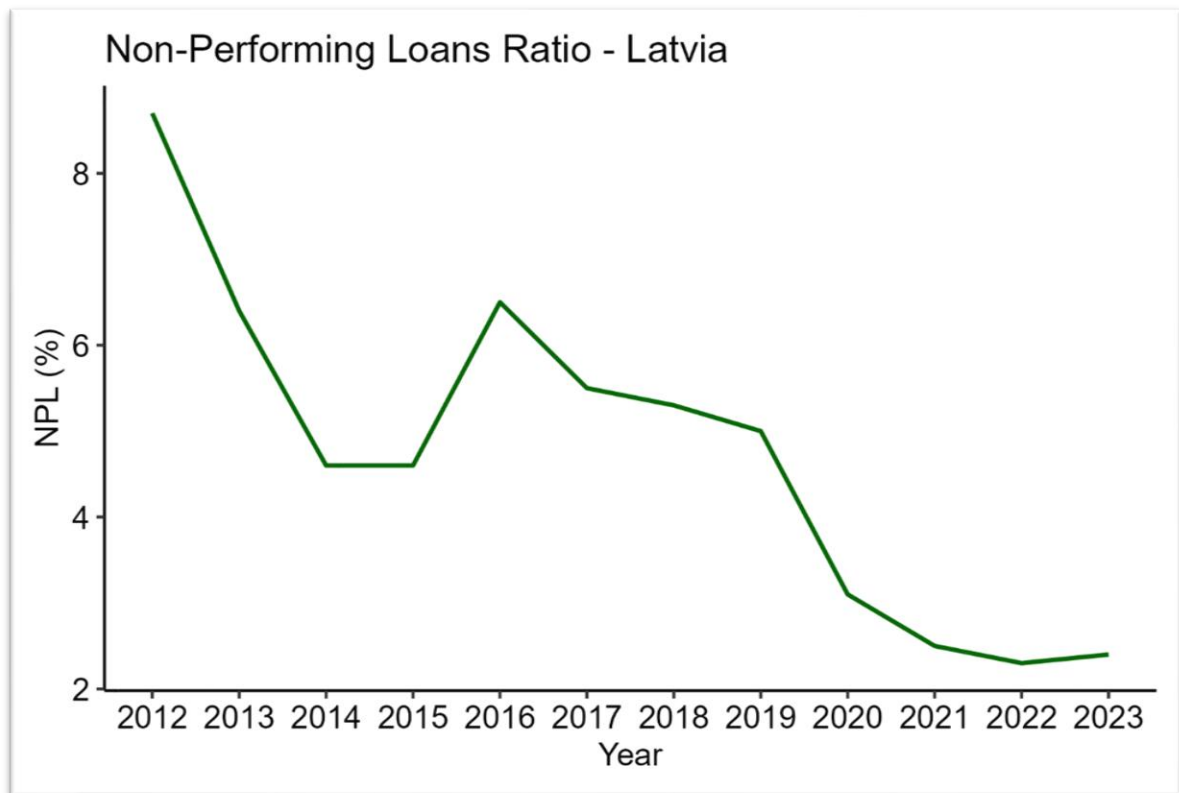


Figure IV.10

In the 2000s, Lithuania managed to avoid any major banking crisis. To be clear, the 2008-2009 recession hit the economy hard (GDP dropped around 15% in 2009), but the core Swedish-owned banks, despite the losses, did not fail. They benefited from support by parent institutions and some regulatory forbearance on loan losses (Baudino et al. 2022). Consequently, unlike some neighbours, Lithuania did not need to nationalise or bail out its largest banks during the GFC. The real problems began in the early 2010s, when banks remained in domestic hands with weaker governance. The first case was Bankas Snoras, Lithuania's fifth largest bank, which dramatically failed in late 2011. An audit and investigation revealed that Snoras's owners had engaged in massive fraud – concealing assets and siphoning off funds overseas (The Baltic Times 2012). In November 2011, the Central Bank of Lithuania seized Snoras, suspended its operations, and shortly thereafter the bank was declared insolvent and put into bankruptcy

(Bakker and Klingen 2012). To prevent additional damage, the government nationalised Snoras (expropriating its shares), but it quickly became evident that the bank's assets were mostly missing or involved in fraudulent operations (*ibidem*). As clarified earlier with regard to Latvia, the case of Snoras – and its Latvian subsidiary Latvijas Krājbanka – was a huge scandal that cost depositors and creditors hundreds of millions of euros borne by taxpayers. The episode severely shook public confidence, but it was not the only one. In early 2013, Ūkio Bankas – another domestically-owned bank – was found to be critically undercapitalised and involved in risky insider lending (Lietuvos Bankas 2013). In February 2013, the central bank terminated Ūkio Bankas' operations due to “harmful actions” by shareholders, false accounting, and violations of prudential requirements (*ibidem*). Ūkio was deemed insolvent and the authorities opted to revoke its license and transfer some assets/deposits to another bank – Šiaulių Bankas (Bloomberg 2013). Criminal investigations later revealed that Ūkio's owner had embezzled at least 40 million Euros from the bank, using the money to finance overseas business endeavors (LRT News 2020).

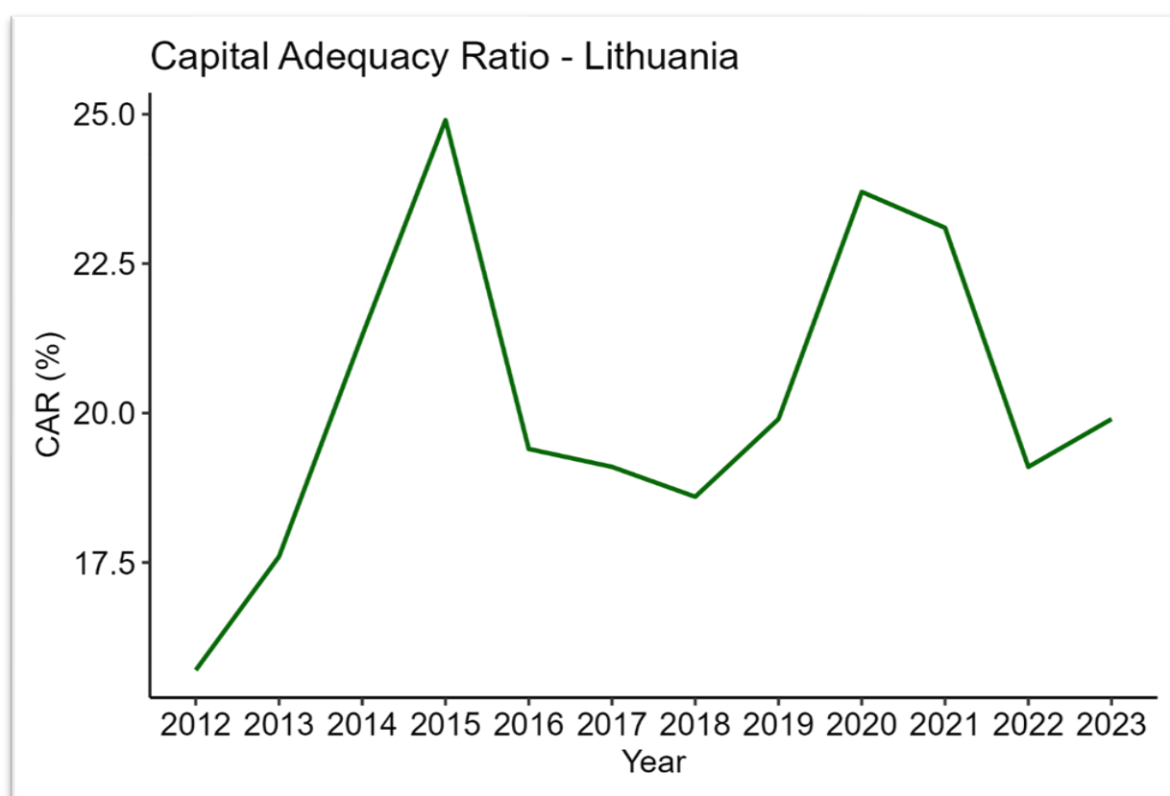


Figure IV.11

Snoras and Ūkio's collapses in 2011-2013 exposed oversight issues in locally run banks. In both cases, the authorities responded promptly, replacing management and reducing depositor losses by selling good assets or activating deposit insurance. Similarly to the pattern in other Baltics, foreign-owned banks remained robust thanks to parent banks' balance sheets, while locally controlled banks were prone to governance failures and abuse. These failures also prompted a cleanup of the sector: by 2015, Lithuania had fewer banks, and the ones remaining were predominantly foreign-owned or much more stringently supervised. Importantly, the state did not incur direct costs for bank bailouts in 2008-09 – except for covering the insured deposits for Snoras and Ukio. Aside from those cases, Lithuania's banking sector fared quite well in the years following 2008 – as reflected in the data. Despite the irregular CAR trend, overall levels are well above the regulatory minimum and registered a reassuring increase from around

16% in 2012 to nearly 25% by 2015 (see Figure IV.11). In addition, the sector has witnessed a surge in liquidity levels in the aftermath of the GFC - peaking above 450% in 2021! (see Figure IV.12) – which might support credit availability and reduce borrowing costs in the upcoming future – reverting the current negative trend of credit growth (see Chapter III) [INTERVIEW MP OFFICIAL FROM CENTRAL BANK LITHUANIA 26/12/2024].

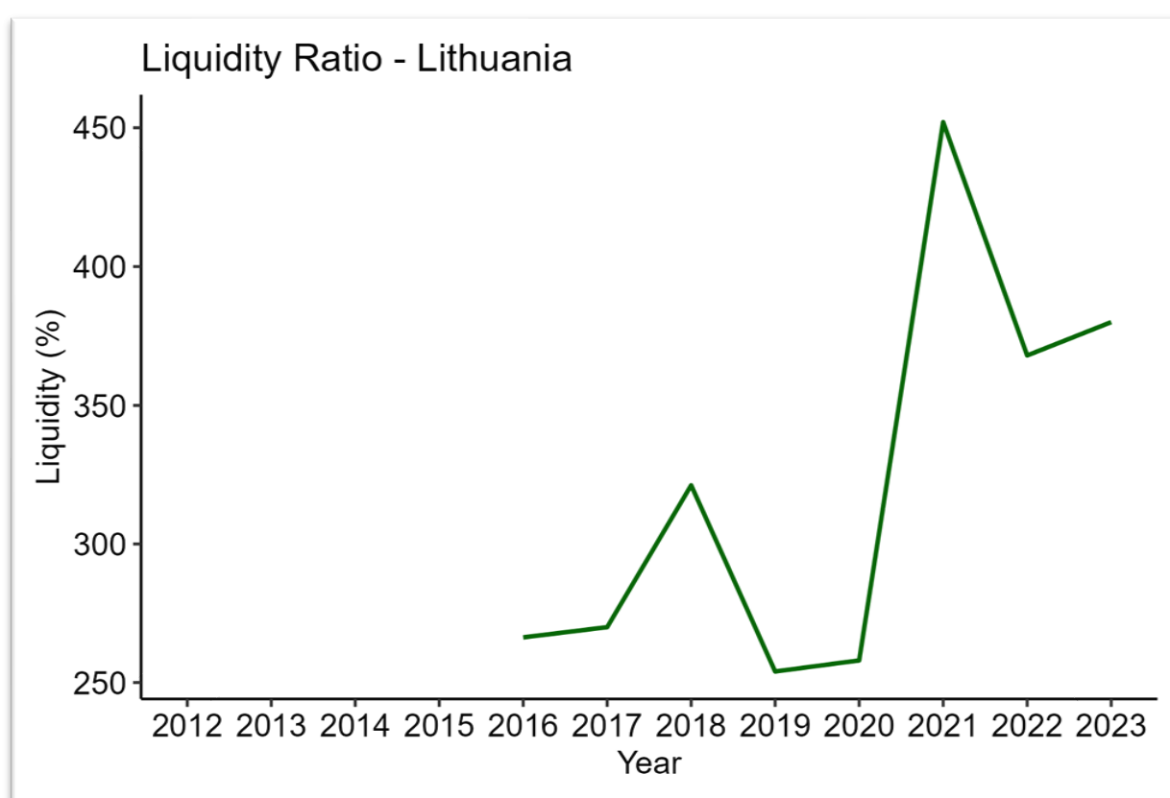


Figure IV.12

Slovakia avoided major bank collapses in the 2000s and 2010s as a result of the policies and reforms mentioned in the previous sections. That path made the country a success story in banking transition and resilience (R. A. Epstein 2014; 2017; Spendzharova 2014b; 2014a). In the early 2000s, weak banks were promptly resolved, including Devín Banka in 2001 and tiny banks like Slovenská Kreditná and AG Banka about 2000 (World Bank 2004). Once foreign

ownership dominated the sector, this became profitable and well-capitalised. In fact, following the 2000-2002 privatisations, confidence in the Slovak banking system was completely restored: deposit growth were resumed, and interest margins fell to levels typical of developed economies (OeNB 2002). Additionally, key banking indicators improved significantly: by 2003, NPL ratios dropped sharply once the problematic assets were cleaned (*ibidem*). The GFC was handled relatively well by Slovak banks. Although Slovakia's economy fell into recession in 2009, its banks remained solvent and did not require any public capital support.⁵³ Among the factors contributing to this outcome, since most loans were already in Euros, Slovakia avoided currency mismatches and capital flight (Mérő and Piroška 2017). Moreover, the commitment of Western parent banks to what is defined the “second home market” played a crucial role (R. A. Epstein 2014).

⁵³ More recently, as part of EU sanctions, the local subsidiary of Russia's Sberbank was wound down in 2022 (Reuters 2022).

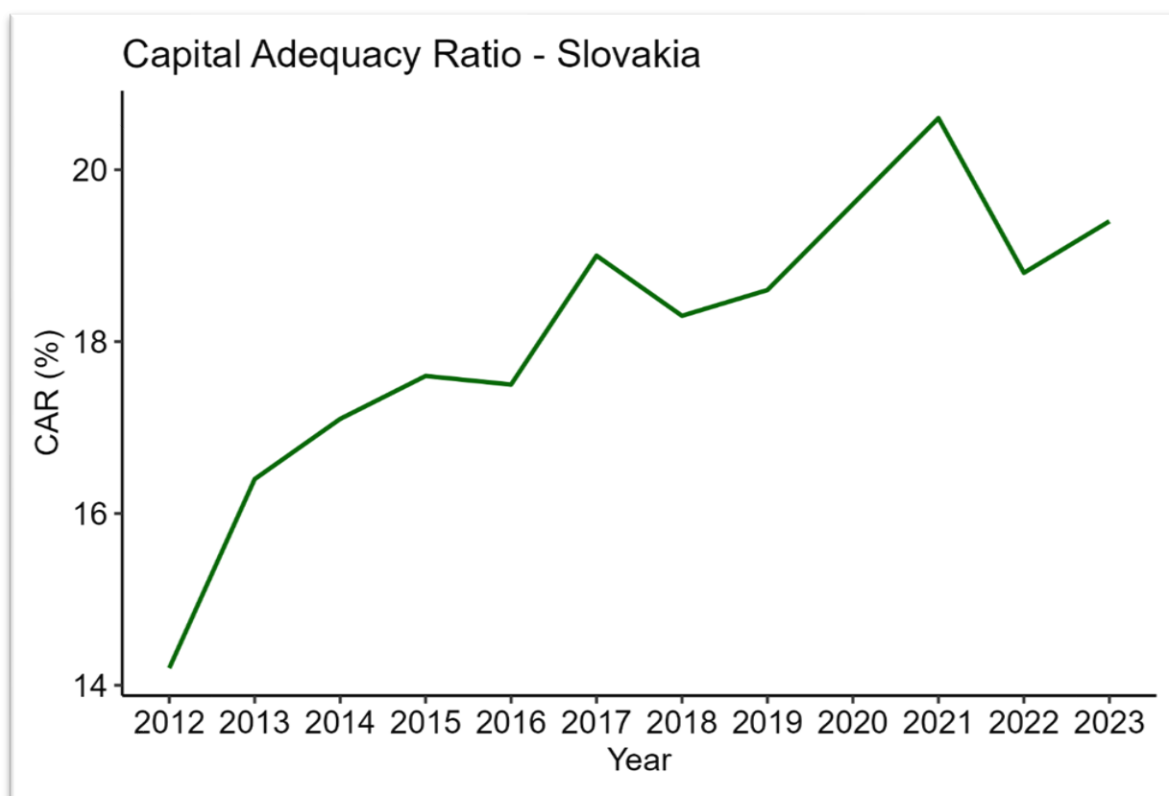


Figure IV.13

Thus, unlike in some neighbouring countries, from 2000 through 2019 no Slovak commercial bank failed, and no extraordinary rescue operations were needed – a result largely credited to the thorough restructuring and foreign ownership established in the early 2000s. In fact, by the 2010s the biggest banks in Slovakia (such as Slovenská sporiteľňa, VÚB, and Tatra Banka) were consistently among the safest in Central Europe, with solid capital buffers and parent support. This stability implies some cost for the government early on – with bank restructuring estimated around 12% of GDP (World Bank 2004). Fortunately, the result was a banking sector that could sustain credit for the growing Slovak economy (*ibidem*) and weather instability in the upcoming years. As from 2014, the major concerns in Slovak banking were more about using MP policy control the rapid expansion of loans and the emergence of an asset-price

bubble in the housing market (Piroska et al. 2021) – and less about bank solvency or ownership issues. In conclusion, Slovakia’s banking evolution illustrates a case of successful post-socialist bank reform and long-term financial stability. This is also visible in data: capital adequacy exhibited the most consistent increase from 2012, going from approximately 14% to over 20% by 2021 (see Figure IV.13). Notably, the leverage ratio remained consistently between 7.5% and 8.5% (see Figure IV.14), indicating a stable capital base during the post-GFC period.

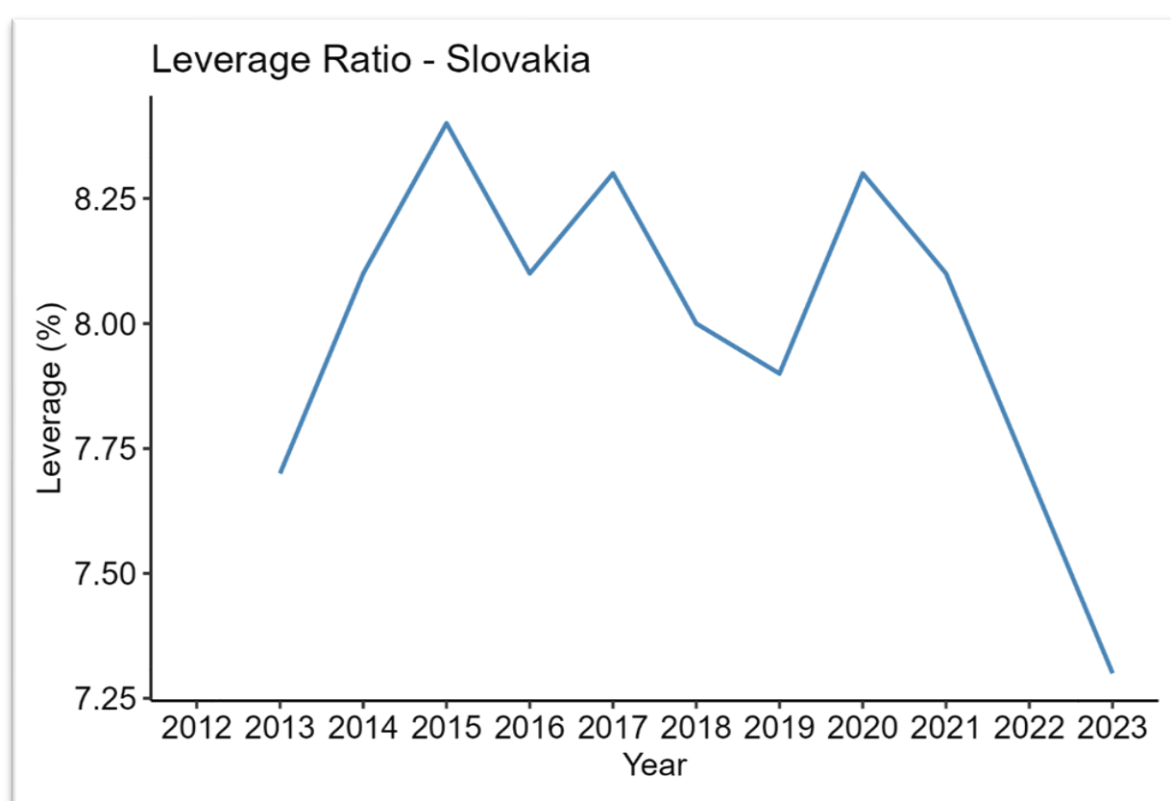


Figure IV.14

Slovenia’s most serious banking crisis occurred relatively late – several years after the GFC – and it proved to be one of the country’s worst economic challenges since independence. During the 2004-2008 boom, Slovenian banks (particularly NLB, NKBM, and Abanka) expanded lending significantly, with the largest share going to big Slovenian corporations and real estate

developments (Mrak et al. 2013). Loan losses increased in 2009 when Slovenia's economy entered crisis, but perpetual renewal and denial concealed them (*ibidem*). Banks were in danger by 2012, as NPLs rose to 15% of total loans and capital deteriorated (see Figure IV.15). Investors doubted Slovenia could save its banks in 2013, threatening an international bailout; the government chose domestic solutions (Mrak et al. 2013). After extensive asset quality checks, the government recapitalised the three largest banks using substantial public funding in December 2013. The Central Bank governor announced that stress tests revealed a capital shortage of around €4.8 billion in the system, of which the state would provide about €3.0 billion to NLB, NKBM, and Abanka (Deutsche Welle 2013). This amount represented nearly 10% of Slovenia's GDP, indicating that the state needed to effectively rescue its banks to prevent collapse (Piroska and Podvršič 2020).

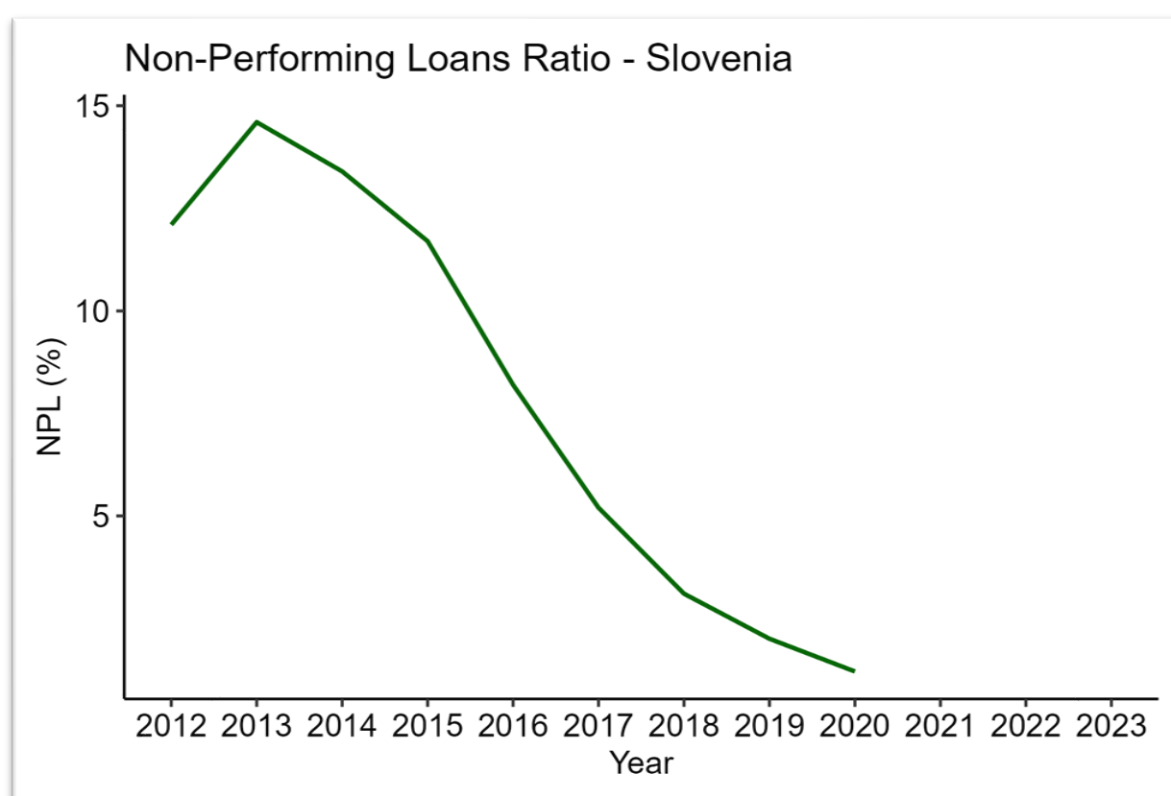


Figure IV.15

To tackle these challenges, Slovenia created a “bad bank” known as the Bank Asset Management Company (*ibidem*). Furthermore, two smaller institutions, Factor banka and Probanka, were considered unrecoverable and mandated to cease operations in 2013 (Reuters 2013). The EU authorised state aid for the organised liquidation of Factor and Probanka, protecting insured depositors and transferring losses to shareholders and junior creditors (*ibidem*). Slovenia experienced its first complete bank collapses in decades – although their impact was minimal due to the banks’ small size. In December 2013, the European Commission approved Slovenia’s bank rescue plan, endorsing the recapitalisation of NLB and NKBM (Piroska and Podvršič 2020). Abanka, the third major bank, gained temporary state assistance before being merged and privatised (*ibidem*). These measures enabled Slovenia to avoid a wider financial crisis and prevent the necessity for an international loan. The consequences were significant: existing bank shareholders, including KBC in NLB, faced substantial losses, and junior bondholders experienced a bail-in, which sparked political controversy. The crisis compelled Slovenia to address overdue reforms in bank governance and credit risk management. As Section 2 has shown, structural prudential tools had been in place before 2009, but tightening/loosening remained minimal (see Figure IV.4). In this sense, the 2013 crisis should be viewed as the result of long-term structural vulnerabilities rather than an exogenous shock. On the other hand, as some scholars noted, external factors as EU integration pressures did prove a decisive factor – with major privatisation episode being less about liberal market reform and more about compliance with supranational crisis regimes (Piroska and Podvršič 2020). At least, since 2014, the banking sector’s health has improved significantly, with NPL ratios steadily falling (see Figure IV.15) and CAR recovering above 20% by 2015 (see Figure IV.16).

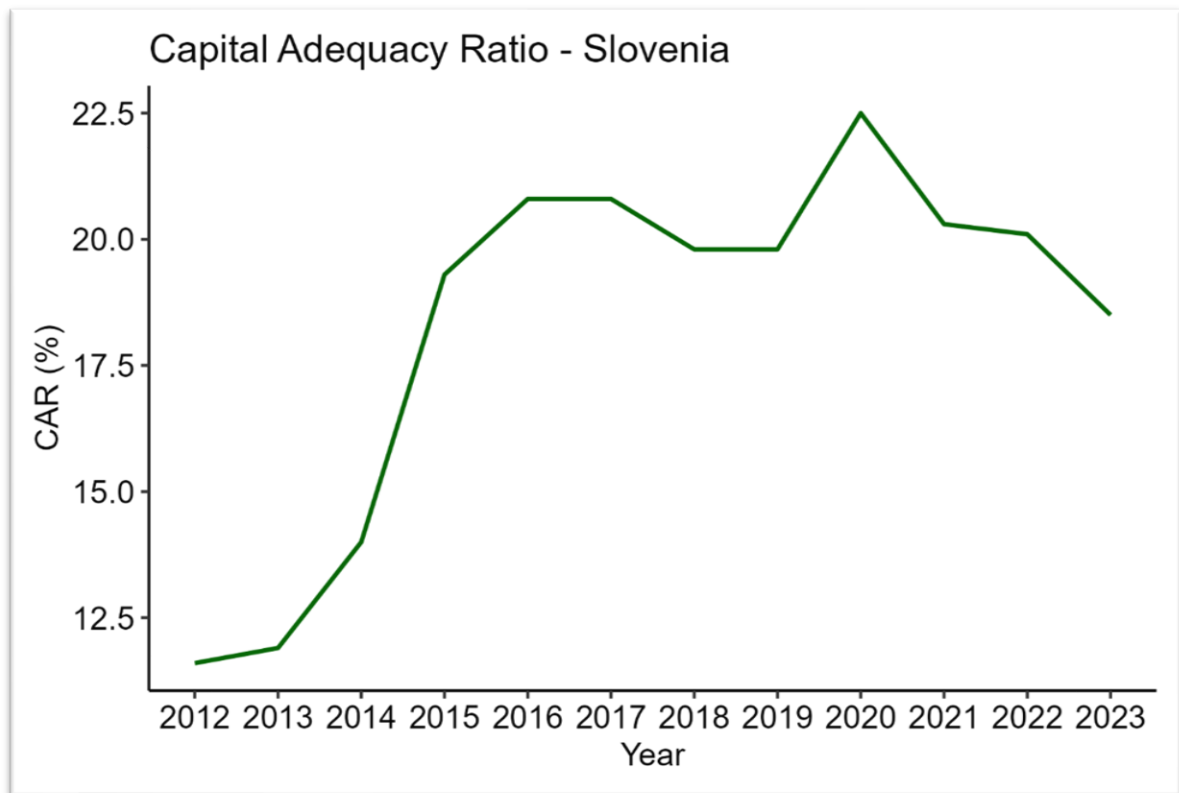


Figure IV.16

Home and Host Countries' Tensions within EU Financial Governance

The comparative historical analysis presented in the first part of the chapter highlights the five peripheral Eurozone countries' distinct trajectories in restructuring, privatisation, and prudential governance. These trajectories are one of the factors influencing their vulnerability to financial crises. All cases show overall policy continuity, reflected in the few episodes of tightening and/or loosening of the examined prudential instruments, although with relevant adjustments and different outcomes. Estonia and Slovakia demonstrated resilience by avoiding significant banking failures, owing to their proactive embrace of foreign ownership and the decisive removal of politically influenced banks. Latvia and Lithuania faced notable, albeit localised, banking failures – specifically Parex Bank in Latvia (2008) and Snoras and Ūkio

Bankas in Lithuania (2011–2013) – which highlighted deficiencies in governance and compliance within domestically controlled banks lacking foreign oversight. Slovenia experienced a significant systemic crisis, characterised by prolonged political maneuvering and regulatory rigidity, which led to the near-collapse of its three largest banks in 2013, requiring extensive public recapitalisation and restructuring.

Arguably, these crises served as catalyst for reforms – particularly privatisations and restructurings that rendered banking sectors more capitalised and resilient, as well as aligned with EU's expectations and regulatory standards. In other words, cross-border banking is a means of European integration, but is also a transmission channel for systemic risk – as unambiguously clarified by scientific research and official reports from EU institutions on multiple occasions (e.g. ECB Financial Stability Committee 2020; Singh 2020). It is worth noting that all the countries under examination adopted the common currency in the years of the GFC – Slovenia joined the EMU in 2007, followed by Slovakia in 2009, Estonia in 2011, Latvia in 2014, Lithuania in 2015. Once part of the Euro, these countries also joined the Banking Union, whose ultimate purpose was exactly to shore up the common currency (Piroska and Epstein 2023). This point is particularly relevant because the Banking Union is the governance setting where (some of) the tensions between home and host countries should have been solved. As a matter of fact, the BU has done little to alleviate this conflict (Piroska and Epstein 2023).

Country	Total Number of Banks	EU branches	% Branches from EU	EU subsidiaries	% Subsidiaries from EU	Non EU branches	% Branches from non-EU	Non EU subsidiaries	% Subsidiaries from non-EU	Total Foreign Credit Institutions	Percentage of foreign banks
Estonia	36	6	0.86	3	0.75	1	0.14	1	0.25	11	0.3056
Latvia	52	5	1.00	3	1.00	0	0.00	0	0.00	8	0.1538
Lithuania	83	7	1.00	4	1.00	0	0.00	0	0.00	11	0.1325
Slovakia	27	15	1.00	10	1.00	0	0.00	0	0.00	25	0.9259
Slovenia	17	3	1.00	6	1.00	0	0.00	0	0.00	9	0.5294
Austria	570	25	0.96	16	0.47	1	0.04	18	0.53	60	0.1053
Belgium	87	29	0.55	12	0.63	24	0.45	7	0.37	72	0.8276
Denmark	99	21	0.84	1	1.00	4	0.16	0	0.00	26	0.2626
Finland	259	26	0.93	4	1.00	2	0.07	0	0.00	32	0.1236
France	415	65	0.76	46	0.53	20	0.24	40	0.47	171	0.4120
Italy	517	50	0.71	18	0.90	20	0.29	2	0.10	90	0.1741
Sweden	155	28	0.85	4	0.80	5	0.15	1	0.20	38	0.2452

Figure IV.17

The tensions between home and host countries are rooted in the phenomenon of cross-border banking, which was introduced and partly quantified in the previous chapter. The integration of CEE countries into the EMU, particularly the BU has significantly transformed the supervisory and resolution landscape, intensifying structural tensions between home and host countries. Within the BU, crucial bank supervision and resolution responsibilities have been delegated to the supranational level, such as the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM). Still, a large number of executive functions are carried out at the national level, resulting in intricate governance structures that are primarily dependent on trust and collaboration across agencies (Fontán et al. 2019). This cooperative system hides significant asymmetries, implying an uneven power balance between home and host supervisors. Home countries generally have a more significant impact owing to their extensive familiarity with supervisory practices for large banking groups and their major regulatory authority over parent banks (Singh 2020). Host countries, instead, are often assigned observer status within supervisory colleges, which hinders their ability to participate in critical decisions that impact domestic financial stability (Fontán et al. 2019).

The legal structure selected by multinational banks heightens these disparities considerably. Banks that operate as branches instead of subsidiaries gain advantages from the single passport regime, allowing EU-incorporated branches to operate across borders without requiring additional authorisation from host countries. Branches are subject solely to home-country supervision, resulting in limited oversight capabilities for host regulators, even when branches reach systemic importance locally (Singh 2020). This arrangement decreases operational and compliance costs for parent banks while significantly undermining host-state control, thereby exacerbating host vulnerabilities during periods of financial distress (*ibidem*). The process of “branchification”, which involves the transformation of subsidiaries into branches, exacerbates these tensions (*ibidem*). Banks choose *branchification* to centralise operations, reduce regulatory burdens, and restrict host-country control (*ibidem*). The supervisory gaps that arise are especially concerning for CEE small host countries that heavily depend on foreign-owned banking institutions, notably Slovakia and Slovenia more so than the Baltic states (see Figure IV.17). The strategic decisions of these institutions tend to prioritise home-country interests over local stability (Mérő and Piroska 2017; Piroska et al. 2021). Furthermore, the financial systems of these countries are primarily bank-based and lack the diversified capital markets characteristic of core countries. Thus, MP policy and banking supervision are essential for managing risks to financial stability (Piroska and Epstein 2023). The EU regulatory frameworks frequently employ a uniform approach, failing to adequately account for the structural disparities present in peripheral economies. Regulations intended for diversified financial systems in core states may create misalignment when uniformly implemented in bank-based CEE economies – potentially worsening financial vulnerabilities instead of mitigating them (*ibidem*).

The centralised role of the ECB within the SSM presents further governance challenges. The ECB classifies banks as “significant” mostly according to asset size, which may neglect

institutions that hold significant assets in smaller national markets but fail to satisfy ECB criteria (Singh 2020). This misalignment limits host countries' capacity to enhance oversight of nationally systemic institutions, resulting in regulatory gaps where neither the ECB nor national supervisors exert adequate control. Perceptions from host countries, including those from Slovakia's Central Bank, indicate concerns that ECB supervision emphasises the overall stability of financial groups rather than addressing the specific stability requirements of smaller nations. Moreover, the decisions of the ECB appear to be dictated more by the demands of banking conglomerates for seamless capital flows than by rigorous considerations of national financial stability [INTERVIEW ML].

Supervisory colleges, designed to standardise oversight between home and host authorities, encounter significant structural deficiencies. The distribution of authority within colleges is typically skewed in favour of home-country regulators, who frequently dominate decision-making processes. Decisions from these colleges are generally non-binding, lack enforceable measures, and exhibit limited transparency and inadequate data-sharing, which disproportionately disadvantages smaller host states (Singh 2020). This fragmentation of supervisory structures leads to significant information asymmetry. Host regulators often do not have real-time access to critical risk data, especially concerning branch operations overseen by home-country authorities. This deficit significantly hinders host authorities' capacity to proactively tackle emerging financial threats and leads to delayed responses during crises, thereby exacerbating systemic risks (*ibidem*).

The resolution strategies outlined in the EU's Bank Recovery and Resolution Directive (BRRD) – namely the Single Point of Entry (SPE) and Multiple Points of Entry (MPE) – add complexity to governance dynamics. SPE centralises loss absorption at the parent level and depends significantly on intra-group financial support, while MPE allows for local resolution autonomy but poses risks of fragmented and conflicting crisis responses (Singh, 2020). Both

approaches fail to adequately consider the political sensitivities and national priorities that frequently obstruct coherent implementation, especially in light of the lack of a comprehensive public risk-sharing mechanism (see Chapter II). The Single Resolution Fund (SRF), overseen by the Single Resolution Board (SRB), was established to offer centralised financial assistance in the context of bank resolutions. Nonetheless, its effectiveness is hindered by various limitations: restricted size, complicated access protocols, and insufficient mechanisms for cross-border burden-sharing (Singh, 2020). The incomplete architecture of the Banking Union, particularly the lack of the European Deposit Insurance Scheme (EDIS), continues to foster fragmentation. National deposit insurance schemes exhibit significant variation in their funding and credibility, which may lead to deposit outflows during crises and diminish confidence in the consistency of protection among Member States (Piroska and Epstein, 2023).

The governance asymmetries and incomplete integration result in a system that negatively affects peripheral host countries. Andrea Enria, Chair of the SSM, observed that the lack of trust among national authorities hinders further banking integration, highlighting the need for improved guarantees for subsidiaries situated outside the home countries of parent banks (Enria 2020). As a result, host countries frequently implement ring-fencing measures that require subsidiaries to uphold high levels of capital and liquidity, indicating a lack of confidence in shared supervision and resolution mechanisms. In conclusion, the supranationalisation achieved through the BU seeks to integrate supervision and resolution throughout the EU. However, it has mistakenly highlighted structural tensions and vulnerabilities, especially for small host countries in the Eurozone. The concentration of authority among home-country and supranational regulators, along with regulatory frameworks that are ill-suited to peripheral banking markets, presents considerable challenges. Host-country regulators have deployed available national policy tools, especially demand-side MP policy, to maintain domestic financial stability, despite existing structural disadvantages

(Piroska et al. 2021). These tensions delineate the essential context for the banking sectors in CEE countries, highlighting the vulnerabilities and adaptive strategies required by the existing EU financial governance framework.

Conclusion

This chapter has shown how the five small host countries' banking sectors were shaped by the transition to market economies, which created distinct institutional and ownership structures and opened the way for varying degrees of foreign bank presence. These systems were later tested to differing degrees by episodes of crisis and bank failure. While Slovenia and Latvia experienced severe disruptions that required large-scale public interventions, others, such as Slovakia and Estonia, faced more contained difficulties and avoided systemic collapse. Lithuania stands in a middle ground, with significant distress but without the scale of losses seen in other cases. Post-GFC reforms strengthened banking systems and restored confidence, yet they did not resolve the underlying imbalances between home and host authorities, nor remove the exposure to decisions taken abroad. As a result, national regulators operate in an environment where they can act effectively in certain areas but remain constrained in others. The next chapter draws on expert interviews to explore how NCAs perceive and navigate such constraints, and how they reconcile them with their continued engagement in the EU MP framework.

V. ALIGNMENT AND INDIVIDUALISM: NATIONAL AUTHORITIES' RESPONSIBILITY TO THE DOMESTIC ECONOMY AND THEIR LOYALTY TO THE EUROPEAN FRAMEWORK

Introduction

As explained in the beginning, the MP Triangle rise questions about the desirability of the MP framework for small host countries in the Eurozone. The challenges posed by the Triangle raise the question as to why small host countries in the Eurozone do not complain about the current MP framework – preferring the *status quo* over institutional change. This is the project's *explanandum*, namely Eurozone small host countries' loyalty to the MP framework. To find the *explanans*, I argue, we should look at the degree of autonomy that NCAs retain within MP governance – understood as the coordination and interplay of national and supranational structures and hierarchies. While the literature is not agnostic about the implications of MP governance, the hypothesis presented here sheds light on the overlooked logic linking autonomy and loyalty.

Several theoretical frameworks in the Governance literature already produced reliable measurements of the amount of autonomy retained at the national level vis-à-vis what is delegated to EU institutions and governance. The topic is also conspicuously analysed by EU Integration Studies, as European integration is largely about moving the locus of policymaking from the national towards the supranational dimension. However, peripheral countries have rarely been the core units of analysis to make inferences about the governance of financial stability within the Eurozone – as opposed to core countries (also referred to home jurisdictions) (Belfrage and Kallifatides 2018; Donnelly 2014; Howarth and Quaglia 2016; Ibrocevic 2022; Lepers and Thiemann 2024; Stellinga 2021; Thiemann 2024). This project, therefore, contributes to bridge this gap. In doing so, it particularly re-stresses the importance

of governance as *explanans* when assessing EU integration – especially the premise that supranational-governance arrangements have always underlying distributional implications (Mügge 2006).

The main hypothesis tested by this dissertation maintains that: **NCA in Eurozone small host countries are *loyal* to the current MP framework, despite the MP Triangle, as a result of the great deal of autonomy and support that MP governance grants them in tailoring MP policy to their priorities.** The type of autonomy NCAs retain within MP governance is precisely composed of three *sources of power*, which relate to the following national and supranational dimensions of MP governance:

1) *Decentralised decision-making*: as opposed to the BU, notably EBA and SSM, small host countries' central banks – particularly their MP policy departments – retain significant centrality in financial stability policymaking: the establishment of the MP framework has not implied supranational centralisation.

2) *National governance settings/Prominence in the policy process*: within those central banks, MP policy departments enjoy considerable autonomy and operational capacity – although the degree varies across countries, as some central banks are smaller than others in terms of staff – and they oversee all the four stages of the policy process;⁵⁴

3) *Limited supranational constraints*: beyond the absence of supranational centralisation, the powers wielded by European institutions cannot impose a specific policy agenda, but only recommend it: the possibility to legitimately bind NCAs to certain action is substantially limited.

⁵⁴ The four stages are: risk identification and assessment; instrument selection and calibration; policy activation; and policy evaluation.

Importantly, such a degree of autonomy allows small host countries' NCAs to pursue a two-pronged strategy. On the one hand, NCAs have been using MP policy in a sort of micro-prudential fashion, whereby domestic financial stability is prioritised and achieved through a focus on individual credit institutions. An important factor contributing to this orientation refers to the substantial continuity between the pre- and post-GFC policy practice. This entail two dimensions: on one side, the autonomy NCAs retain today is not less than what they enjoyed before the establishment of the MP framework; on the other side, MP policy, although existing officially since 2010, has reproduced policy action taking place already before the GFC. This last point was analysed at length in the comparative assessments included in Chapter III, which illustrates how MP policy conduct in many peripheral Eurozone countries has remained strikingly similar to pre-framework practices (Eller et al. 2020). Additional elements related to this factor are also available in this chapter, inasmuch as continuity coincides with the prevailing focus on domestic resilience.

On the other hand, because the powers located at the supranational level do not constitute a real threat to national regulatory autonomy, NCAs find enough incentives to spouse and support the EU-wide MP framework. In particular, the current setting allows NCAs to achieve three objectives:

- a) On the domestic plane, resilience of credit institutions;
- b) On the international plane, membership into the transnational epistemic community working on financial stability;
- c) On the Single Market plane, effective management of financial integration's negative externalities – i.e. cross-border spillovers of MP policy.

The following pages present empirical inferences from interview data to demonstrate how the three sources of autonomy interplay with each other and combine strategically to achieve the objectives above. As disclosed in the [Introduction](#), this investigation is particularly interested in the causal effect of NCAs' perceptions. These perceptions, I argue, act as a driver of NCAs' loyalty to the MP framework – besides other factors contemplated by the alternative hypothesis. The first Section will provide technical details on the methodology. The second Section sets the stage to the core empirical analysis, by addressing the question of governance, notably how its national and supranational dimensions contribute to the mechanism outlined through the core hypothesis. The third Section delves into the interview data in order to interpret which specific objectives NCAs have in their agenda and how they assess their ability to secure financial stability. Ultimately, the findings demonstrate that Eurozone small host countries express high confidence in their ability to mitigate the tensions of the MP Triangle.

Methodology

The following Sections will substantiate the hypothesis by resorting to a large body of interviews conducted with relevant experts. A lengthy discussion of *expert-interviews* methodology is included in the Introduction. As a reminder, it is important to clarify that, to this study, experts are relevant stakeholders either working in the field of financial stability or particularly acquainted with the issues addressed by this dissertation. In particular, the targeted sample is composed of four categories of experts: journalists specialised in banking and finance; high-ranked officials from Central Banks and EU supervisory institutions; members of business associations in the field of banking and finance; academics specialised in pertinent areas/topics. A total of 64 requests were sent out between November 2023 and January 2025. Potential informants were recruited either through publicly available e-mail addresses on

institutional websites – as well as newspapers’ websites in case they were journalists – or through the practice known as “snowballing” – that is upon direct suggestions of other informants. As many as 22 *experts* accepted my request for interviews, some of them agreeing on a second round, resulting in a total of 28 in-depth, semi-structured interviews.

In order to enhance the value of the evidence from expert interviews, the respective inferences are triangulated with official documents published by NCAs, EU institutions and IOs. In the present chapter, the content of the documents is recalled for their potential to support the inferences made from the interviews: FSRs often include a yearly – or multiannual – assessment of national financial stability, thereby formalising – and validating – some of the personal thoughts shared by the experts. At the same time, the descriptive statistics (from Chapter III) were used during interviews as empirical context for the conversation and to focus it on the issues addressed by this study. This allowed me to establish a technical dialogue with the expert: whenever pertinent, I engaged the informant with my understanding of the financial stability assessments derived from the FSRs. The purpose of such strategy was twofold: *a*) validating/rejecting the choice of indicators for my empirical analysis; *b*) stimulating the informant’s personal opinion on the indicators used at the national level vs. the supranational one. Additionally, this exercise aimed at spotlighting any potential juxtaposition or difference between the empirical observations these experts carry out in their institutional duty and the overall perception they have of financial stability. In fact, the ultimate goal of this investigation is not to appraise the stability of small host countries’ banking sectors, but rather to understand whether regulators and supervisors are content with the capacities that the current MP framework has built.

Technical Aspects

The interviews were conducted both on-line and face-to-face. In both cases, the first contact was made by e-mail, whereby a number of details were provided to stimulate interest, to encourage participation, and to ensure anonymity. While the interview request would always include similar elements, I have not used a single, standardised model. First, the message would include a brief introduction of myself: information on who I am and what is my academic affiliation – including a link to my PhD Candidate profile at CEU. Additionally, I would offer a few general information about the project – including the background of the investigation (usually framed in a rather general fashion, as *financial stability*), the geographical scope of the research (the case-studies), and the reasons why the expert's opinion and knowledge would contribute greatly to the project. Importantly, the interview was always presented as an informal conversation, whose purpose is to test hypotheses and personal understanding against the expert's concrete experience and knowledge. To be clear, the subject of the e-mail would always include the caption "interview request", but the message would then propose an informal setting – establishing expectations for a relaxed conversation over topics of reciprocal interest. Once the interviewee has accepted my offer, we would agree on date, time and location. Questions were only seldom agreed in advance – only when the interviewee made specific request: I would then provide a list of specific issues to be discussed. Even in such cases, I would clarify that spontaneous answers are crucial to collect the type of evidence my investigation warrants. At the same time, interviewees were always informed that replying all the answers was not mandatory, and they were free to focus on the more relevant aspects based on their judgement.⁵⁵

⁵⁵ Regarding this last point, striking the right balance between structure and flexibility is not easy to accomplish when preparing interview questions. Leaving enough room for the interlocutor to elaborate as he/she sees fit has the advantage of revealing where the emphasis lies according to their perception. This is crucial considering the relevance this project assigns to intersubjective understanding and subjective knowledge. At the same time, the depth of the issues addressed by this investigation, alongside time-constraints, demands a certain rigor in conducting – notably leading – the interview.

In principle, on-line and face-to-face interviews present different pros and cons. In my case, the choice of one or the other did not depend entirely on strategy, but was rather due to material constraints and chances encountered during the PhD years. A different interview setting may undoubtedly translate into a different experience, but I have not registered significant variation in terms of interview duration and interlocutors' attitude depending on the setting. Perhaps, the only practical difference worth mentioning refers the impact the two settings have on the citation style. Both on-line and face-to-face interviews were recorded either on my phone or directly through the on-line-meeting platform, pursuant to the consent given by the interviewee. This was obtained upon submission of a *consent information sheet* including details about the researcher, the scope of the research, and the use and storage of the data.⁵⁶ The most tangible difference between the recording produced from the two settings refers to the possibility of interpreting the *latent meaning* of the testimonies.⁵⁷

MP Governance: The Sources of NCAs' Autonomy

Interview data enlightens, first, on the interactions between national and supranational governance structures – which, in turn, informs the relationship between the three sources of autonomy mentioned earlier. A general overview of the governance issues most relevant to EU Integration Studies is provided in Chapter II. Within the specific context of financial integration, the gist of this issue is well represented by the *financial trilemma* (Schoenmaker 2013), which succinctly illustrates the major issues underlying the integration of financial supervision in the EU. As discussed in Chapter II, Schoenmaker's conceptualises the

⁵⁶ In the case of face-to-face interviews, the *consent information sheet* was handed out personally and sufficient time was left for the interlocutor to read and express potential doubts. On-line interviews had usually a more intense rhythm: the consent form would only be summarised orally by me and shared via e-mail after the end of the interview. A sample of the consent information sheet can be examined in the Appendix.

⁵⁷ See [Introduction](#) for a comprehensive explanation of the use of *latent* and *manifest meanings* in this dissertation.

fundamental incompatibility haunting global banking governance, whereby *financial stability*, *international banking integration*, and *national regulatory autonomy* cannot coexist with each other – since only two of the three objectives can be realised at once (Schoenmaker 2013). The trilemma has been incorporated into a number of insightful analyses focusing on EU integration (Howarth and Quaglia 2015; Quaglia and Spendzharova 2017). This dissertation, instead, deploys the trilemma for the relevance it can assume when one adopts the perspective of peripheral Eurozone countries. As quoted in Introduction, the extent to which “the public good of international financial stability” can be produced at the national level is one paramount question (Schoenmaker 2013, 19). Schoenmaker argues that the public good – financial stability – cannot be produced by the nation-state within a monetary union (Schoenmaker 2011). However, the empirical observations supporting the present analysis suggest that cross-border banking can, in fact, coexist with national regulatory autonomy and financial stability – but only because the MP framework allows NCAs to maintain strategic autonomy. Budling on the insight that financial stability governance is intimately tied to the issue of financial stability as a public good (Schoenmaker 2013), this Section will show how such interactions play out in the peripheries of the Eurozone. It will do so by providing an overview of the national governance arrangements in the countries under examination, and by considering the individual perspectives of their NCAs on the issue. This element is crucial for understanding the perception of NCAs, notably their confidence into the ability to accomplish their mission.

Perhaps the most succinct summary of these interactions comes from a Latvian informant involved in MP policy at the Central Bank, who states that “countries’ action depends ultimately on three things: autonomy in the MP framework; political will; national legislation” (interview MP official from central bank Latvia 05/11/2024). While the statement may appear inscrutable at first glance, a closer look allows to connect it to a crucial debate in Political Science, namely the tension between delegation and control. This tension, the present study

argues, lies at the heart of the struggle over (further) European integration – and the impact it has on the conflict between the state and the market (see Chapter II). More importantly, the tension between delegation and control shapes the discourse and the action of MP policy in the peripheries of the Eurozone. It is a recurring theme across the interviews – albeit sometimes only implicitly. The quote above is one major example. To begin with, *autonomy* refers to both formal independence and the capacity to design, implement, and justify policies without external veto. This element echoes all the three *sources of power* at the basis of the core hypothesis – de-centralised decision-making, NCAs prominence in policymaking, and limited supranational constraints. Second, *political will* refers to the commitment to financial stability at the national level. Third, *national legislation* defines the legal boundaries – governance structures – within which macroprudential discretion can be exercised legitimately.

The role of national governance is, therefore, paramount. The existing literature has extensively examined how institutional design influences MP policymaking. For instance, Edge and Liang have repeatedly explored the role of Financial Stability Committees (FSC), which were introduced after the GFC to centralise MP functions (2017; 2019). They show that while multi-agency committees enhance coordination and information sharing, they fall short in influencing direct action. Their work suggests that the establishment of FSCs is mainly driven by political economy considerations – rather than the effectiveness of MP policy – including to avoid an excessive concentration of powers in central banks by empowering other institutions – such as ministries of finance (Edge and Liang 2020). Thiemann and Stellinga (2022) further investigate the issue and draw the additional conclusion that FSCs uniquely bridge the gap between technocratic expertise and political authorities, a key factor often at the root of MP policy inaction bias. Despite their insightful content, these analyses do not reckon

with the empirical reality in Eurozone peripheral countries.⁵⁸ There, NCAs register a high level of institutional independence which allows them to achieve the three objectives illustrated in the introduction to this chapter: resilience of credit institutions; rightful membership into the transnational epistemic community of financial regulators; management of cross-border spillovers and other negative externalities of financial integration.

The countries under examination differ in formal MP governance arrangements but share significant *de facto* autonomy exercised by NCAs. Although some officials highlight the distinction between formal structures and operational realities, all interviewees emphasise the considerable *de facto* independence of their departments – even when such powers are formally shared with other institutions. For instance, Slovakia and Lithuania are endowed with particularly autonomous Central Banks. This is well captured in a statement by an official working at the Central Bank of Slovakia who, referring to the national setting, argues that “concentration of powers in one single institution is highly advantageous” (interview MP official from central bank Slovakia 18/12/2024). Similarly, a Lithuanian official noted that the country has no issues of interinstitutional coordination, as “the macroprudential mandate is exclusively within the central bank”, which does not need “any kind of approval to use [its] macroprudential toolkit” (interview MP official from central bank Lithuania 22/12/2023). A former official from Lithuania goes as far as clarifying that, before gaining a formal mandate with the establishment of the MP framework, implemented prudential measures and was not opposed by any legal appeal (interview former official from central bank Lithuania 26/12/2024). In contrast, in Slovenia and Latvia, formal arrangements include coordinating bodies such as FSC, yet autonomy remains strong in practice. In Slovenia, macroprudential oversight is coordinated by the Financial Stability Board (FSB), which is chaired by the Central

⁵⁸ To be clear, all countries from the examined sample feature in the dataset compiled by Edge and Liang (2017). However, the authors’ analyses draw rather general inferences which call for further examination of the individual cases.

Bank Governor and includes representatives from the Central Bank, the Ministry of Finance, and sectoral supervisors. While the FSB sets the strategic direction, implementation rests with the individual supervisory bodies ([Banka Slovenije](#)). However, according to the interviewees, autonomy seems to be even stronger than it appears on paper – especially regarding the relation between technocratic and political institutions. One Slovenian official stresses that MP policy “is usually competent authorities' business”, adding that “a truly independent Central Bank is not bound to the Ministry of Finance” (interview MP official from central bank Slovenia 22/10/2024). Another interviewee from the same institution pointed out that timely MP actions often conflict with the slow pace of political debates, further reinforcing the need for operational independence (interview MP official from central bank Slovenia 21/10/2024).

This sentiment is similarly expressed by an official working at the Central Bank of Latvia, who notes that “macroprudential policy often requires prompt action, which [we] cannot have when politics is involved” (interview MP official from central bank Latvia 05/11/2024). However, it is necessary to consider that MP governance in Latvia is slightly different than Slovakia and Lithuania. Initially – and until 2023 – the country split responsibilities between the Financial and Capital Markets Commission (FCMC) and the Central Bank, coordinated by a Macprudential Council serving mainly as an advisory forum. This Council was a collegial advisory forum rather than a decision-making authority: its role was to facilitate information exchange, joint risk assessment, and discussion of possible measures, while respecting each institution’s independence in decision-making ([Latvijas Banka](#)). Despite this complexity, interviewees report the absence of interinstitutional tensions with political authorities (interview MP official from central bank Latvia 05/11/2024). Moreover, following the merger of the FCMC and Central Bank, Latvia’s macroprudential mandate became more comprehensive, excluding only consumer protection and non-bank supervision (interview MP official from central bank Latvia 05/11/2024). Conversely, Estonia

presents a unique case where macroprudential oversight by Eesti Pank coexists with banking supervision by the Financial Supervisory Authority (FSA) ([Eesti Pank](#)). Coordination with the Ministry of Finance occurs through a domestic joint committee described as a “key venue for discussing macroprudential measures and other financial stability concerns” (interview official from SRB 20/11/2024). Nevertheless, the same official confirmed that strictly MP policy does not require formal consultation with other domestic institutions, thus highlighting a gap between formal governance and operational practice (interview official from SRB 20/11/2024).

These interviews shed light on the on important aspect of the current governance arrangements within which regulators operate. In doing so, they also reveal that the line between delegation and control seems to be largely defined by the perceptions of the NCAs. Regardless of formal governance structures, the perception of the authorities is of absolute confidence in their preparedness and capability to deal autonomously with financial-stability issues given the current governance structure. Indeed, it is this perception that drives the loyalty to the MP framework. This point is proved by the fact that small host countries’ authorities would not settle for anything less than the autonomy they have. One Slovak official allows us to gauge the actual the impact of the institutional design by citing Austria and Germany as examples of countries with divided responsibilities requiring careful coordination and arguing proudly that Slovakia does not suffer from this condition (interview MP official from central bank Slovakia 18/12/2024). Another official from the same country points out what really distinguishes small host countries from home jurisdictions: in the latter, sometimes, “NCAs need to be addressed with warnings from the ESRB to overcome the lack of political support” (interview MP official from central bank Latvia 05/11/2024). These reflections highlight a broader pattern: NCAs from the peripheries tend to present themselves as decisive, skilled and more effective, especially when compared to more politicised institutions in core countries. This is not simply about describing how governance works: it is a rhetorical assertion of

competency and domain – which eventually justifies the need for continuing institutional independence. In this sense, autonomy functions as both a practical tool and a discursive resource. On the one hand, it serves to govern financial integration and its negative externalities; on the other hand, it allows NCAs to present the preservation of the *status quo* as a common interest among all the parties.

Resilience of the Domestic Banking Sector

The previous Section describes national MP governance settings as either enablers or constrainer of MP policy. This Section will extrapolate content from the interviews to understand how NCAs in the peripheries of the Eurozone understand MP policy and the function they perform. Consistently with the research question, it focuses exclusively on the NCA's perceptions of the theory and practice of MP policy – without seeking to evaluate the actual management of financial stability. The latter is rather viewed as a test of NCAs' confidence in their capability. The underlying argument is that the bumpy road that has shaped the current MP framework, particularly what the literature understands as the betrayal of an original macroprudential revolution (Baker 2013b; Thiemann 2019), has contributed to peripheral countries' loyalty towards the current institutional setting. This is because the prioritisation of national financial stability is paramount to the action of NCAs – not only in the peripheries of the Eurozone. Crucially, MP governance makes the prioritisation of individual financial institutions or national financial sectors both possible and legit. This Section will dissect such a claim into its functional components. First, it will briefly recall the evolution of the MP framework, particularly the ambiguities around its original goal and the measurable objectives to achieve it. Subsequently, it will address the specific issues arisen during the interviews, in order to evidence the connection between MP governance, the ambiguities of MP policy, and financial-stability concerns at the national level.

It is important to recall that the scholarship on MP policy had actively worked towards a rupture with the pre-GFC view of financial cycles and financial risk, yet it has also acknowledged how such a change has occurred only partially. Some of the scholars specialising on the topic have noticed that the macroprudential cultural shift was originally very promising but, regrettably, it is falling short of expectations (Baker 2013b; 2013b; Kranke and Yarrow 2019; Stellinga 2021; Thiemann 2024). In 2019, Kranke and Yarrow stated that the “*global governance of systemic risk continues to concentrate on single entities – be they financial institutions or national financial sectors*” (2019, 827).⁵⁹ Put simply, despite the original concerns with the cyclical component of systemic risk, the only significant time-varying tool adopted was the CCyB, itself framed more as a shock absorber than a genuine tool to tame credit cycles (Thiemann 2024).⁶⁰ At the same time, we must consider the possibility that, from a different perspective, the betrayal of MP policy’s original expectations is an overstretching of reality. For instance, there are arguments suggesting that those expectations might have been wrongly put in the first place (Borio 2014). On one hand, Borio – the then Head of the Monetary and Economic Department at BIS – argued that the excessive focus on *individual institutions* before the GFC was fundamentally insufficient: this narrow perspective led to ineffective standard-setting, as it failed to account for both the system-wide consequences of institutional failures and the fact that these consequences vary depending on the phase of the financial cycle (Borio 2014).⁶¹ Within this context, the mission of MP policy would be defined as “protecting the banks from the financial cycle and protecting the financial cycle from the banks” (Borio 2014, 3). On the other hand, Borio clarified that the second goal – shielding the financial cycles

⁵⁹ Emphasis added by me.

⁶⁰ Thiemann (2024) argues that while systemic risk was widely discussed during the years of the GFC and initially met with enthusiasm, its potential to develop into a concrete policy framework was ultimately limited. This was largely due to “the lack of economic research on the cyclical tendencies of the financial system as a whole, in particular the nonbank system of credit mediation,” which hindered the transformation of this intellectual shift into actionable policy.

⁶¹ Economists at the BIS have consistently advocated for broadening the scope of financial stability policy, which they viewed as historically too lenient toward procyclical dynamics. Although fully aware of the practical challenges involved, they repeatedly emphasized the importance of addressing the cyclical dimension of macroprudential (MP) policy – both in the years leading up to and following the GFC (Thiemann 2024).

from banks through countercyclical policy – is significantly more ambitious than the first one: limited empirical evidence of the effectiveness of MP policy as well as regulatory arbitrage and policy leakages make the policy framework too weak to curb the financial cycle without complementary support of fiscal and monetary policies (Borio 2014).

By examining the conduct of MP policy implemented by NCAs in the peripheries of the Eurozone, this study offers an opportunity to revisit the objectives of MP policy from an alternative perspective, which becomes particularly relevant in light of the ambiguities highlighted in Borio's analysis. Consistent with the study's central hypothesis, empirical evidence reveals that the sampled NCAs prioritise domestic financial stability over concerns related to Eurozone-wide financial interconnectedness or the use of counter-cyclical tools. The amount of policy discretion described in the previous Section – that is NCAs playing a prominent, autonomous role in MP policymaking – enables policy practices that appear optimal to NCAs' perception and materially sufficient to maintain financial stability. The interviews analysed in this Section take a revealing picture of the use NCAs make of such discretion: NCAs in Eurozone peripheral countries prioritise national financial stability through MP policy targeted at increasing resilience of the domestic banking sector – both lenders and borrowers, including foreign banking groups. Importantly, the data shows that such an outcome requires a necessary condition, namely the combination of *de-centralised decision-making* with the *prominence* NCAs enjoy within the national institutional setting. This argument is premised primarily on four observations:

1. The domestic economic context does matter to MP policy, yet EU-wide indicators and assessments often risk to overlook such specificities.

2. There is extensive compatibility between resilience of credit institutions and their profitability, and both should (and can only) be prioritised through tailor-made MP policy designed and implemented autonomously by NCAs.

3. The negative consequences of financial instability – notably insufficient liquidity and poor credit quality – affect primarily the domestic economy, meaning that:

4. Stress-testing and resolution plans – which are both micro-prudential pillars – are still crucial but potentially insufficient in case financial instability materialises.

To being with, an official from the Central Bank's macroprudential department in Slovakia provides an explicit example of how NCAs understand their mandate, by stating that their primary objective within the typical context of a small open economy is to safeguard national financial stability (interview MP official from central bank Slovakia 18/12/2024). While acknowledging that larger, core economies may similarly prioritise domestic concerns, the interviewee points to a key asymmetry between core and periphery, by emphasising the unique fragility of smaller economies hosting foreign banking groups (*ibidem*). Moreover, the sensitivity towards the stability of local institutions is heightened by the limitations inherent to EU-wide indicators and assessments, which – according to the interviewee – may overlook hidden vulnerabilities that, once revealed, may trigger the transmission of risk across borders (*ibidem*). This view is not unique to the case of Slovakia, although there is some variation across the sample regarding which specific issues draw the most attention from NCAs. For instance, an informant from Lithuania explains that macroprudential intervention becomes necessary when a mismatch arises between the behaviour of individual institutions and the broader systemic implications at the market level [interview MP official from central bank Lithuania 22/12/2023]. Overall, these perspectives highlight the necessity of the first *source* of autonomy defined earlier – namely *decentralised decision-making* – which empowers NCAs

to tailor their interventions based on information and priorities specific to their jurisdiction. The required policy autonomy is reflected in the fact that authorities place particular emphasis on *credit quality* as a proxy for the resilience of banking groups. The Slovak official further stresses that weak credit quality or deteriorating repayment conditions pose serious threats to the financial system, thereby making resilience a central objective in MP policy (interview MP official from central bank Slovakia 18/12/2024). This emphasis on credit quality features in all case-studies and its centrality is also corroborated by the examination of the FSRs issued by the central banks. For instance, in Slovenia *credit risk* is consistently identified as a key focus of supervision and policymaking (FSR Slovenia 2016), and similar emphasis is reflected into the major objectives of the banking sector *stress-testing*, a key tool deployed continuously by NCAs since before the GFC (Borio 2015).

The emphasis on resilience is echoed by another informant from Lithuania – a former Central Bank official now active in the financial services industry. The interviewee reinforces the same understanding by stating that profitability, which is partly a function of credit quality, should not be viewed as a trade-off but rather as synonymous with financial stability (interview former official from central bank Lithuania 26/12/2024), thereby qualifying the issue as paramount to any supervisory endeavour. Profitability, moreover, is also intimately linked to the issue of *liquidity*, which also emerges as a key risk in several FSRs (FSR Estonia 2018; FSR Lithuania 2017; FSR Slovenia 2016) – and within the specific context of stress-testing exercises (FSR Latvia 2016; FSR Lithuania 2017). As an official from the Central Bank of Latvia clarifies, liquidity is “crucially linked to the issue of resolution plans [for big institutions]: especially the question as to where funds to resolve banks come from, including whether you can expect that the parent [bank] will save the daughters or vice versa” (interview MP official from central bank Latvia 05/11/2024). The Latvian official further explains that FSRs across the Baltic region focus primarily on capital requirements, liquidity, and stress-

testing as essential tools for evaluating resilience to external shocks, especially with respect to SI institutions (*ibidem*). In sum, it emerges that NCAs retain the prominence in the policy process needed to put resilience center-stage in their policy goals. In practice, this is achieved via autonomous determination of how macroprudential tools like capital buffers and liquidity requirements are designed, activated, and sequenced.

In NCAs' assessments, financial stability is primarily understood as the soundness of domestic banks. This is generally gauged through a set of indicators agreed upon at the European level. However, such indicators are strategically adapted by NCAs to target the conditions specific to the domestic economy (see Chapter III). Even when discussing borrower-based measures (BBMs) – typically a stronghold of national autonomy in MP policymaking⁶² – officials assert that the principal aim remains the management of risk within domestic bank portfolios. In the officials' mind, these risks are viewed as structural and systemic, rather than merely cyclical in nature (interview MP official from central bank Slovakia 08/11/2024; interview expert from banking association Slovakia 09/12/2024). In addition, their use is often considered as a natural consequence of the emphasis NCAs' have to give to national financial stability: as clarified by an official from the Central Bank of Lithuania, MP policy's "ultimate objective is financial stability", achievable only through intermediate objectives closely tied to resilience, such as credit quality, leverage, liquidity, and concentration in the banking sector (interview MP official from central bank Lithuania 22/12/2023). This point is particularly important, since the theory underlying the use of BBMs qualifies them as a multi-purpose instrument: in principle, BBMs can target both structural and time-varying risk; in practice, by impacting credit growth more directly, they are very effective in dampening the credit cycle (ESRB 2018). However, the prevailing understanding from the NCAs in the sample views those measures primarily to the purpose of resilience.

⁶² BBMs fall outside the scope of European legislations since they are not contemplated by the CRD/CRR package, thereby being implemented according to national discretion.

One fundamental reason accounting for the illustrated views –namely the centrality of national financial stability considerations – refers to a perceived uniqueness of the national context vis-à-vis EU-wide financial markets. The importance of national specificity is repeatedly emphasised across interviews. For instance, an official from the Central Bank of Slovenia stresses that financial stability must be understood as operating at both the EU and national levels, and that these two rarely coincide due to fundamental divergences in national financial cycles (interview MP official from central bank Slovenia 22/10/2024). A similar point is made by an official from the Central Bank of Lithuania, who argues that NCAs are “best equipped to deal with financial risk even if this brings some fragmentation, because financial cycles are not synchronised across countries and there are many peculiarities” (interview MP official from central bank Lithuania 22/12/2023). These differences reflect deeper structural characteristics, particularly the disparities between major banks in smaller economies and their counterparts in larger ones. Such structural variation further justifies the need for national discretion in managing financial stability risks (interview MP official from central bank Slovenia 22/10/2024). Additionally, a second informant from the Central Bank of Slovakia reinforces this view by arguing that their perspective diverges from the ECB’s broader focus on cross-border banking groups, which tends to overlook country-specific vulnerabilities (interview MP official from central bank Slovakia 28/11/2023). When considered together, these testimonies remark a crucial point made earlier: that NCAs justify their autonomy not only in terms of expertise but also based on the belief that supranational indicators and oversight mechanisms miss the opportunity to identify localised vulnerabilities. This perception is especially salient in small host countries, where foreign ownership and market concentration introduce risks that may escape broader macro-financial monitoring. The importance attributed to discretion in interpreting systemic risk according to country-specific

conditions speaks directly to the third *source* of regulatory autonomy: *limited supranational constraint*.

To be sure, while officials consistently argue that MP policies should align with national financial cycles – due to a perceived lack of synchronisation within the Eurozone – the empirical evidence for such heterogeneity remains contested. Several informants – notably those closer to the view of supranational institutions – challenged the notion that financial cycles across the Eurozone are as asynchronous as NCAs suggest. Acknowledging this complexity, an ESRB official points to identifiable commonalities across national financial cycles, despite variations in their duration and amplitude (interview MP official from ESRB 04/12/2024). Similarly, a representative of the Slovenian Bank Association – who worked closely with the SSM – notes that, historically, economic and financial cycles across the Eurozone have not registered significant divergence, “except for specific gaps, or front runners” (interview expert from banking association Slovenia 25/10/2024). A Slovak scholar affiliated with the Central Bank further stresses the countries’ exposure to regional and global financial markets, thereby challenging the narrative of visibly asynchronised financial cycles (interview economist Slovakia 14/01/2025). Nevertheless, the persistent perception among NCAs that national cycles remain distinct is itself highly revealing: not only does it reflect their operational focus but also the deeper significance of perceived – rather than strictly empirical – heterogeneity. This perception, regardless of its objective accuracy, informs the national emphasis on banking sector resilience materially and explains the rationale underpinning NCAs’ macroprudential policy preferences and confidence. Again, we observe that NCAs’ enduring loyalty to the European MP framework is sustained not by alignment with supranational assessments, but by their belief that the framework tolerates – and even empowers – their capabilities to make country-specific judgments.

Moreover, beyond the ongoing debate over cycles synchronisation, the prevailing focus on domestic banking sectors resilience should not come as a surprise: the necessity of strengthening resilience has always featured in theoretical debates on the objectives and instruments of MP policy (Galati and Moessner 2017). Crucially, this emphasis is not limited to national authorities; it is also endorsed – often explicitly – by EU-level institutions. An official working at the ESRB openly maintains that, under uncertain conditions, increasing the resilience of credit institutions – by ensuring adequate capitalisation – is regarded as a safe and most prudent strategy (interview MP official from ESRB 04/12/2024). This sentiment is also echoed by an economist formerly affiliated with the Bank of England – who has contributed significantly to ECB’s analyses and policy papers. The informant acknowledges that, “regrettably”, central banks’ primary macroprudential goal has never been the so-called “leaning against the credit cycle” that is often heralded by the pioneers of MP thinking (interview former official from central bank England 28/10/2024). On the contrary, it is clarified that any counter-cyclical effect is more accurately described as a “second benefit of MP policy,” subordinate to the principal goal of “boosting financial resilience” (*ibidem*). These statements reveal that, despite potential divergence in analytical perspectives, national and supranational actors converge in practice to a large extent. This mechanism operates as an additional legitimisation of the autonomy that NCAs are granted by MP governance: focusing on resilience does not equal diverting the aim – or the hope – of the European project, because the latter officially contemplates this type of discretion. In this regard, it is worth noting that the focus on the health of individual credit institutions has never been dismissed by the architects of the EU’s MP framework either – at least according to the original proposal. The foundational ideas laid out in the well-known De Larosi re Report acknowledge strong synergies between microprudential and macroprudential supervision. Consequentially, the

Report advocated for the establishment of the European System of Financial Supervision (ESFS) as a means to enhance both domains (De Larosière 2009).⁶³

While these testimonies collectively prove the foundational value of *resilience* for NCAs' analyses and policymaking, it is worth emphasising that such a strong orientation may not exclusively reflect a normative commitment: it may also reflect the inherent ambivalence of the ongoing debate over the goals and effectiveness of MP policy – which extends to the effectiveness of the underlying governance structures. These points remain open and contested across both scholarly and policymaking circles. While the focus on resilience appears to be a diffused condition, it would be inaccurate to label it as the official stance in every jurisdiction. One telling example is provided by a previously cited informant from Lithuania, who argues that the concept of *resilience* has limited practical value: it is unrealistic to eradicate failure, which is physiological to the financial system; instead, he affirms that “financial stability [simply] means the orderly functioning of the system” (interview former official from central bank Lithuania 26/12/2024). This statement reflects a certain ambiguity regarding the abovementioned objectives of MP policy. In criticising what he sees as misallocation of resources onto unrealistic goals, the Lithuanian informant acknowledges a fundamental reality: NCAs remain deeply focused on structural vulnerabilities and the build-up of resilience. For instance, he reports that the excessive focus on banks' liquidity has led to inefficiencies in the banking system, as credit institutions are not able to manage the large volumes of liquidity they hold (*ibidem*). Ultimately, these seemingly contradictory statements reveal an important insight: NCAs appear to adopt resilience not only as an ideational objective, but as a strategic posture to assert competence within a framework whose long-term trajectory is still being negotiated. In this light, their loyalty is less about ideological alignment than about technocratic

⁶³ At the same time, the Report took a critical stance toward excessive centralization of supervisory authority in the ECB (De Larosière 2009).

confidence: a belief that the MP framework, for all its imperfections, grants them the discretion to respond to what they know best – that is, domestic risk.

The Transnational Epistemic Community of Macroprudential Regulators and the Relationship between Home and Host countries

As the previous Sections illustrated, Eastern Periphery's loyalty to the European MP framework owes, to a significant extent, to their capacities as macroprudential regulators. Such capacities have been built over years and are significantly empowered by the governance arrangements at both the national and the supranational levels. Importantly, those capacities have allowed NCAs to prioritise national financial stability – particularly the resilience of credit institutions. This, in turn, increases NCAs' confidence in their ability to manage financial stability, thereby contributing positively to their appeasement with the challenges of the MP Triangle and boosting loyalty to the MP framework. Building on such inferences, this Section outlines an additional dynamic emerging from the interview data to account for NCAs' loyalty: the fact that NCAs from peripheral countries benefit from their membership into a transnational epistemic community which increase status and most importantly, does not deprive them of control over domestic policy. Interview data uniformly confirms this argument by revealing three types of benefits associated with the transnational epistemic community of regulators:

1. NCAs can debate *innovative solutions* with their peers in order to meet new necessities related to financial stability.
2. Being financial supervision heavily premised upon data, membership into the transnational epistemic community comes with the advantage of significant *information sharing*.

3. Membership into the community inherently conveyed *support for EU integration*, thereby decreasing the negative weight for any given *criticism* NCAs might formulate against EU financial governance.

Similar or related dynamics have already been explored in earlier research. Particularly, the dimension of development, establishment and diffusion of supervisory practices among peers is analysed by Mérő and Piroska (2017). The authors observed that MP policy considerations were present even before the establishment of the MP framework – although they only became prominent when the MP framework was presented as an institutionalised response to the GFC. Macroprudential thinking is often described as a normative challenge to efficient market theories which increases the authority of the state over banks (Baker 2013a). As opposed to this argument, Mérő and Piroska (2017) support the view that NCAs in Eurozone peripheries are more concerned with ensuring the resilience of domestic banking systems than with theoretical debates about financial-risk cyclicity.⁶⁴ Focusing on the Slovak case, the authors identify a critical dynamic: on one hand, macroprudential regulators align with EU macroprudential norms to enhance legitimacy and stability (policy diffusion); on the other hand, they prioritise control over the domestic financial system, ensuring that domestic stability was not undermined by external financial interests (Mérő and Piroska 2017). This twofold logic of alignment and individualism extends beyond the case of Slovakia and applies to a large extent also to the dynamics under examination. Interview data reveals that NCAs across the sample exhibit a similar pattern: they embrace EU-level discourses and institutional participation not only to access technical resources but also to signal regulatory innovation and commitment to shared goals. In this sense, declaring loyalty to the MP framework works also as a strategic positioning, a sort of performative alignment in a transnational field of expertise.

⁶⁴ Crucially, this preference points to a “microprudential bias” in MP policy implementation (see Kranke and Yarrow 2019), which provides further validation to the core argument of the previous Section.

As for the benefit hypothesised as innovation, interview data provides consistent evidence reflecting NCAs' appreciation of both the formal and informal channels connecting the transnational epistemic community of macroprudential regulators. Overall, NCAs register a sentiment of satisfaction for the opportunity of exchanging views with like-minded individuals. This community fosters cooperative learning without restricting national discretion. Importantly, it operates both formally – through ECB and ESRB's working groups – and informally – via direct inter-NCA communication. The former channel is often explicitly praised as the strong suit of the MP framework. An official from Slovakia states the “coordination at the EU level – and exchange of knowledge – is very important and clearly an added value” (interview MP official from central bank Slovakia 28/11/2023). Interactions within the venues of the ESRB, according to a Slovenian informant, are a fertile exchange of views and practices which may function as “a sort of lab experiment to understand what works and what doesn't – as well as the reasons behind success and failure” (interview MP official from central bank Slovenia 22/10/2024). A similar opinion is shared by an official from the Central Bank of Estonia. Though stressing the inadequateness of some ESRB's indicators and analyses relative to small host countries' needs, the interviewee argues that “discussions at the supranational level can support policymaking at the national one” (interview MP official from central bank Estonia 28/12/2023). While NCAs are “best positioned to carry out such analyses”, the added value of the ESRB is “horizontal cross-country analysis – whereby countries are assessed using a common methodology, and policy proposals are formulated based on those assessment” (interview MP official from central bank Estonia 28/12/2023).

Moreover, discussions occurring through informal inter-NCA channels are attributed tantamount relevance. A concrete example is provided by Slovenia's experience with the activation of new systemic risk buffers: due to the high uncertainty surrounding the implementation of a new tool, particularly questions about which data is best to use, discussions

involved significant bilateral interactions with Portugal and Lithuania (interview MP official from central bank Slovenia 22/10/2024). This testimony is directly related to the second benefit, namely information sharing, which includes a variety of issues relevant to NCAs' mission. An official from Slovakia reports that regular discussion – held every few months – take place among the heads of macroprudential departments focusing on both country-specific issues and broader Eurozone developments (interview MP official from central bank Slovakia 28/11/2023). As the same official enthusiastically notes, “such a community exists!” (*ibidem*). To be clear, the Slovak official also acknowledges that while the prevailing culture is one of collaboration, there are occasional instances of national pride in supervisory practices, which can lead to reluctance to cooperate. However, such attitudes are unlikely to persist: “because no one wishes to be side-lined from the community” (*ibidem*).

To be clear, this community is fairly diverse: it has both micro- and macroprudential authorities – from within and outside the Eurozone; moreover, it gathers representatives of both home and host jurisdictions. In addition, it often meets in fora welcoming also private bankers and business associations. A first example is given by the Nordic-Baltic Macroprudential Forum (NBMF) set up in 2011, which brings together central bank governors and heads of supervisory authorities. This is often mentioned across all interviews as a crucial platform for information sharing to manage potential externalities of cross-border banking. A similar example is the already mentioned Vienna Initiative, self-defined as a “supranational public-private platform” (Vienna Initiative Steering Committee 2019) still meeting today on a voluntary basis. Instead, a less similar case is represented by EU's Supervisory Colleges, which, according to an informant from Latvia, “provide critical input to macroprudential decision-makers” (interview expert from financial association Latvia 20/01/2025). All these instances show mixed compositions and support the thesis that the current MP framework has, to some extent, evolved from a pre-existing network of supervisory cooperation that dates back

to before the GFC (see Thiemann 2024). More importantly, the examples speak directly to this section's core argument and raise important questions regarding the logic underlying the MP Triangle. That logic maintains that the current distribution of costs and benefits may be skewed in favour of core countries due, among other things, to the high share of foreign banks, which represent a source of both capital and instability for the host jurisdictions. At the same time, officials from home and host jurisdictions – including private bankers – share one and the same network. How are the tensions inherent to diverse – or opposite – standpoints managed? Do such tensions have a constraining effect on NCAs autonomy?

The evidence of a lively and cohesive macroprudential community already suggests that conflict among its members is rare. However, to make sense of this reality it is necessary to further examines the nuances characterising the *implicit support* to European integration. First, concerns about foreign banks, although rarely materialised, do take a relevant spot in NCAs' FSRs. This is uniformly confirmed by the interviews. An official working at the Central Bank of Lithuania affirms that “it is generally risky to have a great dependence on other countries or to host very big branches”, as these are considered “a sort of structural risk of [the host country's] financial sector” (interview MP official from central bank Lithuania 31/10/2024). Moreover, as added by a former official from the Central Bank of Sweden, “actions of banks, even if they are local, are still influenced by their membership in a financial group” because “whether they operate as branches or subsidiaries doesn't make a difference – they still need to be managed centrally in terms of risk” (interview expert financial from association Latvia 20/01/2025). This centralised management might translate into insensitivity towards the specific needs of the host economy. A high-ranked official from the ECB – also part of the ESRB staff – states that “multinational banks do not care much about those countries, especially if they are small” (interview MP official from central bank Slovenia 22/10/2024). Small host countries still dread the ripple effect triggered by multinational banks

in financial distress, as these are usually *too-big-to-fail* while saving them imply costly implications for the domestic economy – particularly in combination with the new EU resolution framework and the ill-fated delay of the common deposit insurance scheme (Piroska and Epstein 2023). An official from Slovakia pertinently recalls that these banks may appear sound according to certain indicators and assessments, “but then one day problems appear and risk spreads across countries” (interview MP official from central bank Slovakia 18/12/2024).

NCA's autonomy in MP policy serves, among other things, to hinder the sometimes-hurtful drive for profit characterising multinational banks' expansion in peripheral markets – to the extent that it translates into systemic risk. One typical expression of this purpose is the possibility of imposing additional buffer to those credit institutions that arguably pose more risk to financial stability. As briefly mentioned in the Introduction, the buffer for SI institutions is a case of diverging interests, since the O-SII buffer cap may unreasonably affect macroprudential decision-making in the host countries. In particular, the CRD limits the host authority from setting buffers more than 1pp higher than set for the parent bank by the home authority (interview MP official from central bank Estonia 28/12/2023). Such limit is mentioned by NCAs in all Baltic countries for its potential to restrict host countries' ability to increase the buffer requirement for domestic banks of similar size. The fact that it is not listed as a downside of the MP framework by Slovakian and Slovenian authorities does not mean these countries have no reason to watch on the foreign banks in their system. As mentioned earlier, a Slovakian official points out that SI credit institutions in host countries constitute only a small percentage of parent banks' balance sheets, thereby making less likely for small host countries to receive the attention they deserve from the EU-wide MP framework (interview MP official from central bank Slovakia 08/11/2024).

Notwithstanding the material tension between home and host countries, empirical evidence from all cases under examination shows that NCAs eagerly refer to the European MP

framework as a system oriented towards the minimisation of *negative cross-border spillovers*. The tool that, above all, serves this purpose is *reciprocity*.⁶⁵ MP policy adopted by one Member State typically apply only to the exposures of financial institutions operating within its jurisdiction – namely, domestic banks and subsidiaries of foreign banks. Reciprocity occurs when the NCA from another Member State – the reciprocating Member State – adopts an identical or equivalent measure to address the same risk associated with specific exposures. This ensures that financial institutions in both countries are similarly affected by the targeted risk. Ultimately, the aim of reciprocation is to guarantee that all EU financial institutions exposed to a given risk are subject to the same MP tool, regardless of their country of operation. In the words of a high-ranked ESRB official, “of course there is room for improvement, but by and large we are in a better place with reciprocity than without it” (interview MP official from ESRB 04/12/2024). To be clear, reciprocity is only recommended by the ESRB, but NCAs are in charge of the ultimate decision as to whether applying it or not. The positive assessment of NCAs regarding its inclusion in the MP framework, therefore, is not proportional to its tangible impact. Yet again, it shows NCA’s strong appreciation for the balance between the autonomy to prioritise national contingencies and the mere existence of a supranational structure theoretically targeting the public good of financial stability. The latter, this project argues, conveys a sense of security that supports the belonging to the European project. As explicitly stated by an official from Slovakia, the system may not be perfect but “at least, I know exactly what is happening, say, in Austria or other home countries that may be relevant to us” (interview MP official from central bank Slovakia 28/11/2023).

⁶⁵ Sometimes referred to as reciprocation.

Conclusion

This chapter has sought to account for the loyalty of NCAs in Eurozone small host countries towards the existing European MP framework. Despite potential disadvantages posed by the MP Triangle, empirical evidence drawn from extensive interview data reveals that these authorities consistently express strong support for the status quo rather than seeking institutional changes. The analysis presented suggests that this loyalty is predominantly driven by the substantial autonomy the current MP governance arrangements grant NCAs.

This autonomy emerges from three interconnected sources: decentralised decision-making at the supranational level, prominent institutional roles at the national level, and minimal supranational constraints. Decentralised decision-making ensures that MP governance remains anchored primarily within national institutions, notably Central Banks, where macroprudential departments enjoy substantial discretion. The prominence of these departments is evident in their control over policy formulation, implementation, and adaptation, allowing for tailored interventions sensitive to country-specific contexts. Limited supranational constraints further enhance this autonomy, as EU institutions such as the ESRB and ECB largely limit their roles to recommendations and informal coordination rather than binding mandates.

Empirical findings confirm that NCAs utilise this autonomy strategically to focus predominantly on enhancing the resilience of their domestic banking sectors. This emphasis on resilience – primarily through capital buffers, liquidity requirements, and borrower-based measures – is not merely ideological but pragmatically rooted in perceived national financial stability needs. Although the MP framework originally promised a revolutionary shift in the management of financial risk, the actual policy practice, as perceived by NCAs, remains aligned closely with pre-framework prudential approaches. These prioritise credit markets and institutions' stability – through structural measures – over more ambitious countercyclical

objectives. Moreover, even though empirical evidence regarding financial-cycle synchronisation across the Eurozone remains contested, NCAs continue to emphasise the uniqueness of their national contexts as justification for maintaining substantial autonomy.

Furthermore, the sustained loyalty towards the MP framework can be attributed significantly to NCAs' active participation in a transnational epistemic community of macroprudential regulators. This participation offers multiple tangible and intangible benefits, such as opportunities for innovative problem-solving, enhanced access to valuable data and information sharing, and implicit support for EU integration efforts. This community provides platforms, both formal (e.g. ESRB working groups) and informal (e.g. bilateral exchanges and regional networks like the NBMF and the Vienna Initiative), facilitating epistemic exchanges without impinging upon national autonomy.

Finally, the interplay between home and host jurisdictions reveals another critical aspect of NCAs' autonomy: their ability to manage and mitigate cross-border spillovers effectively. Although tensions occasionally arise from diverging interests, particularly concerning multinational banks operating in host countries, the MP framework's mechanisms, especially reciprocity agreements, help reduce these conflicts. Reciprocity, despite being voluntary, symbolises EU-wide recognition of cross-border risks and provides a structural reassurance to host NCAs. Most importantly, it offers yet another representation of the fine balance between pragmatism and rhetoric embraced by peripheral NCAs.

In conclusion, this chapter has shown that NCAs' loyalty is sustained by the MP framework's distinctive governance architecture, which balances significant national autonomy with structured transnational coordination. This governance structure enables NCAs to assert both practical authority and rhetorical legitimacy, reinforcing their confidence in effectively managing financial stability. The empirical evidence ultimately suggests that small host countries value the current framework precisely because it allows them sufficient leeway

to navigate the complexities and risks inherent in the Eurozone's financial integration landscape
– here exemplified by the MP Triangle.

VI. CONCLUSION

Argument and Findings

This qualitative, comparative case study has investigated the reasons why small host countries within the Eurozone – Estonia, Latvia, Lithuania, Slovakia, and Slovenia – maintain their commitment to the current MP framework despite the structural challenges reflected in the MP Triangle. It has argued that the sustained loyalty can be attributed to the formal and substantial autonomy afforded to NCAs by MP governance. The interplay of decentralized decision-making, empowering national governance settings, and limited enforcement powers of the key supranational institutions enables NCAs to safeguard domestic financial stability, to participate on a peer-basis into the transnational epistemic community, and to prevent cross-border spillovers effectively.

The introduction set out the aforementioned empirical puzzle, by developing the MP Triangle and locating it within the context of European integration and the public good of financial stability. Chapter II elaborated this theoretical framework, analysing the macroprudential system from the perspective of EU Integration Studies and finding a gap in the respective literature. As a consequence, it put forward the core hypothesis to guide the ensuing empirical investigation. Chapter III operationalised the MP Triangle through the analysis of the five country-cases, showing that their banking sectors combined resilience with persistent credit constraints and exposure to parent-bank decisions. Chapter IV traced the historical evolution of these banking systems from socialism to market economies, revealing distinct national trajectories alongside shared post-crisis vulnerabilities. Chapter V drew on expert interviews to show how NCAs exercise substantial *de facto* autonomy, enabling them to secure banking sectors' resilience domestically while engaging in EU-level cooperation — a combination that ultimately reinforces their loyalty to the framework.

Thus, the dissertation finds that the MP Triangle exists essentially as a potential menace that remains latent. The current system cannot deliver the public good of financial stability – as already anticipated by the literature (see Schoenmaker 2011; Underhill and Jones 2023) – yet it does not generate a zero-sum game. The autonomy granted by MP governance fosters a distinct perception of the balance between delegation and control in the EU, whereby NCAs’ confidence in their preparedness and capability to deal effectively with financial-stability issues is enhanced. This sentiment is particularly strong considering the typically modest institutional capacity of macroprudential departments in the countries under examination, which usually employ a couple of experts – as personally ascertained during fieldwork. Moreover, this sentiment is amplified by an explicit comparison with core countries’ governance settings, which are viewed as more exposed to politics. NCAs from the peripheries tend to present themselves as comparatively more effective than their peers. Nonetheless, they view peers with esteem, as they are all part of the same transnational epistemic community. Small countries’ NCAs would never renounce the benefits of this membership, which fosters policy learning and policy diffusion (see Mérő and Piroska 2017) as well as exchange of data, and provides a certificate of Europeanism. Crucially, these strategies are not merely rhetorical, as they respond to the necessity of addressing – through MP policy – country-specific conditions of the peripheral economies. This necessity is compellingly reflected in the focus on domestic banking sectors resilience.

These findings speak directly to long-standing debates in EU Integration Studies, calling on existing theories and theoretical approaches to pay closer attention to the MP framework, particularly from the perspective of peripheral small host countries. The following sections further clarify this contribution.

Contribution

This dissertation ultimately argues that the underachieved European integration in the realm of financial supervision – resulting from the inevitable clash of heterogeneous national preferences (Stellinga 2021) – can nevertheless reassure small peripheral countries that their needs could be satisfied. These needs are twofold: firstly, the material imperative to safeguard financial stability in domestic banking sectors; secondly, the political aspiration to be recognized as genuine contributors to the European project. The argument put forward, evidenced by a rich body of interviews, interacts with the literature review reported in Chapter I. The review seeks to determine whether the MP framework, beyond its empirical dimension, aligns with the pursuit of a greater good – namely the public good of financial stability – which typically coincides with the goal of European integration. The negative concept of such a goal, as I define it, would be a fragile, temporary compromise that merely tolerates uneven distributional implications – instead of promoting balanced economic development. In order to provide a satisfactory answer that reflect the complexity of the reality under examination, it is necessary to consider two separate aspects.

On a theoretical level, two conclusions can be drawn. Firstly, the institutional perspective indicates that the MP framework does not fully correspond to European integration as conceptualised by mainstream integration theories: the MP triangle reveals that peripheral small host countries face specific challenges; however, this sub-optimal status quo does not lead to further integration contrary to the predictions of mainstream EU Integration Studies. Secondly, the literature has investigated the balance between market-enforcing and market-correcting integration strategies, yet it has not been able to pinpoint the precise position of the MP framework within this spectrum: following the economic perspective, the framework qualifies as a unique arrangement raising concerns about its potential distributional implications. Non-discriminatory market integration – à la Balassa (1969) – is the ultimate goal

of the cooperation among Member States, which have agreed on numerous opportunities to pool and/or delegate competencies above the nation-state. Such a necessity is somewhat self-feeding, since increasing market integration generates interdependencies which, in turn, require further cooperation: potential market failures may result in an uneven distribution of costs.

On the empirical level, however, this study finds a striking divergence from theoretical expectations. The data suggests that the fragility of the current setting – along with its inherent asymmetries – are perceived differently by Eurozone peripheral NCAs. These actors are able to moderate their criticism as a result of the recognition they have acquired within the broader transnational epistemic community – including locally – and the possibility to tailor policy to their priorities. The tension between structural limitations and perceived adequacy illustrates the ambivalent nature of the MP framework. On paper, it falls short of supranational integration and lacks strong enforcement mechanisms. As a matter of fact, NCAs see it as a system that gives them real power and makes it easier to plan their work. One interviewee from the Central Bank of Slovakia expressed it eloquently: “[The] system may not be perfect in terms of its supranational centralisation, but it is already there” (interview MP official from central bank Slovakia 28/11/2023). The very features that could be interpreted as institutional weaknesses – fragmentation, limited convergence, uneven supranationalisation – are reinterpreted as functional advantages: flexibility, local autonomy, and access to information. The duality of the MP framework is well illustrated by the concept of *pharmakon*, which encapsulates the gap between two alternative – sometimes conflicting – interpretations of the same phenomenon. In this sense, MP governance works like a *pharmakon*: in principle, it can cause uneven distribution; in practice, it can provide a stable, enabling framework for minor peripheral players at the same time.

This hermeneutical reading not only clarifies the complexity of the empirical puzzle and its resolution but also constitutes the core theoretical contribution of this dissertation: when

examining European integration from the perspective of the Eurozone peripheries and the case of financial stability, the classic dichotomy between market enforcement versus market correction, on the one side, and negative vs. positive integration, on the other, necessitates an honest review. In particular, the case under examination indicates the necessity to integrate Scharpf's structuralist asymmetry thesis with a constructivist understanding, in order to realise that actors' agency can reframe issues and determine what is politically and materially feasible. As argued in the Introduction to this dissertation, Eurozone peripheral NCAs utilise the existing governance structure to break down the challenges of the MP Triangle into politically manageable components to their advantage.

From Re-Insurance to Re-Assurance

To be clear, Scharpf's thesis that European integration suffers from a pro-market bias has been the subject of considerable discussion and review lately. A *Discussion* on the *Journal of European Public Policy* including relevant interventions was published about a month prior to the submission of this dissertation. Driven by the similar intention to review – and revise – the mainstream approach to European integration, Schelkle argues that the classic binary of negative and positive integration might not be the most effective framework for understanding the EU (Schelkle 2025). On the contrary, the polity is best understood as a political system with “institutional memory” and “reflexive capacity” (*ibidem*). This means that the EU adapts in response to crises without fundamentally transforming into a federal entity. Instead, it builds a form of mutual protection – what Schelkle calls “re-insurance” – that allows national differences to persist while still achieving collective stabilization (*ibidem*).

While this dissertation acknowledges the great value of Schelkle's reflections, it compels to introduce and discuss a complementary dynamic: rather than *re-insurance*, MP governance serves primarily as a mechanism of *re-assurance*. Certain critical actors, likely

those whose role is either crucial or simply emphasised by the context such as NCAs, are reassured that their distinct concerns are recognised as legitimate and consequential. However, two important caveats must be considered:

1. The observed reassuring effects primarily reflect the perspectives of NCAs. Despite their institutional authority, these actors do not necessarily represent broader societal or political interests beyond financial stability, although this domain is undeniably crucial.
2. The form of Europeanism exhibited through MP governance is arguably transnational rather than supranational. The epistemic community of macroprudential regulators operates primarily through horizontal professional coordination and shared expertise rather than through hierarchical political integration.

In sum, MP governance demonstrates that limited supranational integration does not necessarily impede positive outcomes from the standpoint of peripheral NCAs. However, recognizing the partiality and bounded nature of these outcomes is critical. Structures alone do not determine outcomes (Crespy 2025): perception is what eventually turns a *pharmakon* from a source of danger into one of salvation. In practical terms, this translates into three core, interrelated achievements identified by this dissertation's central hypothesis: enhanced resilience of national credit institutions, effective membership in a transnational epistemic community, and the capacity to manage the negative externalities of financial integration.

Experimentalism Revised

The analysis presented throughout this dissertation requires revisiting the concept of experimentalist governance (XG), introduced in Chapter I as a potentially relevant analytical

lens. At first glance, MP governance exhibits similarities to the experimentalist approach elaborated by Zeitlin and Sabel (2008): it embodies a polyarchic arrangement characterised by significant national discretion combined with shared monitoring at the EU level, thereby recalling foundational aspects of Directly Deliberative Polyarchy (DDP) (*ibidem*).

However, this dissertation's empirical findings reveal important limitations in directly applying XG to the MP framework. Firstly, one of the central features of experimentalism – recursive learning aimed at common policy innovation – is not a primary, deliberate objective within MP governance. Instead, as evidenced by the interviews conducted, learning occurs incidentally through informal exchanges in ESRB working groups. Rather than consciously developing shared policy solutions, national authorities engage in reciprocal, indirect influence driven primarily by a common sense of professional belonging. Secondly, XG frameworks typically incorporate increasing penalty defaults to maintain participants' compliance and alignment with collectively agreed objectives (Zeitlin 2022). By contrast, MP governance explicitly lacks such strong enforcement mechanisms. Instead, it tolerates considerable differentiation and permits flexibility to NCAs in designing and implementation of the macroprudential toolkit, with limited pressure toward full convergence. This flexibility is instrumental in producing the “re-assurance” mechanism identified by this dissertation, further differentiating MP governance from classic experimentalist models that prioritize collective convergence as the standard of successful integration. Most importantly, the existence and persistence of the MP Triangle directly challenge XG's applicability to MP governance. Experimentalism assumes the transformative power of institutional heterogeneity, viewing differentiation as a leverage point toward greater integration. The MP Triangle, by contrast, illustrates persistent asymmetries and structural vulnerabilities that remain unresolved rather than overcome. Hence, MP governance emerges as a distinctive hybrid arrangement, where

partial – or limited – European integration meets national autonomy and strategic transnational collaboration.

Thus, rather than qualifying as a pure form of experimentalist governance, MP governance may be best understood as a case of partial experimentalism, exhibiting some experimentalist traits without fully committing to the integrative, transformative logic central to the XG paradigm. This unique position clarifies and sharpens this dissertation's contribution to broader debates on European integration. It highlights how limited supranational integration and the consequential obstacles in delivering the public good of financial stability, coupled with flexible national autonomy and the absence of deliberate recursive learning, can still yield positive outcomes, though circumscribed and contingent upon specific actors and contexts. Ultimately, the MP framework demonstrates the necessity of broadening the theoretical conversation beyond established integration theories, to more precisely capture the reality of contemporary EU governance structures.

Policy Relevance

Although conceived primarily as a theoretical contribution, the findings of this dissertation have direct implications for ongoing debates on the governance of European public goods – and for understanding the evolution of European integration. By situating the MP framework within the context of European integration, the analysis offers a perspective on how limited supranationalisation can nonetheless yield positive outcomes for certain actors in the Eurozone peripheries.

The results suggest that granting a degree of national autonomy – despite its apparent inconsistency with the aim of delivering a European public good – may in some cases strengthen the overall resilience of the system. In the macroprudential domain, such autonomy

enables critical peripheral actors to address country-specific issues while participating in supranational – read transnational – coordination mechanisms. This challenges the expectation, implicit in much of the literature, that centralisation or experimentalist harmonisation are necessary to deliver European public goods. The tension between delegation and control, acknowledged as a structural feature of EU governance, emerges here as a central factor in reconciling EU-wide objectives with national priorities. The findings show that national autonomy can exist alongside significant cooperation and may even play a key role in involving peripheral actors. While the NCAs examined here do not represent the full range of interests in their respective political-economies, their perspective is nonetheless significant: it shapes how macroprudential policy is implemented in practice and influences the integration-autonomy balance in other policy domains.

Defining financial stability as a European public good highlights the political and economic aspects of the governance challenge. The current MP framework does not fully deliver that public good, yet it prevents outcomes from degenerating into a zero-sum game between core and periphery. The ways in which *reassurance* works – based on institutional independence, acknowledgment from peers, and connection to a global knowledge network – helps reduce possible distributional conflicts. This outcome aligns with the conceptual metaphor of the *pharmakon* – simultaneously embedding a source of danger and one of salvation. This dynamic may be important for the governance of other European public goods, like energy security or water management, where integration encounters similar tensions between uniformity and responsiveness to local conditions. These insights gain more importance in the current context of strategic discussions about the EU's future. Recent policy reports, by Letta (2024) and Draghi (2024),⁶⁶ indicate that the EU has reached a satisfactory

⁶⁶ To download the reports, follow these links: https://single-market-economy.ec.europa.eu/news/enrico-lettas-report-future-single-market-2024-04-10_en; https://single-market-economy.ec.europa.eu/news/enrico-lettas-report-future-single-market-2024-04-10_en.

level of market and regulatory integration, addressing both market-enforcing and market-correcting aspects. However, the evidence presented here highlights the ongoing imbalance between these strategies and how it influences core-periphery relations, especially in the area of financial stability but also beyond. As maintained by Bruszt, Piroska and Medve-Bálint (2022), post-GFC EU institutional reforms have not fundamentally transformed the EU polity, missing opportunities to build a genuine level playing field.

Recognising the potential benefits of national autonomy for specific actors – while acknowledging its limits for delivering inclusive public goods – could inform better policy design and impact assessments in the face of future integration challenges, including prospective EU enlargement and sectoral reforms.

Limitations

While this study provides novel insights into the role of MP governance in sustaining the loyalty of small Eurozone host countries, there are a number of limitations that affect its findings and suggest clear venues for future research. The limitations identified in this section relate to the empirical scope, methodological approach, and theoretical framing.

The analysis has focused uniquely on the limited perspective of NCAs, which in the countries studied are part of central banks. While these actors are required to ensure financial stability, they cannot claim that they represent all societal or political interests in peripheral countries. These actors are institutionally appointed to safeguard financial stability. Their viewpoint shows a practical, technical reasoning influenced by their involvement in a transnational network of financial regulators. This specific perspective restricts the explanatory range of the findings and overlooks other aspects of core-periphery relations, including those that might be more apparent to fiscal authorities, political actors, or market participants. In

other words, this research focuses on the views of a particular elite – rather than providing a complete picture of the Eurozone peripheries.

Second, the investigation is interested in sectoral dynamics. To begin with, the exclusive focus on banking leaves other segments of the financial system, such as capital markets and non-bank financial intermediaries, outside the analysis. While this choice reflects the central role of banking in the economy, it excludes potential vulnerabilities and spillovers from other sectors that do matter to financial stability. In addition, also the sectoral focus on MP departments within central banks carries its own bias. These departments constitute a distinct niche: their emergence and consolidation were partly a by-product of monetary policy centralisation in the European Central Bank, which curtailed the autonomy of national monetary policy units. While this shift enhanced the institutional profile of MP units, it also consolidated certain professional orientations. For instance, although MP policy includes both structural and counter-cyclical aspects, the peripheral NCAs in this study focused more on structural resilience than on counter-cyclicality. This raises questions for future research: is the prevalence of structural measures a path-dependent element or instead the response to country-specific conditions – including the high share of foreign banks? Exploring this question could shed lights on the already debated micro-prudential mindset characterizing MP policy.

Third, and the related to the last point, it is important to disclose relevant methodological challenges. The empirical analysis has employed systemic risk indicators that reflect prevailing supervisory practice but remain contested in the literature and in practice. These metrics are shaped by the dual nature of MP policy – structural, resilience-focused measures versus time-varying, counter-cyclical tools. The tension between these approaches may not have directly influenced the present study but it certainly constituted an obstacle for the general research design and the interactions with the experts interviewed. On a related note, Elite interviews in central banks and supervisory authorities entail inherent access barriers, and

even when secured, officials may exercise discretion in the information they disclose. While Banking Union-related documents are comprehensive by design, other technical reports available in English often offer only partial coverage of relevant developments.

Venues for Future Research

Addressing the abovementioned limitations opens several directions for future research. One is to broaden the set of actors examined. This study has focused on NCAs within central banks, but future work could look at finance ministries, political actors, market participants, and civil society organisations. This would help assess whether the reassuring effects of MP governance are widely shared or mainly confined to a narrow technocratic community. Such an approach could be combined with a comparative design covering both Eurozone and non-Eurozone peripheries, which would help reveal how different institutional contexts shape these perceptions. At the same time, expanding the scope of analysis beyond banking – to capital markets, non-bank financial institutions, and cross-sectoral linkages – would make it possible to test whether the *pharmakon* dynamic identified here also applies outside the banking sector.

Another promising direction is to study more closely the dynamics of the transnational epistemic community itself. In *Priests of Prosperity* (2016), Johnson argues that the transformation of central banks in post-communist countries was driven primarily by a powerful, cohesive, and highly homogenous transnational community, who fostered the transplantation and internationalisation of key principles of Western central-banking – such as price stability, inflation targeting, independence, and transparency. The author compellingly portrays this network as a “wormhole”, because of its ability to connect professionals across borders quickly and effectively, allowing ideas and practices to circulate with minimal political interference. The present research suggests possible similarities for macroprudential departments in the Eurozone periphery. These units are a niche within central banking, and

their rise in prominence is linked to the loss of autonomy in monetary policy departments after the centralisation of monetary policy in the ECB. This transition likely enhanced the prominence of MP departments within their institutions and fostered stronger connections with a cohesive, transnationally oriented network of colleagues.

At the same time, the interviews conducted for this investigation implicitly indicate the existence of potential tensions between different departments over the management of financial stability. Future investigations could help determine whether such tensions derive from the belief that inflation is a significantly more critical and constructive objective than the counter-cyclical measures required by monetary policy. Relatedly, these studies could also address the observed prioritisation of structural over counter-cyclical measures in peripheral NCAs, determining whether this reflects structural dependencies – particularly the role of foreign-owned banks – or choices rooted in persistent ideologies aligned with the micro-prudential mindset.

Furthermore, future research could collect additional evidence to confirm whether MP departments exhibit the same “wormhole” characteristics described by Johnson (2016) for classic central-banking networks – namely the ability to exchange information, diffuse norms, and coordinate policy approaches across borders with high efficiency and low political friction. More crucially, such an inquiry could also examine whether the existence of such networks is a necessary condition for European integration in policy domains that would otherwise be characterised by high levels of political contestation. It could also question whether integration in the absence of these networks produces more conflictual, less cooperative outcomes. This line of research would not only clarify the role of epistemic communities in stabilising sub-optimal governance arrangements but also help strengthen the argument that certain domains of EU integration, like MP policy, can function with limited formal supranational authority.

These research directions address gaps identified here and are also connected to the central question that guided this dissertation: how can a governance framework marked by structural asymmetries still secure the loyalty of peripheral actors? The MP framework falls short of the integrative force – and ideal – typically contemplated by mainstream EU integration theories, and it cannot grant the production of the European public good of financial stability. At the same time, the evidence indicates that it delivers functional benefits for Eurozone small host countries in the specific domain of banking stability: regulatory autonomy, the capacity to tailor policy to domestic needs, and meaningful participation in transnational professional networks. These features prevent it from degenerating into a zero-sum game and provide tangible benefits to technocratic actors in the periphery. However, functional adequacy for certain actors does not render the status quo normatively desirable. As Bruszt et al. (2021) argue, post-GFC EU institutional reforms have not fundamentally transformed the EU polity, missing the opportunity to build a genuine level playing field. The temporary sustainability of a setting such as the MP framework of this settlement may simply reflect that existing power imbalances and structural asymmetries have been managed rather than resolved, thereby raising the question as to whether a system that works for some can really be considered suitable for everyone.

BIBLIOGRAPHY

- Agénor, Pierre-Richard, Enisse Kharroubi, Leonardo Gambacorta, and Giovanni Lombardo. 2017. *The International Dimensions of Macroprudential Policies*.
- Alam, Zohair, Mr Adrian Alter, Jesse Eiseman, et al. 2019. "Digging Deeper--Evidence on the Effects of Macroprudential Policies from a New Database." *IMF Working Papers*, IMF Working Papers, vol. 2019 (66): 2019/066.
- Ampudia, Miguel, Marco Lo Duca, Mátyás Farkas, Gabriel Perez-Quiros, Gerhard Rünstler, and Eugen Tereanu. 2021. *On the Effectiveness of Macroprudential Policy*. May.
- Andrieș, Alin Marius, Florentina Melnic, and Nicu Sprincean. 2022. "The Effects of Macroprudential Policies on Credit Growth." *The European Journal of Finance* 28 (10): 964–96. <https://doi.org/10.1080/1351847X.2021.1939087>.
- Arató, Krisztina, Boglarka Koller, and Anita Pelle. 2021. *The Political Economy of the Eurozone in Central and Eastern Europe: Why In, Why Out?* Routledge.
- Badarau, Cristina, Marcos Carias, and Jean-Marc Figuet. 2020. "Cross-Border Spillovers of Macroprudential Policy in the Euro Area." *The Quarterly Review of Economics and Finance* 77 (August): 1–13. <https://doi.org/10.1016/j.qref.2020.01.005>.
- Baker, Andrew. 2013a. "The New Political Economy of the Macroprudential Ideational Shift." *New Political Economy* 18 (1): 112–39. <https://doi.org/10.1080/13563467.2012.662952>.
- Baker, Andrew. 2013b. "The Gradual Transformation? The Incremental Dynamics of Macroprudential Regulation." *Regulation & Governance* 7 (4): 417–34. <https://doi.org/10.1111/rego.12022>.
- Baker, Andrew. 2015. *The Bankers' Paradox: The Political Economy of Macro Prudential Regulation*. No. 37. SRC Discussion Paper Series. LSE Systemic Risk Center.
- Bakker, Bas B., and Christoph A. Klingen. 2012. *How Emerging Europe Came Through the 2008/09 Crisis: An Account by the Staff of the IMF's European Department*. International Monetary Fund. <https://www.elibrary.imf.org/display/book/9781616353810/9781616353810.xml>.
- Balassa, Bela. 1969. *The Theory of Economic Integration (Routledge Revivals)*. George Allen and Unwin LTD.

- Ban, Cornel, and Dorothee Bohle. 2021. "Definancialization, Financial Repression and Policy Continuity in East-Central Europe." *Review of International Political Economy* 28 (4): 874–97. <https://doi.org/10.1080/09692290.2020.1799841>.
- Basel Committee on Banking Supervision. 2008. *Principles for Sound Liquidity Risk Management and Supervision*. Bank of International Settlement. <https://www.bis.org/publ/bcbs144.htm>.
- Basel Committee on Banking Supervision. 2013. *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools*. Bank of International Settlement. <https://www.bis.org/publ/bcbs238.htm>.
- Baudino, Patrizia, Olga Lielkalne, Tomas Reichenbachas, Mari Tamm, and Rastko Vrbaski. 2022. *The 2008 Financial Crises in the Baltic Countries*. FSI Crisis Management Series, no 3. Bank for International Settlements, Financial Stability Institute.
- Belfrage, Claes Axel, and Markus Kallifatides. 2018. "The Politicisation of Macroprudential Regulation: The Critical Swedish Case." *Environment and Planning A: Economy and Space* 50 (3): 709–29. <https://doi.org/10.1177/0308518X17750877>.
- Bjerregaard, Elisabetta, and Tom Kirchmaier. 2019. "The Danske Bank Money Laundering Scandal: A Case Study." SSRN Scholarly Paper No. 3446636. Social Science Research Network, September 2. <https://doi.org/10.2139/ssrn.3446636>.
- Bloomberg. 2013. "Lithuanian Siauliu Bankas Agrees to Assume Insolvent Ukio Assets." *Bloomberg.Com*, February 24. <https://www.bloomberg.com/news/articles/2013-02-24/lithuanian-siauliu-bankas-agrees-to-assume-insolvent-ukio-assets>.
- Bohle, Dorothee. 2018. "Mortgaging Europe's Periphery." *Studies in Comparative International Development* 53 (2): 196–217. <https://doi.org/10.1007/s12116-018-9260-7>.
- Bohle, Dorothee, and Béla Greskovits. 2012. *Capitalist Diversity on Europe's Periphery*. Cornell University Press.
- Bonizzi, Bruno. 2013. "Financialization in Developing and Emerging Countries." *International Journal of Political Economy* 42 (4): 83–107. <https://doi.org/10.2753/IJP0891-1916420405>.
- Borio, Claudio. 2014. "Macroprudential Frameworks: (Too) Great Expectations?" August 13. <https://www.bis.org/speeches/sp140813.htm>.
- Borish, Michael S., Wei Ding, and Michel Noël. 1997. "The Evolution of the State-owned Banking Sector during Transition in Central Europe." *Europe-Asia Studies* 49 (7): 1187–208. <https://doi.org/10.1080/09668139708412496>.

- Bortz, Pablo G., and Annina Kaltenbrunner. 2018. "The International Dimension of Financialization in Developing and Emerging Economies." *Development and Change* 49 (2): 375–93. <https://doi.org/10.1111/dech.12371>.
- Braun, Benjamin, and Marina Hübner. 2018. "Fiscal Fault, Financial Fix? Capital Markets Union and the Quest for Macroeconomic Stabilization in the Euro Area:" *Competition & Change*, ahead of print, February 14. Sage UK: London, England. <https://doi.org/10.1177/1024529417753555>.
- Brenner, Dominik. 2021. *Fortressing on Markets: Financial Supervision in the Capital Markets Union*. CEU Political Science Department PhD Theses 2021/7. Central European University.
- Bruszt, László, and Julia Langbein. 2020. "Manufacturing Development: How Transnational Market Integration Shapes Opportunities and Capacities for Development in Europe's Three Peripheries." *Review of International Political Economy* 27 (5): 996–1019. <https://doi.org/10.1080/09692290.2020.1726790>.
- Bruszt, Laszlo, and Gerald A. McDermott. 2014. *Leveling the Playing Field: Transnational Regulatory Integration and Development*. Oxford University Press.
- Bruszt, László, Dóra Piroska, and Gergő Medve-Bálint. 2022. "The EIB in the Light of European Integration Theories: Conserving the Tilted Playing Field." In *Deciphering the European Investment Bank*. Routledge.
- Bruszt, Laszlo, and Visnja Vukov. 2017. "Making States for the Single Market: European Integration and the Reshaping of Economic States in the Southern and Eastern Peripheries of Europe." *West European Politics* 40 (4): 663–87. <https://doi.org/10.1080/01402382.2017.1281624>.
- Bruszt, Laszlo, and Visnja Vukov. 2024. "Core-Periphery Divisions in the EU? East-West and North-South Tensions Compared." *Journal of European Public Policy* 0 (0): 1–24. <https://doi.org/10.1080/13501763.2023.2290205>.
- Brzoza-Brzezina, Michał, Marcin Kolasa, and Krzysztof Makarski. 2015. "Macroprudential Policy and Imbalances in the Euro Area." *Journal of International Money and Finance* 51: 137–54.
- Cantone, David, Nadya Jahn, and Elena Rancoita. 2019. *Thinking beyond Borders: How Important Are Reciprocity Arrangements for the Use of Sectoral Capital Buffers?* No. 8. Macroprudential Bulletin. European Central Bank. https://www.ecb.europa.eu/press/financial-stability-publications/macroprudential-bulletin/html/ecb.mpbu201909_02~2c474f05ba.en.html#toc1.
- Cardoso, Fernando Henrique, and Enzo Faletto. 1979. *Dependency and Development in Latin America*. University of California Press.

- Carpantier, Jean-Francois, Javier Olivera, and Philippe Van Kerm. 2018. "Macroprudential Policy and Household Wealth Inequality." *Journal of International Money and Finance* 85 (July): 262–77. <https://doi.org/10.1016/j.jimonfin.2017.11.009>.
- Cassola, Nuno, Christoffer Kok, and Francesco Paolo Mongelli. 2019. *The ECB after the Crisis: Existing Synergies among Monetary Policy, Macroprudential Policies and Banking Supervision*.
- Central Bank of Italy. 2022. "An EU Legal Framework for Macroprudential Supervision through Borrower-Based Measures." Conference Papers, Quaderni di Ricerca Giuridica della Consulenza Legale (September).
- Central Bank of Latvia. 2018. *Financial Stability Report*. Central Bank of Latvia.
- Cerutti, Eugenio, Stijn Claessens, and Luc Laeven. 2017. "The Use and Effectiveness of Macroprudential Policies: New Evidence." *Journal of Financial Stability* 28 (C): 203–24.
- Cerutti, Eugenio M., and Haonan Zhou. 2018. "Cross-Border Banking and the Circumvention of Macroprudential and Capital Control Measures." IMF Working Papers. *IMF Working Papers* 2018 (217). <https://doi.org/10.5089/9781484378328.001.A001>.
- Covi, Giovanni, Mehmet Ziya Gorpe, and Christoffer Kok. 2021. "CoMap: Mapping Contagion in the Euro Area Banking Sector." *Journal of Financial Stability* 53 (April): 100814. <https://doi.org/10.1016/j.jfs.2020.100814>.
- Crespy, Amandine. 2025. "The Asymmetry of EU Socio-Economic Governance: Theoretical Fault Lines and Constructivist Avenues for Future Research." *Journal of European Public Policy* 0 (0): 1–13. <https://doi.org/10.1080/13501763.2025.2516120>.
- Dal Maso, Giulia. 2022. "Past and Present Financialization in Central Eastern Europe: The Case of Western Subsidiary Banks." *Journal of Balkan and Near Eastern Studies* 24 (1): 60–77. <https://doi.org/10.1080/19448953.2021.1992185>.
- Darracq Paries, Matthieu, Christoffer Kok, and Elena Rancoita. 2019. "Macroprudential Policy in a Monetary Union with Cross-Border Banking." SSRN Scholarly Paper No. 3364096. Rochester, NY, March 29. <https://doi.org/10.2139/ssrn.3364096>.
- De Larosière. 2009. *High-Level Group on Financial Supervision in the EU*.
- De Schryder, Selien, and Frederic Opitz. 2021. "Macroprudential Policy and Its Impact on the Credit Cycle." *Journal of Financial Stability* 53 (April): 100818. <https://doi.org/10.1016/j.jfs.2020.100818>.

- Dehmej, Salim, and Leonardo Gambacorta. 2019. "Macroprudential Policy in a Monetary Union." *Comparative Economic Studies* 61 (2): 195–212. <https://doi.org/10.1057/s41294-019-00085-0>.
- Della Porta, Donatella, and Michael Keating. 2008. *Approaches and Methodologies in the Social Sciences: A Pluralist Perspective*. Cambridge University Press.
- Deutsche Welle. 2013. "Slovenia Recapitalization Plan – DW – 12/12/2013." *Dw.Com*, December 12. <https://www.dw.com/en/slovenia-says-it-can-fix-banking-sector-without-international-aid/a-17289722>.
- Donnelly, Shawn. 2014. "Power Politics and the Undersupply of Financial Stability in Europe." *Review of International Political Economy* 21 (4): 980–1005. <https://doi.org/10.1080/09692290.2013.801021>.
- Draghi, Mario. 2018. "Risk-Reducing and Risk-Sharing in Our Monetary Union." (European University Institute), November 5. <https://www.ecb.europa.eu/press/key/date/2018/html/ecb.sp180511.en.html>.
- Dumičić, Mirna. 2018. "Effectiveness of Macroprudential Policies in Central and Eastern European Countries." *Public Sector Economics* 42 (1): 1–19. <https://doi.org/10.3326/pse.42.1.1>.
- Eberlein, Burkard, and Edgar Grande. 2005. "Beyond Delegation: Transnational Regulatory Regimes and the EU Regulatory State." *Journal of European Public Policy* 12 (1): 89–112.
- ECB Financial Stability Committee. 2020a. *Cross-Border Spillover Effects of Macroprudential Policies: A Conceptual Framework*. No. 242/2020. Occasional Paper Series. European Central Bank. <https://data.europa.eu/doi/10.2866/40927>.
- ECB Financial Stability Committee. 2020b. "Framework to Assess Cross-Border Spillover Effects of Macroprudential Policies." European Central Bank, April.
- Eller, Markus, Reiner Martin, Helene Schuberth, and Lukas Vashold. 2020. "Macroprudential Policies in CESEE—an Intensity-Adjusted Approach." *Focus on European Economic Integration* Q2/20, 65–81.
- Enderlein, Henrik, and Amy Verdun. 2009. "EMU's Teenage Challenge: What Have We Learned and Can We Predict from Political Science?" *Journal of European Public Policy* 16 (4): 490–507. <https://doi.org/10.1080/13501760902872106>.
- Enria, Andrea. 2019. "Mutually Assured Cooperation – the Issue of Cross-Border Banks." Paper presented at The Institute of International Finance, Washington DC. December 4. <https://www.bankingsupervision.europa.eu/press/speeches/date/2019/html/ssm.sp190412~40a85c6eab.en.html>.

- Epstein, Rachel A. 2014. "When Do Foreign Banks 'Cut and Run'? Evidence from West European Bailouts and East European Markets." *Review of International Political Economy* 21 (4): 847–77.
- Epstein, Rachel A. 2017. *Banking on Markets: The Transformation of Bank-State Ties in Europe and Beyond*. Oxford University Press.
<https://doi.org/10.1093/oso/9780198809968.001.0001>.
- Epstein, Rachel A., and Martin Rhodes. 2014. *International in Life, National in Death? Banking Nationalism on the Road to Banking Union*.
- Epstein, Rachel, and Martin Rhodes. 2018. "From Governance to Government: Banking Union, Capital Markets Union and the New EU." *Competition & Change* 22 (2): 205–24. <https://doi.org/10.1177/1024529417753017>.
- European Central Bank. 2018. "ECB Determined ABLV Bank Was Failing or Likely to Fail." *Press Release*, February 24.
<https://www.bankingsupervision.europa.eu/press/pr/date/2018/html/ssm.pr180224.en.html>.
- European Systemic Risk Board. 2018. *The ESRB Handbook on Operationalising Macroprudential Policy in the Banking Sector*. Publications Office.
<https://data.europa.eu/doi/10.2849/04791>.
- Feyen, Erik, Raquel Letelier, Inessa Love, Samuel Munzele Maimbo, and Roberto Rocha. 2014. *The Impact of Funding Models and Foreign Bank Ownership on Bank Credit Growth: Is Central and Eastern Europe Different?* Policy Research Working Papers. The World Bank. <https://doi.org/10.1596/1813-9450-6783>.
- Financial Times. 2025. "EU Cracks down on State Meddling in Bank M&A." *European Banks*. *Financial Times*, July 20. <https://www.ft.com/content/ac3586cd-ca27-47e6-ba76-d6b55c57efd3>.
- Fleming, Alexander, Alex Lily, and Marie-Renee Bakker. 1997. "Banking Crises in the Baltics." *Finance & Development*. *Finance & Development* 34 (001).
<https://doi.org/10.5089/9781451953206.022.A013>.
- Fontán, Ismael Ahmad, Thorsten Beck, Katia D'Hulster, Pamela Lintner, and D Filiz Unsal. 2019. *Banking Supervision and Resolution in the EU: Effects On Small Host Countries In Central, Eastern And South Eastern Europe*.
- Galán, Jorge E. 2020. "The Benefits Are at the Tail: Uncovering the Impact of Macroprudential Policy on Growth-at-Risk." *Journal of Financial Stability*, November 23, 100831. <https://doi.org/10.1016/j.jfs.2020.100831>.
- Galati, Gabriele, and Richhild Moessner. 2017. "What Do We Know About the Effects of Macroprudential Policy?" *Economica* 85 (340): 735–70.
<https://doi.org/10.1111/ecca.12229>.

- Genschel, Philipp, and Markus Jachtenfuchs. 2014. *Beyond the Regulatory Polity?: The European Integration of Core State Powers*. OUP Oxford.
- Genschel, Philipp, and Markus Jachtenfuchs. 2016. "More Integration, Less Federation: The European Integration of Core State Powers." *Journal of European Public Policy* 23 (1): 42–59. <https://doi.org/10.1080/13501763.2015.1055782>.
- Genschel, Philipp, and Markus Jachtenfuchs. 2018. "From Market Integration to Core State Powers: The Eurozone Crisis, the Refugee Crisis and Integration Theory." *JCMS: Journal of Common Market Studies* 56 (1): 178–96. <https://doi.org/10.1111/jcms.12654>.
- Goertz, Gary. 2006. *Social Science Concepts: A User's Guide*. Princeton University Press.
- Grittersová, Jana. 2014. "Transfer of Reputation: Multinational Banks and Perceived Creditworthiness of Transition Countries." *Review of International Political Economy* 21 (4): 878–912. <https://doi.org/10.1080/09692290.2013.848373>.
- Haas, Ernst B. 2004. *The Uniting of Europe: Political, Social, and Economic Forces, 1950-1957*. University of Notre Dame Press.
- Haas, Ralph de, and Iman van Lelyveld. 2010. "Internal Capital Markets and Lending by Multinational Bank Subsidiaries." *Journal of Financial Intermediation* 19 (1): 1–25. <https://doi.org/10.1016/j.jfi.2009.02.001>.
- Hafeez, Bilal, Xiping Li, M. Humayun Kabir, and David Tripe. 2022. "Measuring Bank Risk: Forward-Looking z-Score." *International Review of Financial Analysis* 80 (March): 102039. <https://doi.org/10.1016/j.irfa.2022.102039>.
- Hirschman, Albert O. 1970. *Exit Voice and Loyalty: Responses to Decline in Firms, Organizations, and States*. Harvard Univ Pr.
- Hooghe, Liesbet, and Gary Marks. 1997. *The Making of a Polity: The Struggle over European Integration*. https://cadmus.eui.eu/bitstream/handle/1814/1509/1997_EUI%20WP_RSCAS_031.pdf?sequence=1.
- Hooghe, Liesbet, and Gary Marks. 2019. "Grand Theories of European Integration in the Twenty-First Century." *Journal of European Public Policy* 26 (8): 1113–33. <https://doi.org/10.1080/13501763.2019.1569711>.
- Höpner, Martin, and Armin Schäfer. 2010. "A New Phase of European Integration: Organised Capitalisms in Post-Ricardian Europe." *West European Politics* 33 (2): 344–68. <https://doi.org/10.1080/01402380903538997>.
- Höpner, Martin, and Armin Schäfer. 2012a. "Embeddedness and Regional Integration: Waiting for Polanyi in a Hayekian Setting." *International Organization* 66 (3): 429–55. <https://doi.org/10.1017/S002081831200015X>.

- Höpner, Martin, and Armin Schäfer. 2012b. "Integration Among Unequals: How the Heterogeneity of European Varieties of Capitalism Shapes the Social and Democratic Potential of the EU." SSRN Scholarly Paper No. 2149634. Rochester, NY, July 27. <https://doi.org/10.2139/ssrn.2149634>.
- Howarth, David, and Lucia Quaglia. 2015. *The Political Economy of the Single Supervisory Mechanism: Squaring the 'Inconsistent Quartet.'*
- Howarth, David, and Lucia Quaglia. 2016. "The Comparative Political Economy of Basel III in Europe." *Policy and Society* 35 (3): 205–14.
- Howarth, David, and Amy Verdun. 2020. "Economic and Monetary Union at Twenty: A Stocktaking of a Tumultuous Second Decade: Introduction." *Journal of European Integration* 42 (3): 287–93.
- Huljak, Ivan, Reiner Martin, Diego Moccero, and Cosimo Pancaro. 2022. "Do Non-Performing Loans Matter for Bank Lending and the Business Cycle in Euro Area Countries?" *Journal of Applied Economics* 25 (1): 1050–80. <https://doi.org/10.1080/15140326.2022.2094668>.
- Ibrocevic, Edin. 2022. "Independence without Purpose? Macroprudential Regulation at the Bundesbank." *Economy and Society* 0 (0): 1–24. <https://doi.org/10.1080/03085147.2022.2117339>.
- International Monetary Fund. 2001. "Successful Transition: Estonia Establishes Itself as Market Economy in Position for Accession to European Union." IMF Survey. *IMF Survey* 30 (018). <https://doi.org/10.5089/9781451927894.023.A007>.
- International Monetary Fund. 2008. "Press Release: IMF Executive Board Approves 1.68 Billion (US\$2.35 Billion) Stand-By Arrangement for Latvia." *IMF*, December 23. <https://www.imf.org/en/News/Articles/2015/09/14/01/49/pr08345>.
- Johnson, Juliet. 2016. *Priests of Prosperity: How Central Bankers Transformed the Postcommunist World*. Cornell University Press.
- Johnston, Alison, and Aidan Regan, eds. 2021. *Is the European Union Capable of Integrating Diverse Models of Capitalism?* Routledge.
- Jones, Erik, R. Daniel Kelemen, and Sophie Meunier. 2016. "Failing Forward? The Euro Crisis and the Incomplete Nature of European Integration." *Comparative Political Studies* 49 (7): 1010–34. <https://doi.org/10.1177/0010414015617966>.
- Jones, Erik, R. Daniel Kelemen, and Sophie Meunier. 2021. "Failing Forward? Crises and Patterns of European Integration." *Journal of European Public Policy* 28 (10): 1519–36. <https://doi.org/10.1080/13501763.2021.1954068>.
- Jones, Erik, and Geoffrey R. Underhill. 2024. "Europe after the Crises: Toward an Optimum Financial Area?" *Journal of European Integration*, 1–19. <https://doi.org/10.1080/07036337.2024.2407090>.

- Jones, Erik, and Geoffrey R. D. Underhill. 2014. "Theory of Optimum Financial Areas: Retooling the Debate on the Governance of Global Finance." *SSRN Electronic Journal*, ahead of print. <https://doi.org/10.2139/ssrn.2531856>.
- Jones, Erik, and Amy Verdun. 2005. *The Political Economy of European Integration: Theory and Analysis*. Psychology Press.
- Kranke, Matthias, and David Yarrow. 2019. "The Global Governance of Systemic Risk: How Measurement Practices Tame Macroprudential Politics." *New Political Economy* 24 (6): 816–32. <https://doi.org/10.1080/13563467.2018.1545754>.
- Lepers, Etienne, and Matthias Thiemann. 2024. "Taming the Real Estate Boom in the EU: Pathways to Macroprudential (in)Action." *Regulation & Governance* 18 (2): 513–33. <https://doi.org/10.1111/rego.12529>.
- Lietuvos Bankas. 2013. "The Operation of Ūkio Bankas Is Temporarily Suspended, a Temporary Administrator Is Appointed." *Press Release*, December 2. <https://www.lb.lt/en/news/the-operation-of-ukio-bankas-is-temporarily-suspended-a-temporary-administrator-is-appointed>.
- Lindstrom, Nicole, and Dóra Piroška. 2007. "The Politics of Privatization and Europeanization in Europe's Periphery: Slovenian Banks and Breweries for Sale?" *Competition & Change* 11 (2): 117–35. <https://doi.org/10.1179/102452907X181938>.
- Lombardi, Domenico, and Manuela Moschella. 2017. "The Symbolic Politics of Delegation: Macroprudential Policy and Independent Regulatory Authorities." *New Political Economy* 22 (1): 92–108. <https://doi.org/10.1080/13563467.2016.1198758>.
- LRT News. 2020. "Investigators Conclude 6-Year Ūkio Bankas Embezzlement Probe." *Lrt.Lt*, January 28. <https://www.lrt.lt/en/news-in-english/19/1137379/investigators-conclude-6-year-ukio-bankas-embezzlement-probe>.
- Lupovici, Amir. 2009. "Constructivist Methods: A Plea and Manifesto for Pluralism." *Review of International Studies* 35 (1): 195–218.
- Madariaga, Aldo, and Stefano Palestini. 2021. *Dependent Capitalisms in Contemporary Latin America and Europe*. Springer Nature.
- Mahoney, James, and Gary Goertz. 2006. "A Tale of Two Cultures: Contrasting Quantitative and Qualitative Research." *Political Analysis* 14 (3): 227–49. <https://doi.org/10.1093/pan/mpj017>.
- Majone, Giandomenico. 1994. "The Rise of the Regulatory State in Europe." *West European Politics* 17 (3): 77–101.

- Masciandaro, Donato, and Marc Quintyn. 2016. "The Governance of Financial Supervision: Recent Developments." *Journal of Economic Surveys* 30 (5): 982–1006. <https://doi.org/10.1111/joes.12130>.
- Matthijs, Matthias, and Mark Blyth. 2015. *The Future of the Euro*. Oxford University Press, USA.
- McPhilemy, Samuel. 2016. "Integrating Macro-Prudential Policy: Central Banks as the 'Third Force' in EU Financial Reform." *West European Politics* 39 (3): 526–44. <https://doi.org/10.1080/01402382.2016.1143243>.
- Medve-Bálint, Gergő. 2014. "The Role of the EU in Shaping FDI Flows to East Central Europe." *JCMS: Journal of Common Market Studies* 52 (1): 35–51. <https://doi.org/10.1111/jcms.12077>.
- Mehrling, Perry. 1999. "The Vision of Hyman P. Minsky." *Journal of Economic Behavior & Organization* 39 (2): 129–58.
- Mérő, Katalin, and Dóra Piroška. 2017. "Policy Diffusion, Policy Learning and Local Politics: Macroprudential Policy in Hungary and Slovakia." *Europe-Asia Studies* 69 (3): 458–82. <https://doi.org/10.1080/09668136.2017.1318827>.
- Mérő, Katalin, and Dóra Piroška. 2018. "Rethinking the Allocation of Macroprudential Mandates within the Banking Union – a Perspective from East of the BU." *Journal of Economic Policy Reform* 21 (3): 240–56. <https://doi.org/10.1080/17487870.2017.1400435>.
- Mertens, Daniel, and Matthias Thiemann. 2018. "Market-Based but State-Led: The Role of Public Development Banks in Shaping Market-Based Finance in the European Union." *Competition & Change* 22 (2): 184–204. <https://doi.org/10.1177/1024529418758479>.
- Moravcsik, Andrew. 1993. "Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach." *JCMS: Journal of Common Market Studies* 31 (4): 473–524. <https://doi.org/10.1111/j.1468-5965.1993.tb00477.x>.
- Moravcsik, Andrew. 1998. *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht*. 1st edition. Cornell University Press.
- Moschella, Manuela, and Lucia Quaglia. 2025. "Much More Than a Report: The Search for Europe's New Political Identity and the Politics of Competitiveness." *JCMS: Journal of Common Market Studies* n/a (n/a). <https://doi.org/10.1111/jcms.70007>.
- Mrak, Mojmir, Matija Rojec, and Carlos Silva-Juregui. 2013. *Slovenia: From Yugoslavia to the European Union*. World Bank.

- Mügge, Daniel. 2006. "Reordering the Marketplace: Competition Politics in European Finance." *JCMS: Journal of Common Market Studies* 44 (5): 991–1022. <https://doi.org/10.1111/j.1468-5965.2006.00671.x>.
- Mügge, Daniel. 2013. "The Political Economy of Europeanized Financial Regulation." *Journal of European Public Policy* 20 (3): 458–70. <https://doi.org/10.1080/13501763.2012.752122>.
- Nelson, Stephen C. 2020. "Banks beyond Borders: Internationalization, Financialization, and the Behavior of Foreign-Owned Banks during the Global Financial Crisis." *Theory and Society* 49 (2): 307–33. <https://doi.org/10.1007/s11186-020-09381-6>.
- Nouy, Danièle. 2018. "Risk Reduction and Risk Sharing – Two Sides of the Same Coin." Paper presented at Financial Stability Conference, Berlin. October 31. <https://www.bankingsupervision.europa.eu/press/speeches/date/2018/html/ssm.sp181031.en.html>.
- OCCRP. 2011. "Latvian Bank Woes." OCCRP. <https://www.occrp.org/en/project/the-proxy-platform/latvian-bank-woes>.
- OECD. 2002. *OECD Economic Surveys: Slovak Republic 2002*. OECD Economic Surveys: Slovak Republic. OECD. https://doi.org/10.1787/eco_surveys-svk-2002-en.
- OECD. 2013. *Banks' Restructuring and Smooth Deleveraging of the Private Sector in Slovenia*. OECD Economics Department Working Papers No. 1059. Vol. 1059. OECD Economics Department Working Papers. <https://doi.org/10.1787/5k44v5122gf0-en>.
- OeNB. 2002. *Focus on Transition 2/2002*.
- Olson, Mancur. 2009. *The Logic of Collective Action: Public Goods and the Theory of Groups, Second Printing with a New Preface and Appendix*. Vol. 124. Harvard University Press.
- Ostrom, Elinor. 1990. *Governing the Commons: The Evolution of Institutions for Collective Action*. Cambridge University Press.
- Piroska, Dóra, and Rachel A. Epstein. 2023. "Stalled by Design: New Paradoxes in the European Union's Single Financial Market." *Journal of European Integration* 45 (1): 181–201. <https://doi.org/10.1080/07036337.2022.2154344>.
- Piroska, Dóra, Yuliya Gorelkina, and Juliet Johnson. 2021. "Macroprudential Policy on an Uneven Playing Field: Supranational Regulation and Domestic Politics in the EU's Dependent Market Economies." *JCMS: Journal of Common Market Studies* 59 (3): 497–517. <https://doi.org/10.1111/jcms.13097>.

- Piroska, Dóra, and Ana Podvršič. 2020. "New European Banking Governance and Crisis of Democracy: Bank Restructuring and Privatization in Slovenia." *New Political Economy* 25 (6): 992–1006. <https://doi.org/10.1080/13563467.2019.1669548>.
- Pistor, Katharina. 2012. "Governing Interdependent Financial Systems: Lessons from the Vienna Initiative." *Journal of Globalization and Development* 2 (2). <https://doi.org/10.1515/1948-1837.1191>.
- Poghosyan, Tigran. 2019. "How Effective Is Macroprudential Policy? Evidence from Lending Restriction Measures in EU Countries." SSRN Scholarly Paper No. 3367430. Rochester, NY, March 1. <https://papers.ssrn.com/abstract=3367430>.
- Polanyi, Karl. 2001. *The Great Transformation: The Political and Economic Origins of Our Time*. Beacon Press.
- Popov, Alexander, and Gregory F. Udell. 2012. "Cross-Border Banking, Credit Access, and the Financial Crisis." *Journal of International Economics*, Symposium on the Global Dimensions of the Financial Crisis, vol. 87 (1): 147–61. <https://doi.org/10.1016/j.jinteco.2012.01.008>.
- Poutineau, Jean-Christophe, and Gauthier Vermandel. 2017. "Global Banking and the Conduct of Macroprudential Policy in a Monetary Union." *Journal of Macroeconomics*, Banking in Macroeconomic Theory and Policy, vol. 54 (December): 306–31. <https://doi.org/10.1016/j.jmacro.2017.04.010>.
- Quaglia, Lucia. 2010. "Completing the Single Market in Financial Services: The Politics of Competing Advocacy Coalitions." *Journal of European Public Policy* 17 (7): 1007–23. <https://doi.org/10.1080/13501763.2010.499239>.
- Quaglia, Lucia, and Aneta Spendzharova. 2017. "The Conundrum of Solving 'Too Big to Fail' in the European Union: Supranationalization at Different Speeds." *JCMS: Journal of Common Market Studies* 55 (5): 1110–26. <https://doi.org/10.1111/jcms.12531>.
- Reuters. 2011. "Lithuania Reassures on Banks after Snoras Takeover." Markets. *Reuters*, November 17. <https://www.reuters.com/article/markets/lithuania-reassures-on-banks-after-snoras-takeover-idUSL5E7MH099/>.
- Reuters. 2013. "EU Commission Clears SNS REAAL, Slovenian Banks Revamp Plans." Markets. *Reuters*, December 18. <https://www.reuters.com/article/markets/eu-commission-clears-sns-reaal-slovenian-banks-revamp-plans-idUSL6N0JX214/>.
- Reuters. 2018. "ECB Revokes Licence of Estonian Bank amid Money Laundering Probe." Markets. *Reuters*, March 27. <https://www.reuters.com/article/markets/ecb-revokes-licence-of-estonian-bank-amid-money-laundering-probe-idUSL8N1R92LY/>.

- Reuters. 2022. *EU to Add Sberbank, Russian Metals Baron to Sanctions List*. European Markets. July 19. <https://www.reuters.com/markets/europe/eu-add-sberbank-russian-metals-baron-sanctions-list-2022-07-19/>.
- Richardson, Jeremy. 2012. "Supranational State Building in the European Union." In *Constructing a Policy-Making State?* Oxford University Press. <https://doi.org/10.1093/acprof:oso/9780199604104.003.0001>.
- Richter, Björn, Moritz Schularick, and Ilhyock Shim. 2019. "The Costs of Macropprudential Policy." *Journal of International Economics* 118 (May): 263–82. <https://doi.org/10.1016/j.jinteco.2018.11.011>.
- Rupeika-Apoga, R., S.H. Zaidi, Y.E. Thalassinou, and E.I. Thalassinou. 2018. "Bank Stability: The Case of Nordic and Non-Nordic Banks in Latvia." *International Journal of Economics and Business Administration* VI (Issue 2): 39–55. <https://doi.org/10.35808/ijeba/156>.
- Sabel, Charles F., and Jonathan Zeitlin. 2008. "Learning from Difference: The New Architecture of Experimentalist Governance in the EU." *European Law Journal* 14 (3): 271–327. <https://doi.org/10.1111/j.1468-0386.2008.00415.x>.
- Scharpf, Fritz W. 1997. *Balancing Positive and Negative Integration: The Regulatory Options for Europe*.
- Scharpf, Fritz W. 1999. *Governing in Europe: Effective and Democratic?* In *Governing in Europe: Effective and Democratic?* Oxford University Press. <https://oxford.universitypressscholarship.com/view/10.1093/acprof:oso/9780198295457.001.0001/acprof-9780198295457>.
- Scharpf, Fritz W. 2001. "Notes Toward a Theory of Multilevel Governing in Europe." *Scandinavian Political Studies* 24 (1): 1–26. <https://doi.org/10.1111/1467-9477.00044>.
- Scharpf, Fritz W. 2010. "The Asymmetry of European Integration, or Why the EU Cannot Be a 'Social Market Economy.'" *Socio-Economic Review* 8 (2): 211–50. <https://doi.org/10.1093/ser/mwp031>.
- Scharpf, Fritz W. 2016. *Forced Structural Convergence in the Eurozone: Or a Differentiated European Monetary Community*. Working Paper No. 16/15. MPIfG Discussion Paper. <https://www.econstor.eu/handle/10419/150047>.
- Schelkle, Waltraud. 2017. *The Political Economy of Monetary Solidarity: Understanding the Euro Experiment*. Illustrated Edition. OXFORD UNIV PR.
- Schelkle, Waltraud. 2025. "The Emerging System of Re-Insurance in the EU: Beyond Negative and Positive Integration." *Journal of European Public Policy* 0 (0): 1–11. <https://doi.org/10.1080/13501763.2025.2508778>.

- Schoenmaker, Dirk. 2011. "The Financial Trilemma." *Economics Letters* 111 (1): 57–59.
<https://doi.org/10.1016/j.econlet.2011.01.010>.
- Schoenmaker, Dirk. 2013. *Governance of International Banking: The Financial Trilemma*. Oxford University Press.
- Schoenmaker, Dirk, and Peter Wierts. 2016. "Macroprudential Supervision: From Theory to Policy." *National Institute Economic Review* 235 (February): R50–62.
<https://doi.org/10.1177/002795011623500115>.
- Schüler, Yves S., Paul P. Hiebert, and Tuomas A. Peltonen. 2020. "Financial Cycles: Characterisation and Real-Time Measurement." *Journal of International Money and Finance* 100 (February): 102082.
<https://doi.org/10.1016/j.jimonfin.2019.102082>.
- Seikel, Daniel. 2019. "Patterns of Pooling and Delegation after the Crisis: Old and New Asymmetries." *Journal of European Integration* 41 (6): 693–709.
<https://doi.org/10.1080/07036337.2018.1553962>.
- Šestáková, Monika, and SoĎa Ferenčíková. 2015. *RESTRUCTURING OF THE BANKING SECTOR IN SLOVAKIA OVER THE LAST TWO DECADES*.
- Shirakawa, Masaaki. 2012. "International Financial Stability as a Public Good." *Keynote Address at a High-Level Seminar Co-Hosted by the Bank of Japan and the International Monetary Fund (IMF) in Tokyo*.
- Singh, Dalvinder, ed. 2020. *European Cross-Border Banking and Banking Supervision*. 1st ed. Oxford University Press.
<https://doi.org/10.1093/oso/9780198844754.001.0001>.
- Škrabić Perić, Blanka, Ana Rimac Smiljanić, and Zdravka Aljinović. 2018. "Credit Risk of Subsidiaries of Foreign Banks in CEE Countries: Impacts of the Parent Bank and Home Country Economic Environment." *The North American Journal of Economics and Finance* 46 (November): 49–69.
<https://doi.org/10.1016/j.najef.2018.03.009>.
- Song, Lingfeng, and Yinsainan Zhang. 2021. "Banking Network Structure and Transnational Systemic Risk Contagion—The Case of the European Union." *Finance Research Letters* 39 (March): 101660.
<https://doi.org/10.1016/j.frl.2020.101660>.
- Spendzharova, Aneta. 2014a. *Regulating Banks in Central and Eastern Europe: Through Crisis and Boom*. Palgrave Macmillan UK.
<https://doi.org/10.1057/9781137282750>.
- Spendzharova, Aneta. 2014b. "Banking Union under Construction: The Impact of Foreign Ownership and Domestic Bank Internationalization on European Union Member-States' Regulatory Preferences in Banking Supervision." *Review of*

- International Political Economy* 21 (4): 949–79.
<https://doi.org/10.1080/09692290.2013.828648>.
- Stellinga, Bart. 2020. “The Open-Endedness of Macroprudential Policy. Endogenous Risks as an Obstacle to Countercyclical Financial Regulation.” *Business and Politics* 22 (1): 224–51. <https://doi.org/10.1017/bap.2019.14>.
- Stellinga, Bart. 2021. “The Rise and Stall of EU Macro-Prudential Policy. An Empirical Analysis of Policy Conflicts over Financial Stability, Market Integration, and National Discretion*.” *JCMS: Journal of Common Market Studies* 59 (6): 1438–57. <https://doi.org/10.1111/jcms.13195>.
- Stone-Sweet, Alec, and Wayne Sandholtz. 1997. “European Integration and Supranational Governance.” *Journal of European Public Policy* 4 (3): 297–317.
- Tay, J. S. W., and R. H. Parker. 1990. “Measuring International Harmonization and Standardization.” *Abacus* 26 (1): 71–88. <https://doi.org/10.1111/j.1467-6281.1990.tb00233.x>.
- The Baltic Times. 2001. *Hansapank Buys Lithuanian Savings Bank*. April 26. https://www.baltictimes.com/news/articles/4887/?utm_source=chatgpt.com.
- The Baltic Times. 2012. *Snoras, Krajbanka Shine Light Once More on Dozing Regulators*. June 6. <https://www.baltictimes.com/news/articles/31360/>.
- Thiemann, Matthias. 2019. “Is Resilience Enough? The Macroprudential Reform Agenda and the Lack of Smoothing of the Cycle.” *Public Administration* 97 (3): 561–75. <https://doi.org/10.1111/padm.12551>.
- Thiemann, Matthias. 2024. *Taming the Cycles of Finance?: Central Banks and the Macro-Prudential Shift in Financial Regulation*. Cambridge University Press.
- Thiemann, Matthias, Carolina Raquel Melches, and Edin Ibrocevic. 2021. “Measuring and Mitigating Systemic Risks: How the Forging of New Alliances between Central Bank and Academic Economists Legitimize the Transnational Macroprudential Agenda.” *Review of International Political Economy* 28 (6): 1433–58. <https://doi.org/10.1080/09692290.2020.1779780>.
- Truchet, Marc, Cahen Didier, and Jean-Marie Andrés. 2024. “Eurofi Financial Forum Budapest September 2024.” Paper presented at 2024 Eurofi Financial Forum, Budapest. September.
- Underhill, Geoffrey R. D., and Erik Jones. 2023. “Optimum Financial Areas: Retooling the Governance of Global Finance.” *The World Economy* 46 (6): 1582–608. <https://doi.org/10.1111/twec.13394>.
- Verdun, Amy. 1998. “The Institutional Design of EMU: A Democratic Deficit?” *Journal of Public Policy* 18 (2): 107–32. <https://doi.org/10.1017/S0143814X98000063>.

- Verdun, Amy, Achim Hurrelmann, and Emmanuel Brunet-Jailly. 2023. *European Union Governance and Policy-Making, Second Edition: A Canadian Perspective*. University of Toronto Press.
- Vienna Initiative Steering Committee. 2019. *Ten Years of the Vienna Initiative - 2009-2019*. European Investment Bank.
- Vollaard, Hans. 2014. "Explaining European Disintegration." *JCMS: Journal of Common Market Studies* 52 (5): 1142–59. <https://doi.org/10.1111/jcms.12132>.
- Weissenbacher, Rudy. 2019. *The Core-Periphery Divide in the European Union: A Dependency Perspective*. Springer International Publishing. <https://doi.org/10.1007/978-3-030-28211-0>.
- White, William. 2020. "International Financial Regulation: Why It Still Falls Short." *Institute for New Economic Thinking Working Paper Series*, August 4, 1–41. <https://doi.org/10.36687/inetwp131>.
- Wiener, Antje, Tanja A. Borzel, and and Thomas Risse. 2019. *European Integration Theory*. Third Edition, New to this Edition:, Third Edition, New to this Edition: Oxford University Press.
- Woll, Cornelia. 2014. *The Power of Inaction: Bank Bailouts in Comparison*. Cornell University Press.
- World Bank. 2000. <https://documents.worldbank.org/en/publication/documents-reports/documentdetail/728671468772190114/multi-page>.
- World Bank. 2002.
- World Bank. 2004. *Implementation Completion Report*.
- World Bank. 2018. *Global Financial Development Report 2017/2018: Bankers without Borders*. World Bank.
- Zeitlin, Jonathan. 2015. *Extending Experimentalist Governance?: The European Union and Transnational Regulation*. Oxford University Press.
- Zeitlin, Jonathan. 2022. "Uniformity, Differentiation, and Experimentalism in EU Financial Regulation: The Single Supervisory Mechanism in Action." SSRN Scholarly Paper No. 3857077. Rochester, NY. <https://doi.org/10.2139/ssrn.3857077>.
- Zeitlin, Jonathan, and Bernardo Rangani. 2023. "EU Regulation between Uniformity, Differentiation, and Experimentalism: Electricity and Banking Compared." *European Union Politics* 24 (1): 121–42. <https://doi.org/10.1177/14651165221126387>.

APPENDIX A: CODING STRATEGY

This appendix outlines the methodological approach adopted to analyse and code the interview transcripts collected during fieldwork. In particular, it describes: 1) the coding strategy and analytical framework; 2) key themes emerging inductively from the interviews; 3) predefined analytical issues derived deductively from theoretical priors, and 4) illustrative examples demonstrating the linkage between key themes, issues, and direct quotes.

Coding Strategy and Analytical Framework

The interview transcripts underwent a structured qualitative analysis following a dual categorization approach:

1. By *common themes*: Themes emerged inductively from interview data, reflecting recurring patterns or categories articulated by interviewees.
2. By *country cases*: Interviews were also analysed in relation to their country-specific context.

The analysis followed these distinct steps:

- a. **Preliminary Coding:** Transcripts were initially coded based on expected theoretical issues derived from existing literature.
- b. **Independent Theme Identification:** Each interview was re-examined independently to identify key themes, irrespective of the preliminary issues.

c. **Theme-Issue Matching:** Key themes were then matched to relevant issues wherever a meaningful linkage emerged.

d. **Cross-case Synthesis:** Individual themes from interviews were further grouped into broader concepts or coherent narratives applicable across multiple country cases.

This analytical distinction between empirical findings (*key themes*) and the theoretical framework (*issues*) serves multiple purposes:

- To control the researcher bias by explicitly differentiating inductive data-driven insights from deductive expectations.
- To enhance methodological transparency, facilitating replicability.
- To highlight both explicit and implicit references by interviewees, ensuring comprehensive analysis.

List of Key Themes

Key Themes are broad categories or recurring patterns that emerge organically from the interviews:

- **Governance of Systemically Important Institutions:** This theme examines the mechanisms and strategies employed by national and supranational authorities to oversee

and regulate systemically important banks. It considers factors such as the impact of foreign ownership, the structure of banking institutions, and the challenges posed by cross-border operations. Additionally, it emphasises the significance of coordination with foreign regulatory bodies and the role of governance frameworks in ensuring financial stability.

- **Market Fragmentation and National Autonomy:** This theme examines the tension between the European Union's drive for harmonisation and the need for national flexibility in macroprudential policymaking. It highlights the critical importance of preserving national autonomy to address country-specific financial cycles, risks, and structural peculiarities. It also clarifies how market conditions across the Eurozone are not homogenous enough to overcome the barriers of national fragmentation.

- **EU Institutions as Facilitators:** This theme examines the frameworks, processes, and collaborative mechanisms that shape macroprudential policymaking at both national and European levels. It emphasises the interaction between supranational institutions, ECB and the ESRB, and NCAs. The theme highlights the critical roles of coordination, consultation, and reciprocity in effectively addressing cross-border spillovers and systemic risks.

- **Public Perception of Financial Stability:** This theme examines public perceptions of and engagement with financial stability and macroprudential policies. It emphasises the impact of crises, economic conditions, and tangible financial issues on public awareness and attitudes, while highlighting gaps in understanding the broader mechanisms that underpin financial stability.

- **Tackling Systemic Risk Comprehensively:** This theme focuses on the multifaceted approach necessary to identify, assess, and mitigate systemic risks within the financial system. It underscores the importance of forward-looking, adaptable strategies that address both traditional and emerging risks, such as climate change and technological

disruptions. Collaborative efforts between national and supranational authorities are pivotal in enhancing financial stability and managing the interplay of cyclical, structural, and spillover risks.

- **National Institutional Setting:** This theme analyses the structural and operational differences across national macroprudential governance frameworks, with a focus on the allocation of responsibilities, the interaction between political dynamics and financial oversight, and the independence of key institutions. It underscores how institutional arrangements and mandates influence the effectiveness of macroprudential policy implementation and decision-making.

- **Market Integration and Macroprudential Governance:** This theme explores the balance between participating in a unified European financial system and maintaining national safeguards to address country-specific financial risks. It emphasises the importance of frameworks that integrate market stability across borders while ensuring that unique domestic needs are not overlooked.

- **Bias in the Macroprudential Framework:** This theme investigates perceived and systemic biases within the macroprudential framework that appear to disproportionately favour larger or core economies, potentially jeopardising the financial stability of smaller or peripheral countries – as well as financial stability as an EU-wide public good. It underscores how standardised approaches and supranational priorities may fail to account for the specific conditions and vulnerabilities of individual countries, particularly smaller ones.

- **Progress in Supranational Integration:** This theme captures the progress and ongoing challenges in advancing deeper integration within the EU's financial stability framework at the supranational level. It highlights efforts to harmonise macroprudential policies and governance mechanisms, while recognising the enduring tensions and limitations arising from national sovereignty, diverse economic contexts, and differing institutional roles.

List of Key Issues

Issues represent theoretically informed categories that structured the analysis of interviews:

- **Governance for Financial Stability:** Frameworks and mechanisms for managing financial stability at national, supranational, and international levels.
- **Cooperation between Institutions:** Collaborative interactions among NCAs, between national and supranational levels, and among supranational bodies.
- **Power Relations:** Dynamics of tensions and differing interests among member states and supranational institutions.
- **Impact of Macroprudential Policy:** Effects on households, firms, host- and home countries.
- **Use of Macroprudential Policy:** Significance of policy implementation or inaction at national and supranational levels.
- **Perceptions of Credit Institutions:** Issues related to profitability and liquidity.
- **Sources of Systemic Risk:** Identification of systemic risk factors nationally and supranationally.
- **Distributional Implications:** Economic and political impacts within and across countries.
- **Definition of Financial Stability:** Divergent conceptualisations across governance levels and related conflicts of interest.

- **Fragmentation:** Indicators and dynamics of market and institutional fragmentation.
- **Subsidiaries and/or Branches of Foreign Banks:** The role of foreign bank operations in host country stability.
- **Technocracy vs. Politics:** Interactions between technocratic institutions and political bodies.
- **Country-Specific Conditions:** Importance of national contexts in policymaking and governance.

APPENDIX B: INTERVIEW LIST

National Competent Authorities

Central Bank of Slovakia – Expert in macroprudential policy. Online interview, 28 November 2023.

Central Bank of Lithuania – Expert in macroprudential policy. Online interview, 22 December 2023.

Central Bank of Estonia – Expert in macroprudential policy. Online interview, 28 December 2023.

Financial Market Authority of Austria (FMA) – Expert in anti-money laundering. Online interview, 01 August 2024.

Central Bank of Slovenia – Expert in macroprudential policy. Face-to-face interview, 21 October 2024.

Central Bank of Slovenia – Expert in macroprudential policy. Face-to-face interview, 22 October 2024.

Central Bank of Lithuania – Expert in macroprudential policy. Online interview, 31 October 2024.

Central Bank of Latvia – Expert in macroprudential policy. Online interview, 05 November 2024.

Central Bank of Slovakia – Expert in macroprudential policy. Online interview, 08 November 2024.

Nordic Investment Bank – Expert in financial supervision, former official at Ministry of Finance of Estonia, former member of Central Bank of Estonia. Online interview, 20 November 2024.

European Systemic Risk Board (ESRB) – Official. Online interview, 04 December 2024.

Central Bank of Slovakia – Expert in macroprudential policy. Online interview, 18 December 2024.

Former Central Bank of Lithuania – Expert in financial supervision. Online interview, 26 December 2024.

Central Bank of Austria – Expert in macroprudential policy. Face-to-face interview, 31 January 2025.

Business Associations

Bank Association of Slovenia – Specialist. Face-to-face interview, 25 October 2024.

Bank Association of Slovakia – Specialist. Face-to-face interview, 09 December 2024.

Financial Association of Latvia (Finance Latvia) – Specialist, former official at Swedish Financial Markets Authority. Online interview, 20 January 2025.

Economists

Florence School of Banking and Finance – Economist. Online interview, 09 January 2024.

UK National Institute of Economic and Social Research (NIESR) – Expert in financial supervision, former economist at the Bank of England. Online interview, 28 October 2024.

University of Ljubljana – Economist. Face-to-face interview, 03 December 2024.

Slovak Academy of Science – Economist. Online interview, 14 January 2025.

Journalists

Delo(a), Slovenia. Face-to-face interview, 22 October 2024.

Delo(b), Slovenia. Face-to-face interview, 22 October 2024.

Finance, Slovenia. Face-to-face interview, 24 October 2024.

Independent Journalist, Estonia. Online interview, 15 November 2024.

Postimees, Estonia. Online interview, 18 November 2024.

Dienas, Latvia. Online interview, 13 December 2024.

APPENDIX C: FINANCIAL STABILITY REPORTS

The following Financial Stability Reports were examined as primary documentary data alongside interview material. Page counts refer to the official PDF versions as published by the issuing central bank.

Estonia – Eesti Pank

1. Eesti Pank. *Financial Stability Review 2012/2*. Tallinn: Eesti Pank, 2012. **92 pp.**
2. Eesti Pank. *Financial Stability Review 2016/2*. Tallinn: Eesti Pank, 2016. **90 pp.**
3. Eesti Pank. *Financial Stability Review 2018/2*. Tallinn: Eesti Pank, 2018. **88 pp.**
4. Eesti Pank. *Financial Stability Review 2023/2*. Tallinn: Eesti Pank, 2023. **82 pp.**

Latvia – Latvijas Banka

1. Latvijas Banka. *Financial Stability Report 2012 (No. 2)*. Riga: Latvijas Banka, 2012. **73 pp.**
2. Latvijas Banka. *Financial Stability Report 2016 (No. 2)*. Riga: Latvijas Banka, 2016. **74 pp.**
3. Latvijas Banka. *Financial Stability Report 2018 (No. 2)*. Riga: Latvijas Banka, 2018. **88 pp.**
4. Latvijas Banka. *Financial Stability Report 2023*. Riga: Latvijas Banka, 2023. **76 pp.**

Lithuania – Bank of Lithuania

1. Bank of Lithuania. *Financial Stability Review 2012*. Vilnius: Bank of Lithuania, 2012. **90 pp.**

2. Bank of Lithuania. *Financial Stability Review 2016*. Vilnius: Bank of Lithuania, 2016. **88 pp.**
3. Bank of Lithuania. *Financial Stability Review 2018*. Vilnius: Bank of Lithuania, 2018. **84 pp.**
4. Bank of Lithuania. *Financial Stability Review 2023*. Vilnius: Bank of Lithuania, 2023. **64 pp.**

Slovakia – Národná banka Slovenska

1. Národná banka Slovenska. *Analysis of the Slovak Financial Sector 2012*. Bratislava: Národná banka Slovenska, 2012. **112 pp.**
2. Národná banka Slovenska. *Analysis of the Slovak Financial Sector 2016*. Bratislava: Národná banka Slovenska, 2016. **106 pp.**
3. Národná banka Slovenska. *Analysis of the Slovak Financial Sector 2018*. Bratislava: Národná banka Slovenska, 2018. **104 pp.**
4. Národná banka Slovenska. *Financial Stability Report, May 2023*. Bratislava: Národná banka Slovenska, 2023. **82 pp.**

Slovenia – Banka Slovenije

1. Banka Slovenije. *Financial Stability Review, December 2012*. Ljubljana: Banka Slovenije, 2012. **92 pp.**
2. Banka Slovenije. *Financial Stability Review, June 2016*. Ljubljana: Banka Slovenije, 2016. **84 pp.**
3. Banka Slovenije. *Financial Stability Review, June 2018*. Ljubljana: Banka Slovenije, 2018. **88 pp.**

4. Banka Slovenije. *Financial Stability Review, May 2023*. Ljubljana: Banka Slovenije, 2023. **85 pp.**

APPENDIX C: CONSENT INFORMATION SHEET

Below is the standard informed consent form used in interviews conducted for this research.

While the template was occasionally adapted (e.g., for online or in-person settings, or institutional requirements), the core content remained consistent across all interviews.

Form

Name and Contact Details of the Researcher: _____

Purpose of the research: You are invited to participate in a study on the management of financial stability within the Eurozone, with a particular focus on the challenges faced by small peripheral economies. This interview is part of a broader research agenda, which includes but is not limited to the researcher's PhD project. The research may contribute to academic publications, including articles and papers, that explore various aspects of financial stability and financial supervision in the European Union – including through a comparative perspective with other regions.

Role of the participant: The voluntary participation in this study requires answering open-ended questions. The length of the interview will be around 60 minutes. This interview will take place in a mutually agreed-upon location in which you feel comfortable and or potentially via an online platform (Teams, Zoom, Skype, etc.), if meeting in person is not possible.

Potential risks and benefits: Apart from the commitment of time, there are no known inconveniences or risks associated with participation in this research. Strict confidentiality and anonymity measures will be in place to ensure that your identity and responses are protected. The potential benefits of participating in this research include the opportunity to share your views on the topics discussed during the interview, contributing to academic understanding of financial stability and related areas. Your insights may also help inform future research and policy discussions.

Participation and withdrawal: Your participation in this study is entirely voluntary. You may choose to withdraw from the study, for any reason, even after signing the consent form or completing the interview. If you wish to withdraw, you should communicate your decision to the researcher within 60 days of the interview. Upon withdrawal, any data you have provided will be securely destroyed unless you specifically indicate that it may still be used for research purposes.

Anonymity and confidentiality: No personal names, nor any information conducive to you, will be used in the transcripts, analysis, publications, or presentations related to this research. In some cases, general references to your organization or role (e.g., "an official from organization X") may be made in the most general formulation possible – removing all identifying details. The researcher will take all necessary measures to protect your confidentiality and anonymity, including secure storage of data and adherence to institutional data protection policies.

Storage of information: The information you provide will be stored in electronic form, and all data will be securely protected. Access to the data will be restricted to the researcher, and all electronic documents will be password protected and stored on a secure, encrypted server in accordance with institutional data protection policies.

Sharing of research results: Upon completion of this project, the results will be included in the researcher's PhD dissertation and may also be published in academic papers or presented at conferences. If you would like to receive a summary of the research findings or access any documents resulting from this project, please indicate your preference, and they will be shared with you once available.

Consent Form

The purpose of an informed consent is to ensure that you understand the purpose of the study and how you will be involved.

- I have read the information presented in the information letter about a study being conducted by _____
- I have had the opportunity to ask questions about my involvement in this study and to receive additional details I requested.
- I understand that if I agree to participate in this study, I may withdraw from the study by the indicated time.
- I have been given a copy of this form.
- I agree to participate in the study.

Name of Participant:

Signature:

Date:

