

The International Dimension of the EMU: The Interplay between the Global Financial Stability Architecture and the European Union

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1. Introduction

It is a truism that the European Union's self-proclaimed autonomy may be a helpful concept in legal terms – primary to preserve the monopoly of the European Court of Justice to interpret EU law² – but it is equally clear that the EU is to a large extent influenced by the decisions and policies of other international institutions.³ The present chapter aims to assess this external influence in relation to a specific, but core dimension of the EU, the Economic and Monetary Union (EMU).⁴ More specifically, we will assess the influence of what these days is known as the Global Financial Stability Architecture (GFSA), on the EMU. As will be further explained below, the GFSA is a network of the key global financial institutions that collect data, conduct research, provide insight and propose rules of conduct for the financial sector. Its *mission* is to rethink (global) macroeconomic policy to make economies more resilient – how to steer the economy clear of risks that could lead it to collapse; how to deal with real-time crises; and how to initiate recovery. Its primary *method* is to find out how differing components of financial markets act and react to one another, and to propose prudential regulation that shapes the behaviour of private financial service providers, of governments and of central banks.⁵

The main aim of the present chapter is to explain whether, and how, international institutions shape EU law, policies and procedures in the EMU context. Indeed, as the financial crisis revealed, the EU has been far from autonomous or isolated and its decisions were taken in the context of decisions taken in the so-called Global Financial Stability Architecture (GFSA), consisting of both

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² M. Cremona, A. Thies and R.A. Wessel (Eds.), *The European Union and International Dispute Settlement*, Oxford: Hart Publishing, 2017.

³ R.A. Wessel and S. Blockmans (Eds.), *Between Autonomy and Dependence: The EU Legal Order Under the Influence of International Organisations*, The Hague: T.M.C. Asser Press/Springer, 2013; as well as R.A. Wessel and S. Blockmans, *The Legal Status and Influence of Decisions of International Organizations and other Bodies in the European Union*, in P. Eeckhout, M. Lopez-Escudero (Eds.), *The European Union's External Action in Times of Crisis*, Hart Publishing, 2016, pp. 223-248; and earlier A. Føllesdal, R.A. Wessel and J. Wouters (Eds.), *Multilevel Regulation and the EU: The Interplay between Global, European and National Normative Processes*, Leiden, Boston: Martinus Nijhoff Publishers, 2008.

⁴ See for a more detailed analysis of the EMU, Chapters [...] in this Volume.

⁵ Donnelly, S. (2012). Institutional change at the top: from the financial stability forum to the financial stability board (pp. 261-275). Campus; Helleiner, E. (2010). *The Financial Stability Board and International Standards*. Waterloo: Centre for International Governance Innovation.; Elson, A. (2011). *Governing global finance: The evolution and reform of the international financial architecture*. Springer; Underhill, G. R., Blom, J., & Mügge, D. (Eds.). (2010). *Global financial integration thirty years on: from reform to crisis*. Cambridge University Press; Underhill, G. R. (2014) *The Emerging Post-Crisis Financial Architecture: how far has reform gone?*, GR: EEN Working Paper no. 46, University of Warwick, May 2014.

formal international organizations (such as the IMF, World Bank or OECD) and more informal international organizations (including a number of international standard-setting bodies).⁶ The latter in particular are characterized by different instruments (in which soft law dominates⁷), and policy narratives form a vital part of the substantive obligations⁸ to which EMU and its member states are expected to conform, or explain their non-adoption.⁹ Those policy narratives are also part of what binds the single institutions into a cohesive whole with a greater overarching purpose, known as an *architecture*.¹⁰ It answers not only the question of what the overall mission of the architecture is (financial stability), but also on what basis, and with what means: in other words, with what strategy.¹¹ Using the GFSM as our focal point is helpful not only to analyse the most relevant international institutions in relation to the EMU, but also to understand the legal and policy links between them.

This chapter thus examines the nature of the GFSM and its relationship to EMU law, policy and practice. It does so by taking an outside-in perspective, focusing on global developments and institutions and their influence on the EMU. Other chapters in the present Volume approach the interplay between the EU and the outside world from the perspective of the EU's external relations or by dealing with international agreements concluded between the EU and third states in relation to the EMU.¹² The present chapter makes the case that the GFSM influences financial stability rules

⁶ See on informal international lawmaking: Pauwelyn, J., Wessel, R. A., & Wouters, J. (Eds.). (2012). *Informal international lawmaking*. Oxford University Press; Pauwelyn, J., Wessel, R. A., & Wouters, J. (2014). When structures become shackles: stagnation and dynamics in international lawmaking. *European Journal of International Law*, 25(3), 733-763; Wouters, J., & Odermatt, J. (2014). Comparing the 'Four Pillars' of Global Economic Governance: A Critical Analysis of the Institutional Design of the FSB, IMF, World Bank, and WTO. *Journal of International Economic Law*, 17(1), 49-76; Bernstein, S., & van der Ven, H. (2017). Best practices in global governance. *Review of International Studies*, 43(3), 534-556;

⁷ See, for instance, Galbraith, J., & Zaring, D. (2013). Soft law as foreign relations law. *Cornell L. Rev.*, 99, 735; Brummer, C. (2015). Soft law and the global financial system: rule making in the 21st century. Cambridge University Press; Brummer, C. (2010). Why soft law dominates international finance—and not trade. *Journal of International Economic Law*, 13(3), 623-643; Brummer, C. (2010). How international financial law works (and how it doesn't). *Geo. LJ*, 99, 257; Brummer, C. (2014). Minilateralism: How trade alliances, soft law and financial engineering are redefining economic statecraft. Cambridge University Press; Arner, D. W., & Taylor, M. W. (2009). The global financial crisis and the financial stability board: Hardening the soft law of international financial regulation. *UNSWLJ*, 32, 488; Abbott, K. W., & Snidal, D. (2000). Hard and soft law in international governance. *International organization*, 54(3), 421-456; Abbott, K. W., Keohane, R. O., Moravcsik, A., Slaughter, A. M., & Snidal, D. (2000). The concept of legalization. *International organization*, 54(3), 401-419; Shaffer, G., & Pollack, M. A. (2009). Hard vs. soft law: alternatives, complements and antagonists in international governance; Guzman, A. T., & Meyer, T. L. (2010). International soft law. *Journal of Legal Analysis*, 2(1), 171-225.

⁸ See Ban, C. & Gallagher, K. (2015) Recalibrating Policy Orthodoxy: The IMF Since the Great Recession. *Governance* 28, 2: 131-46; Nelson, S. C. (2014). Playing favorites: how shared beliefs shape the IMF's lending decisions. *International Organization*, 68(02), 297-328; Best, J. (2003). From the top-down: the new financial architecture and the re-embedding of global finance. *New Political Economy*, 8(3), 363-384; Chwieroth, J. M. (2014). Controlling capital: the International Monetary Fund and transformative incremental change from within international organisations. *New Political Economy*, 19(3), 445-469.

⁹ Newman, A., & Bach, D. (2014). The European Union as hardening agent: soft law and the diffusion of global financial regulation. *Journal of European Public Policy*, 21(3), 430-452; Assuming also that supranational institutions lack enforcement powers. See Tallberg, J., & McCall Smith, J. (2014). Dispute settlement in world politics: States, supranational prosecutors, and compliance. *European Journal of International Relations*, 20(1), 118-144.

¹⁰ Borrás, S., & Radaelli, C. M. (2011). The politics of governance architectures: creation, change and effects of the EU Lisbon Strategy. *Journal of European Public Policy*, 18(4), 463-484; Armstrong, K. A. (2012). EU social policy and the governance architecture of Europe 2020. *Transfer: European Review of Labour and Research*, 18(3), 285-300; Copeland, P. (2014). EU enlargement, the clash of capitalisms and the European social dimension. Oxford University Press; Zeitlin, J. (2010). Towards a stronger OMC in a more social Europe 2020: A new governance architecture for EU policy coordination? In Marlier, E., ed. *Europe, 2020*, 253-273. Peter Lang.

¹¹ Hannoun, H. (2010, February). Towards a global financial stability framework. In *Speech at the 45th SEACEN Governors' Conference, Siem Reap province, Cambodia* (pp. 26-27).

¹² See in particular Chapters [...]

within the EU, and within EMU more specifically, by setting out standards and benchmarks for Europeans to adopt, with the goal of maximising financial stability. As we will see, in part, the EU pushes this development;¹³ in part, however, it filters GFSA (soft) law to comply with European political priorities.¹⁴

This chapter is structured as follows. Section 2 sets the stage by analysing the relevant international bodies that are now seen as forming the Global Financial Stability Architecture. Section 3 aims to reveal the institutional links between the emergence of the GFSA and the EU. This is followed by an assessment of the influence of international law and policies on the EMU in relation to a number of specific areas of financial regulation (Section 4). Finally, Section 5 will be used to draw some conclusions.

2. The Emergence of the Global Financial Stability Architecture

The GFSA can really be considered an architecture since 2009, when the G20 made a concerted attempt to expand the activity and output of international standard-setting bodies (ISSBs) in the financial sector, connect them with one another, and to make their impact more than the sum of their parts. In general, only few international bodies have the competence to enact legally binding rules¹⁵ and the formal and informal bodies making up the GFSA are no exception. The GFSA largely provides ‘soft law’ at the international level to steer national governments and the EU in a certain direction, which then may transpose it into ‘hard law’. This does not imply that the norms produced in the framework of the GFSA are merely general, broad guidelines. On the contrary, they cover so-called micro prudential regulation (applicable only to one of banking, insurance or capital market sectors) and macro prudential supervision (which takes a holistic approach to how the three micro prudential areas affect each other) and require additional measures, from regulation to capital controls to state aid and quantitative easing for financial markets. It also includes discussions within the G20 and its financial stability conferences on both the overall steering of the architecture, and the broad discussions of macroeconomic policy and strategy within the Group. To understand the composition of the GFSA and its impact, it is worthwhile looking at its development.

2.1 *Precedents to the Post-2008 GFSA*

The post-2009 GFSA stands in contrast with previous periods. During the Bretton Woods era of 1945-1971, public policy limited financial markets greatly, both globally and nationally. Financial stability consisted of a system of fixed exchange rates guaranteed by the United States government (Treasury and Federal Reserve) and the International Monetary Fund (IMF), which provided low-cost loans to governments in financial distress (unable to borrow to pay for government spending, to pay for trade deficits and ultimately unable to support the exchange rate).¹⁶

¹³ Mügge, D. (2014). Europe’s regulatory role in post-crisis global finance. *Journal of European Public Policy* 21, 3: 316-326; Quaglia, L. (2014). The sources of European Union influence in international financial regulatory fora. *Journal of European Public Policy*, 21(3), 327-345; Posner, E. (2009). Making rules for global finance: transatlantic regulatory cooperation at the turn of the millennium. *International Organization*, 63(4), 665-699.

¹⁴ Quaglia, L., & Spetzharova, A. (2017). Post-crisis reforms in banking: Regulators at the interface between domestic and international governance. *Regulation & Governance*, 11(4), 422-437. Donnelly, S. (2017). Advocacy coalitions and the lack of deposit insurance in Banking Union. *Journal of Economic Policy Reform*, 1-14.

¹⁵ See for instance R.A. Wessel, ‘Informal International Law-Making as a New Form of World Legislation?’, *International Organizations Law Review*, 2011, pp. 253-265.

¹⁶ Helleiner, E. (2010). A Bretton Woods moment? The 2007–2008 crisis and the future of global finance. *International affairs*, 86(3), 619-636.

Financial stability during this era was primarily a national affair of macroeconomic policy (judicious use of monetary and fiscal policy to smooth out highs and lows of demand in the economic cycle), and largely inseparable from a strategy of supporting mass production, consumption and employment. The IMF provided the key means of dealing with countries in which this financial stability had broken down, and minimising the likelihood that the country's breakdown could spread to other members of the system—either through broken business contacts or through a general collapse of confidence in the system's ability to sustain economic interdependence. This era distinguished itself from those preceding and following not only by these institutions, but by the overarching narrative of embedded liberalism that pursued global trade in a context of national social welfare systems, which the IMF and US government supported.¹⁷

During the first decade of the post-Bretton Woods era (1971-2007), exchange rates floated freely without guarantees from the USA, the IMF shifted from lending to support exchange rates to lending to sovereign default governments, and after a panic caused by the collapse of Herstatt Bank in Germany in 1974, the Basel Committee was established at the Bank for International Settlements (BIS)¹⁸ to agree on common regulatory standards for banks. It was the first micro prudential ISSB, and heralded a period in which informal organizations started to supplement the functions of formal international organizations, such as the IMF. The International Accounting Standards Board (IASB) was also established as a private body promoting mutually-agreed financial reporting standards outside the United States.¹⁹

This first decade cannot be seen as a proper architecture of interlocking institutions with a common shared mission, but the first building blocks of what would follow. Rather than a shared narrative of proper public policy and its broader goals as found in Bretton Woods, this period was one in which shared expectations of what global financial stability entailed was absent. Similarly, the willingness of states to cooperate by a process of mutual accommodation and coordination was weaker than the tendency to descend into protectionism and attempts at providing local financial and economic stability at the expense of international trade. Protectionism rose, global and European governance devolved from rules and institutions to communication between national heads of government, and two efforts in Europe to peg exchange rates to one another in a precursor of EMU (the Snake and the Snake in the Tunnel) fell apart as national governments favoured the immediate demands of national constituents over the possible benefits of not undercutting each other through high debt and borrowing levels, high inflation rates, and competitive exchange rate devaluations.²⁰ It was a time of turbulence and near anarchy in which a GFSA could not be said to exist.

The second decade of the post Bretton Woods saw the United States and the United Kingdom promote the establishment of two other ISSBs alongside the Basel Committee that brought together regulators from advanced economies: the International Association of Insurance Supervisors (IAIS) in London; and the International Organisation of Securities Commissions (IOSCO) in Madrid.²¹ Alongside the Basel Committee, they were intended to promote common regulatory standards for the insurance and securities markets (stock and bond markets, hedge and other investment funds, credit

¹⁷ Ruggie, J. G. (1982). International regimes, transactions, and change: embedded liberalism in the postwar economic order. *International organization*, 36(2), 379-415.

¹⁸ See <https://www.bis.org/bcbs/>.

¹⁹ <http://www.ifrs.org>. Pauly, L. W. (2009). The old and the new politics of international financial stability. *JCMS: Journal of Common Market Studies*, 47(5), 955-975.

²⁰ Story, J., & Walter, I. (1997). Political economy of financial integration in Europe: The battle of the systems. Manchester University Press. See also Chapter [1.1] in this volume.

²¹ <https://www.iaisweb.org/home>; <https://www.iosco.org>.

rating agencies), respectively. After the Financial Crisis of 1997, which began in East Asia then went global, these bodies were joined by the Financial Stability Forum,²² which the G7 called into being to acquire insight into how the Basel Committee, IAIS, IOSCO and IASB were learning from the past and responding to new challenges, and to act as a sort of steering committee for the bodies to act together toward a common goal. As the global economy recovered, however, the promise of a coordinated mission typical of an architecture faded. Nevertheless, the IMF and World Bank adopted these ISSB standards as benchmarks for their reviews of national government policies on financial stability, in an exercise known at the World Bank as the Report on Observance of Standards and Codes (ROSCO) and at the IMF as part of Article IV consultations.²³

These standards worked from a new shared master narrative, known alternatively as the Washington Consensus and neoliberalism, that countries would do best by maximising the role of capitalist markets within their countries, and allowing them to function between them as well. This meant the liberalisation of (international) trade and finance, the reduction of public ownership and state regulation in the economy, and the introduction of macroeconomic policies geared to attracting (international) investment capital. The latter implied that governments should practice austerity in public finance—balancing budgets rather than borrowing and spending during downturns—and that central banks should act conservatively to control inflation through interest rates and the money supply, which in turn would keep inflation low and exchange rates strong, all things being equal. This became known as the Washington Consensus because the IMF and World Bank, both seated in Washington D.C., had adopted the framework during this period, meaning that its terms and conditions on countries in financial distress, and its definition of what it meant to be a member in good standing of the international community with regard to financial stability, had been solidified. However, this understanding of financial stability had few provisions for financial stability per se. Markets were thought to be efficient and self-correcting, without inherent deficiencies that needed to be prevented through further regulation.

Within Europe, a similar shift from embedded liberalism to neoliberalism took place between 1978 and 1984. 1979 marked the second European attempt to coordinate national currencies and macroeconomic policies – with the launch of the the European Monetary System (EMS).²⁴ Instead of governments managing their currencies and economies politically with the expectation of mutual adjustment, coordination took place by Europe adjusting to the German economy, which served as an anchor until the establishment of EMU. This meant that governments committed themselves to adjusting to the expectations of financial markets rather than steering against them.²⁵

German ordoliberalism then became the central narrative for the EMS, and for EMU and Banking Union later on.²⁶ A brief French period of resistance between 1981 and 1984 was followed with effective policy consensus within the future Eurozone.²⁷ It shared with the neoliberal

²² <https://web.archive.org/web/20090512222115/http://www.fsforum.org/> .

²³ See <http://www.worldbank.org/en/programs/rosc> and <http://www.imf.org/external/NP/rosc/rosc.aspx>.

²⁴ The first attempt was the Snake in the Tunnel arrangement of 1972, in which European currencies were pegged to each other, and collectively to the United States dollar. It ended under pressure in fall 1973. See Delivorias, A. (2015) *A History of European Monetary Integration*. Brussels: European Parliamentary Research Service.

²⁵ Donnelly, S. (2004). *Reshaping Economic and Monetary Union: membership rules and budget policies in Germany, France and Spain*. Manchester University Press. Sinclair, T. J. (2014). *The New Masters of Capital: American bond rating agencies and the politics of creditworthiness*. Cornell University Press.

²⁶ Schäfer, D. (2016). A banking union of ideas? The impact of ordoliberalism and the vicious circle on the EU banking union. *JCMS: Journal of Common Market Studies*, 54(4), 961-980.

²⁷ Verdun, A. (2000). *European responses to globalization and financial market integration: perceptions of economic and monetary union in Britain, France and Germany*. Springer.

Washington Consensus a devotion to fiscal austerity for governments and a hard currency macroeconomic policy by central banks. It did not share the carefree view of financial market liberalisation on the other side of the Atlantic, however. Although Germany introduced a series of financial market promotion acts to create new room for financial service providers to operate and financial markets to establish themselves, financial stability required strict precautionary measures to limit the size of financial markets, their business practices, and their behaviour toward the real economy.

During the last years before the GFC, these institutions worked to define how global financial stability could be furthered together with growth by pushing the financialisation²⁸ of the global economy even further. By financialisation reference is made to the opening up of the economy, its markets and institutions to financing and risk management through stock, bond and derivative markets as an alternative to bank finance and strong regulation of risk. Securitisation in particular could benefit flagging global economic growth by massively increasing the supply of money²⁹ while increasing, through financial engineering and advances in probability analysis, the safety of financial instruments used as money,³⁰ to the point that they were considered by central banks and regulators as foolproof.³¹

2.2 The Current GFSA

The post-GFC architecture was set up to relaunch securitisation on a sound basis,³² and more broadly to rethink macroeconomic policy. The first of the goals remains, while the second has stalled due to a combination of uncertainty over actions and reactions in financial markets, and political divisions between Germany and the rest of the G7 over whether to pursue an accommodating or restrictive monetary policy. Over time, the ambition to redirect macroeconomic policy has given way to data collection on the interaction of many different kinds of prices in the global economy (including those of the real economy and those of financial markets), with a view to determining their ultimate effect on inflation, growth and sometimes employment rates.

Each of the ISSBs had the mission to monitor, analyse and provide standards for their areas of specialty,³³ and the Financial Stability Board (FSB) to link those standards together and promote member state adoption.³⁴ Rather than accept critiques that the system of financialisation was broken beyond repair, and required a strong regulatory response to provide financial stability, the G20 chose instead to focus on incremental changes based on data collected and evidence-based conclusions that could make securitisation safer. It lacks, however, agreement on a new meta-narrative of what constitutes proper macroeconomic policy and how financial market regulation fits into that mission.³⁵

²⁸ Krippner, G. R. (2005). The financialization of the American economy. *Socio-economic review*, 3(2), 173-208; Assa, J. (2012). Financialization and its consequences: The OECD experience. *Finance Research*, 1(1), 35-39;

²⁹ Langley, P. (2008). Financialization and the consumer credit boom. *Competition & Change*, 12(2), 133-147.

³⁰ Krippner, G. R. (2011). *Capitalizing on Crisis*. Harvard University Press; Parenteau, R. W. (2005). The late 1990s US bubble: Financialization in the extreme. in Epstein, G. A. (Ed.). (2005). *Financialization and the world economy*. Edward Elgar Publishing: 111-148; Foster, J. B. (2008). The financialization of capital and the crisis. *Monthly review*, 59(11), 1.

³¹ Reinhart, C. M., & Rogoff, K. S. (2009). *This Time is Different: Eight centuries of financial folly*. Princeton: Princeton University Press

³² April 2009 G20 Communique.

³³ Glenn, J. (2014). In the aftermath of the financial crisis: risk governance and the emergence of pre-emptive surveillance. *Review of International Studies*, 40(2), 227-246.

³⁴ Donnelly, S. (2012). Institutional change at the top: from the financial stability forum to the financial stability board (No. 75, pp. 261-275). Campus.

³⁵ Davies, H. (2010). Global financial regulation after the credit crisis. *Global Policy*, 1(2), 185-190.

Critiques of the previous system remained,³⁶ but did not lead to a new dominant direction.³⁷ This took place in an environment of intense political competition over macroeconomic policy ideas.³⁸

The implications of this silence on securitisation, financial regulation and macroeconomic policy were a continuation of financial activities leading to the crisis, and a macroeconomic policy intent on preventing financial sector collapse through quantitative easing. Meanwhile, the GFSM started creating the building blocks of a knowledge central to a new, as yet undefined macroeconomic policy in an environment where consensus was lower and uncertainty higher over how to rethink theory and practice. The collection and analysis of microeconomic data through micro prudential supervisors created the building blocks, however, for shifting macroeconomic policy from broad principles to include how the laws of economics look in different parts of the economy.³⁹

The decade leading up to the GFC was characterised by excessive risk taking and acceptance in bank lending and investments, securitisation (through two kinds of financial engineering products: asset-backed securities (ABSs) and collateralised debt obligations (CDOs)),⁴⁰ credit ratings, and shadow banking (hedge funds and other special purpose vehicles for unregulated market transactions). Until the crash, risk of default, and its impact on financial stability, was thought by financial stability experts to be manageable through a combination of pricing risk (at the point of providing retail and business loans), bundling risk (in synthetic securities), assessing risk (credit ratings),⁴¹ using synthetic securities as risk-free forms of capital, and insuring them against loss (financial derivatives known as credit default swaps). Banks could lend more, earn more, and retain less capital for emergencies because they maintained, and regulators accepted, that the algorithmic features of risk management, distribution, market support and insurance were foolproof.

Even if this system proved not to be foolproof, credit rating agencies would monitor the composition of securitisations and report on the results; while banks would take out insurance against loss in the form of yet another security: credit default swaps (CDSs). Regulators accepted that this three-fold, complex means of ensuring financial stability would make bankruptcy a thing of the past, actually lowering capital requirements in Basel II. In other words, financial engineering was thought to make financial markets safer with greater efficiency and lower costs, as long as everyone played by the rules and did not abuse the securitisation model by putting too many problem assets into the products. The problem leading up to the GFC was that banks did precisely this: making loans at high interest rates to depositors who had little chance of repaying. This hollowed out the quality of the ABSs that contained these loans and the CDOs made up of ABSs.

The reasons for the blind faith in securitisation and reliance on it was not just a technical advancement in the nature of money and risk management through quantitative analysis, but a desire

³⁶ De Grauwe, P. (2016). *The Limits of the Market: The Pendulum Between Government and Market*. Oxford University Press.

³⁷ McNamara, K. R. (1998). *The currency of ideas: monetary politics in the European Union*. Cornell University Press; Ban, C. (2016). *Ruling Ideas: How Global Neoliberalism Goes Local*. Oxford University Press; Dyson, K., & Maes, I. (Eds.). (2017). *Architects of the Euro: Intellectuals in the Making of European Monetary Union*. Oxford University Press.

³⁸ Farrell, H., & Quiggin, J. (2017). Consensus, Dissensus, and Economic Ideas: Economic Crisis and the Rise and Fall of Keynesianism. *International Studies Quarterly*; Dellepiane-Avellaneda, S. (2015). The political power of economic ideas: The case of 'expansionary fiscal contractions'. *The British Journal of Politics & International Relations*, 17(3), 391-418; Matthijs, M., & McNamara, K. (2015). The euro crisis' theory effect: northern saints, southern sinners, and the demise of the eurobond. *Journal of European Integration*, 37(2), 229-245; Schmidt, V. (2017). The Resilience of 'Bad Ideas' in Eurozone Crisis Discourse, Even as Rival Ideas inform Changing Practices;

³⁹ Stiglitz, J. E. (2011). Rethinking macroeconomics: What went wrong and how to fix it. *Global Policy*, 2(2), 165-175.

⁴⁰ Jobst, A. (2005). The regulatory treatment of asset securitisation: The Basel Securitisation Framework explained. *Journal of Financial Regulation and Compliance*, 13(1), 15-42.

⁴¹ Salmon, F. (2012). The formula that killed Wall Street. *Significance*, 9(1), 16-20; Wilmott, P., & Orrell, D. (2017). The Money Formula: Dodgy Finance, Pseudo Science, and How Mathematicians Took Over the Markets, 207-225.

by banks to lower the cost of risk management, coupled with a political desire in the United States to expand the money supply domestically, and then globally after the 9/11 attacks of 2001. Securitisation radically expanded the money supply in two ways: by allowing banks to sell the loans they had made, re-lending the cash, and so on until they ran out of customers willing to borrow (rather than retaining the asset for interest income as banks traditionally do); and by allowing banks to use ABSs and CDOs with investment grade ratings as if it were cash for the purpose of their requirement to hold certain minimum levels of capital as a buffer against shocks; (rather than holding capital retained or from investors which could otherwise be lent out). Because these instruments paid interest, other banks, particularly large banks with an appetite for more sophisticated financial instruments readily bought them and used them instead of cash, which is how the US practice went global.

In the end, this means of diffusing ABSs and CDOs throughout the global economy, primarily over large banks with diversified portfolios, opened up channels of contagion that transformed the American financial collapse into a global one, and the Great Financial Crisis into a Eurozone Crisis (EZC). Europe struggled to find its feet, with Southern European governments and Ireland in particular experiencing financial fragility (inability to rejuvenate economic growth borrow on financial markets). This is the context in which calls for a recalibration of global financial stability policy were raised, in which the impetus for a new GFSA made itself felt, and in which the links between the global and European financial stability architectures were established. However, while the financial regulation community recognised that securitisation practice had undermined financial stability, it held to the notion that securitisation was safe in principle and could be made sustainable by recalibrating the level at which riskier assets could be incorporated.⁴² But residual uncertainty remained regarding the source of instability for these assets that might not be traced back to poor lending practices.

The core of the global response in the short to medium term was therefore to look for a path to fix the system rather than radically change it. While the G20 opted to end the Washington Consensus as a running assumption in April 2009, it did not agree on a replacement and simultaneously agreed to pursue a cornerstone of the late Washington Consensus order: the goal to restore securitisation on a safe basis. It was in this environment that BIS Deputy SG Hannoun makes the case for a Global Financial Stability Architecture in 2009.⁴³

3. International Bodies and the EMU

EMU policy fields have quite significant international dimensions. The present section aims to reveal the institutional links between the emergence of the GFSA and the EU. The first European legal/institutional response parallel to the global developments was to upgrade coordinating committees for micro prudential regulation in the banking, insurance and securities sectors into European Supervisory Authorities, taking effect at the beginning of 2011, to establish a European System of Financial Supervision (ESFS) to coordinate their activities, and a European Systemic Risk Board to advise European decision makers on further legal, regulatory and monetary policy initiatives. Those bodies developed close contacts to their international counterparts, sometimes with

⁴² This is by no means a purely historical concern. The high level of non-performing loans in some European banking sectors has incited a number of proposals to bundle and sell off the assets into new securities that could replicate the pre-GFC problem in Europe. This is the central strategy behind the EU's Capital Markets Union.

⁴³ Hannoun, H. (2010, February). Towards a global financial stability framework. In *Speech at the 45th SEACEN Governors' Conference, Siem Reap province, Cambodia* (pp. 26-27).

overlaps of personnel, thereby facilitating the congruence of policy expertise and methods of pursuing goals. The subsections below outline the international bodies to which European institutions are linked. They start with the Financial Stability Board, which is tasked with steering the technical work of the GFSA's various bodies on behalf of the G20, with compiling and discussing synergies between the various components for which individual ISSBs are responsible, in the context of macroprudential supervision, or supervision of the financial system as a whole, rather than individual sectors like banking, insurance and the others (financial market actors). That macroprudential supervision then provides the context in which the individual ISSBs that collectively make up the GFSA are relevant and discussed. It is striking that there is more than one body for banking issues. This reflects the urgency of dealing with failed banks after 2008, as well as building up the different components of a financial stability support structure for banks that are failing.

3.1 *Financial Stability Board*

The international body that was explicitly created with the goal of financial stability in mind, is the Financial Stability Board (FSB). The FSB deals with overarching issues of financial stability, but primarily on the regulatory side, while broader macroeconomic policy questions (quantitative easing, etc.) are left to the G7/G20 and central banks. It was established in 2009 as a successor to the Financial Stability Forum and tasked with coordinating and linking up knowledge and standards across the three micro prudential ISSBs outlined below.⁴⁴

The Board itself is comprised of 24 members (all national with the exception of Hong Kong) and a number of non-governmental entities. While the EU is thus not a member as such, France, Germany, Italy, the Netherlands, Spain and the UK have seats at the table. Non-national institutional members consist of IFIs (WB & IMF), central banks (BIS and ECB), ISSBs (BCBS, IOSCO, IAIS, IASB), ECB as head of the SSM, the OECD, and two further BIS Committees: the Committee on the Global Financial System and the Committee on Payments and Markets Infrastructures (CPMI).

While the FSB has a fairly limited membership, it practices outreach to other jurisdictions through so-called Regional Consultative Groups. This is a practice shared with other ISSBs, particularly the OECD. The purpose is to combine two competing impulses. On the one hand, membership is supposed to be limited to ease decision-making, compatible with club governance.⁴⁵ This allows for transnational deals between like-minded experts and elites,⁴⁶ though there is no guarantee that those deals will be ratified.⁴⁷ On the other hand, the group aspires to see its standards adopted globally, by a large number of jurisdictions that have no formal membership. The Regional Consultative Groups allow the FSB to square this circle, or at least to attempt to do so. In practice, FSB-sanctioned standards are used more broadly as well. The IMF in particular took on the role of reviewing the degree of FSB standard adoption in all countries as a part of its Financial Services Assessment Program, and Article IV consultations.

⁴⁴ Arner, D. W., & Taylor, M. W. (2009). The global financial crisis and the financial stability board: Hardening the soft law of international financial regulation. *UNSWLJ*, 32, 488. Germain, R. (2011). The Financial Stability Board. in Hale, T., & Held, D. (Eds.). (2011). *Handbook of transnational governance*. Cambridge, MA: Polity, 50-54.

⁴⁵ Tsingou, E. (2015). Club governance and the making of global financial rules. *Review of International Political Economy*, 22(2), 225-256.

⁴⁶ Newman, A., & Posner, E. (2016). Transnational feedback, soft law, and preferences in global financial regulation. *Review of International Political Economy*, 23(1), 123-152;

⁴⁷ Quaglia, L., & Spdzharova, A. (2017). Post-crisis reforms in banking: Regulators at the interface between domestic and international governance. *Regulation & Governance*, 11(4), 422-437; Spdzharova, A. (2016). Regulatory cascading: Limitations of policy design in European banking structural reforms. *Policy and Society*, 35(3), 227-237.

The FSB consolidates these standards into commitments for FSB member states. These commitments are soft in two senses: the FSB has no legal personality nor capacity to issue binding standards; and its standards provide room for national legislators and competent authorities to flesh out the details of what it requires. Much like the OECD's and EU's open method of coordination,⁴⁸ a combination of benchmarks, reporting and peer review is designed to assess performance and apply pressure for adaptation. FSB member states are expected to adopt and implement standard recommendations to retain their status as members in good standing, while other states may but otherwise face no consequence for non-observance and implementation.

The Board's intended impact is reflected in the existence of three standing committees: Assessment of Vulnerabilities (SCAV); Standards Implementation (SCSI);⁴⁹ and Supervisory and Regulatory Cooperation (SCSRC).

The *Standing Committee for Assessment of Vulnerabilities* is where the FSB looks for sources of financial instability that might be significant enough to require countermeasures, as well as links between those sources and the rest of the global financial system. It can be thought of as the place that most directly reflects the state of FSB thinking on what financial (in)stability means in practical terms and what should be done about it. It is therefore here that one can best see evidence of how much the GFSM remains committed to a key part of its original mission – to relaunch securitisation on a sound basis.

Of the topics dealt with by the Committee, three stand out as prominent topics. The first, and the only one to which SCAV devotes an annual report, is *shadow banking*.⁵⁰ These are the hedge funds and special-purpose vehicles attached to banks that are largely unregulated, and responsible for both investing and trading in derivatives (securitisations), and for borrowing the funds to carry out those transactions.⁵¹ The second is *derivatives trading*, largely between these entities. The third and most recent is *leverage*, or borrowing, by shadow banks and corporate entities, with a strong focus on foreign exposures (borrowing in a foreign currency).⁵² All are key components to the problems underlying securitisation that generated the Financial Crisis of 2007-2009.

FSB work on all of these areas are typified by data collection and presentation about the magnitude of shadow banking, trading and leverage respectively as risks in and of themselves. The emphasis in all of them is on the magnitude of financial assets and liabilities being created and traded, particularly in relation to the overall size of the economy. Underlying this focus appears to be a belief that securitisation is safe, even when it incorporates risky assets, provided the involvement of risky assets is contained to modest, but as yet vaguely defined levels. The same can be said for foreign exposures and to a lesser degree (of consensus) for leverage. Foreign exposures have long been recognised as important financial stability risks in emerging markets, but attracted

⁴⁸ The so-called 'open method of coordination' is characterised by a 'horizontal', intergovernmental, approach and rests on soft law mechanisms such as guidelines and indicators, benchmarking and sharing of best practice. See for instance E. Barcevičius, T. Weishaupt, J. Zeitlin (Eds.), *Assessing the Open Method of Coordination*, Springer, 2011.

⁴⁹ FSB (2017) *FSB assesses implementation progress and effects of reforms*. Basel: 28 February.

⁵⁰ FSB (2017) *Global Shadow Banking Monitoring Report 2016*. Basel: 10 May.

⁵¹ Langley, P. (2008). Sub-prime mortgage lending: a cultural economy. *Economy and Society*, 37(4), 469-494. Wainwright, T. (2009). Laying the Foundations for a Crisis: Mapping the Historico-Geographical Construction of Residential Mortgage Backed Securitization in the UK. *International Journal of Urban and Regional Research*, 33(2), 372-388. Nelson, S. C., & Katzenstein, P. J. (2014). Uncertainty, risk, and the financial crisis of 2008. *International Organization*, 68(2), 361-392.

⁵² FSB (2014) *Letter from IMF-FSB-BIS Work on Data Gaps Involving FX Exposures*. 11 September; FSB (2014) *Joint CGFS-FSB-SCAV Workshop on Risks from Currency Mismatches and Leverage on Corporate Balance Sheets*. Basel: 11 September. FSB (2014) *Corporate Funding Structures and Incentives*. Basel: 25 September.

Derivatives trading is different than the other two, however, since it has been the subject of a regulatory initiative on the part of advanced economies to mandate the transfer of over-the-counter (OTC) derivatives through central counter parties (CCPs). CCPs are platforms functioning as financial institutions that underwrite trades between two other financial institutions. Should one of the parties to the transaction fail to pay, the CCP steps in to make the payment instead. The purpose is to prevent financial collapse of one financial institution from unleashing a domino effect resulting in systemic contagion.

The *Standing Committee on Implementation and Compliance* is responsible for the exercises that compel members to file reports and submit to peer review on a regular basis.⁵³ In a soft law context, it is the primary means by which FSB-sanctioned standards are translated into meaningful obligations by national governments, though the latter retain some discretion on how to transpose them. Some of the peer reviews are applied to all members at once on a specific issue of critical importance. To date these thematic issues have covered the same topics dealt with above: shadow banking; OTC derivatives trading; bank regulation. A prerequisite for the FSB to become involved is that the topic is cross-sectoral or cross-functional, so that it does not replicate a review by one of the micro prudential ISSBs, the IMF or the World Bank. Other peer reviews cover the entire spectrum of financial market practices and regulations that apply within a specific country. Overall, the country reviews keep in mind three points: the overall provisions for financial stability; ensuring a commitment to openness and transparency of the financial sector, as well as implementing international standards.⁵⁴

Data on implementation and compliance is derived from two sources: from country reviews, in which member states are visited by counterparts from other FSB members; and from IMF reports under the Financial Sector Assessment Program (FSAP), that conclude with a Financial System Stability Assessment (FSSA) for the world's 25 largest systemic jurisdictions. A great deal of the data collection is therefore already on hand when the FSB shows up. In addition to these reviews, SCSI has been given the task of conducting ex post impact assessments on the adoption of financial stability standards. In other words, it is responsible for asking whether adoption of standards in the past has made a meaningful contribution to financial stability that is worth the cost.

The *Standing Committee on Supervisory and Regulatory Cooperation* sets out the protocols and memoranda of understanding that regulate the collection, processing and sharing of data between national competent authorities, and interaction in the case of supervising and resolving cross-border financial institutions.

In addition to the standing Committees, the FSB has Regional Consultative Groups that allow the Board to discuss standards with non-members as well as members. The Regional Consultative Group for Europe has both Eurozone members (Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain) and non-members (Czech Republic, Denmark, Hungary, Iceland, Israel, Norway, Poland, Sweden, Switzerland, UK, GIFCS (Group of International Financial Centre Supervisors: small jurisdictions)). Each country is represented by finance or treasury ministers, central bank representatives and securities regulators.

In addition to linking up standards generated elsewhere, the FSB also acts as a clearing house of ongoing and innovative research into elements of the economy that are changing, developing, and impacting financial stability, as well as recommended standards in those areas, particularly ones that help supervisors to collect further data for analysis. Examples of initiatives to generate better

⁵³ FSB (2010) *FSB Framework for Strengthening Adherence to International Standards*. Basel: 9 January.

⁵⁴ FSB (2017) *Handbook for FSB peer reviews*. Basel: 31 March.

international oversight of financial market activity are the Data Gaps Initiative, the Legal Entity Identifier project, and the Unique Product Identifier project. Research and initiatives on new areas can be seen in reports on cybersecurity in financial services and artificial intelligence.

All in all, the FSB's direction of global macroeconomic policy is negligible. Moschella⁵⁵ notes that FSB goes beyond coordinating national affairs, to deal with assessing vulnerabilities and monitoring member state implementation of Board-recommended initiatives. At the same time, Helleiner and Pagliari also note that the FSB's capacity to work independently of its members is quite limited, so that the initiative lies with member applications rather than the other way around.⁵⁶ It embodies the post-2008 focus on macro prudential supervision, but reflects a combination of intergovernmental compromise, and lowest denominator decision-making typical of organisations that require consensus.⁵⁷

In this context, the FSB has worked on measures that reinforce the work of other standard setters, where technical knowledge matters greatly, and where specific international points of conflict can be sorted out, if anywhere. The most important output of standards that the FSB adopts is that they push financial institutions to hold more capital in reserve to hedge against the risk of a financial shock. This has a modest macroeconomic drag in the short term, in return, it is hoped, for greater resilience to shocks down the road. The wait and see approach to shadow banking and foreign exposures, coupled with the central counter parties initiative, however, is not only modest in terms of restricting securitisation, but sets up the CCP infrastructure through which a relaunch of securitisation on even grander scales can be prepared. As Underhill⁵⁸ notes, this reflects an accommodating attitude toward monetary policy and financial regulation within the GFSB.

As will be highlighted with regard to EMU in section 4, the GFSB's work to relaunch securitisation on a sound basis resonates in EU Commission proposals for a Capital Markets Union, which promotes the use of financial engineering to assist states and corporations, particularly banks, in existing the so-called doom loop of financial fragility between states and sovereigns in Southern Europe and Ireland. It also is behind the European Systemic Risk Board's plans to use securitisation, with all the precautions that go along with it, to keep the money supply stable and growing in the Eurozone in the absence of a large EU budget.⁵⁹

⁵⁵ Moschella, M. (2013). Designing the Financial Stability Board: a theoretical investigation of mandate, discretion, and membership. *Journal of International Relations and Development*, 16(3), 380-405.

⁵⁶ Helleiner, E., & Pagliari, S. (2011). The end of an era in international financial regulation? A postcrisis research agenda. *International Organization*, 65(1), 169-200.

⁵⁷ Scharpf, F. W. (2006). The joint-decision trap revisited. *JCMS: Journal of Common Market Studies*, 44(4), 845-864.

⁵⁸ Underhill, G. R. (2015). The emerging post-crisis financial architecture: The path-dependency of ideational adverse selection. *The British Journal of Politics and International Relations*, 17(3), 461-493.

⁵⁹ Expertise on financial stability at international financial institutions (IMF, OECD) and key European think tanks broadly accepted the need for automatic fiscal stabilisers for the Eurozone to mitigate both economic shocks to the Eurozone's weakest economies and long-lasting trends of low or negative economic growth that could prevent economies and banks from rebounding after an initial crash. See Donnelly, S. (2016). Expert advice and political choice in constructing European banking union. *Journal of banking regulation*, 17(1-2), 104-118.

3.2 *Bank for International Settlements*

The BI⁶⁰ is responsible for overarching financial stability policy in the sense of combining macroeconomic policy expertise with financial stability and banking regulation.⁶¹ It also supports and coordinates a number of the committees and organisations outlined below. In a sense one might ask whether the contribution to the GFSA by the BIS is as meaningful as the one by the FSB described above. In practice, it is probably greater.

Part of the answer lies in the constitution of the BIS, the profile of its officers, and the Committees it forms to study topics of interest. Unlike the FSB, the BIS has a much larger staff, resources and high-profile representatives to give the Bank's views and research greater standing. A great number of working and research papers are issued, and the position of Chief Economist provides profile to the views of the Bank. Whereas the FSB examines a wide but still limited range of phenomena, the Bank may focus on broader economic developments, their implications for macroeconomic practice, which may then have implications for standard setters, but often central banks and national governments as well. It is the true counterpart to the more politically-oriented G7 and G20 fora, in the sense that it is free to propose agenda items, promote discussion of policy and standards, and create the room for the ISSBs it supports (including the FSB) to set standards and guidelines themselves.

From time to time this means that the BIS may be critical of G7/G20 political compromises, or current trends by elected governments on either overall macroeconomic policy or specific parts of it, without explicitly referring to the global steering body. A recent development at the Bank that illustrates this willingness to wade into contentious issues (that affect the Eurozone in particular) is the warning by the Bank's Head of Monetary and Economics Department that the extended period of low interest rates that has persisted since 2008 has permitted macroeconomic imbalances to form in the form of asset bubbles that could endanger financial stability when they burst.⁶² This speaks in particular, though not exclusively, to the current fight between the Eurogroup and the ECB over whether national governments ought to cut back on borrowing to comply with EMU membership rules, or whether those rules should be relaxed in some way to allow for more robust economic growth.⁶³ Low interest rates, a key component of quantitative easing,⁶⁴ persist in part because economic growth remains anaemic in much of the Eurozone, which in turn is caused by the bloc's strong, and globally unique political focus on national budgetary retrenchment.⁶⁵ These low interest rates then follow to keep economies from crashing, but incite financial manias and crashes instead.⁶⁶

⁶⁰ Alexander, K. (2009). Bank for international settlements. In *Handbook of Transnational Economic Governance Regimes* (pp. 305-318). Brill.

⁶¹ Simmons, B. A. (1993). Why innovate? Founding the bank for international settlements. *World Politics*, 45(3), 361-405; Seabrooke, L. (2006). The bank for international settlements. *New Political Economy*, 11(1), 141-149.

⁶² Borio, C. (2017) Secular stagnation or financial cycle drag? Speech at the 33rd Economic Policy Conference of the National Association for Business Economics. 5-7 March, p. 9.

⁶³ Donnelly, S. (2018). ECB-Eurogroup Conflicts and Financial Stability in the Eurozone. *Credit and Capital Markets—Kredit und Kapital*, 51(1), 113-126.

⁶⁴ See Chapter [5.2] on Monetary Policy in this Volume. Low and negative interest rates help to ensure that incentives are low to save money, and relatively high to spend it. They are a prerequisite for ensuring that increased liquidity into the financial system is not frozen again.

⁶⁵ Donnelly, S. (2011). The public interest and the economy in Europe in the wake of the financial crisis. *European Political Science*, 10(3), 384-392; Piattoni, S. (2017). The European Union between Intergovernmentalism and 'Shared and Responsible Sovereignty': The Haptic Potential of EMU's Institutional Architecture. *Government and Opposition*, 52(3), 385-411.

⁶⁶ Borio, C. (2017) *Secular stagnation or financial sector drag?* Keynote speech to the National Association for Business Economics. Washington D.C. 5-7 March.

In this context of chronic fragility, central bankers have found it difficult, if not impossible to taper quantitative easing.⁶⁷ QE which was originally intended to compensate for temporary fragility during a downturn. Regardless of how gradual the raising of interest rates, the retraction of issued liquidity and the sale of financial instruments on central bank balance sheets is portrayed. While the Federal Reserve has had more room to taper due to more robust growth,⁶⁸ the ECB has had to face a more fragile economy, leading it to take a “slower for longer” approach to winding down QE.⁶⁹ Meanwhile, QE has had further impacts on emerging markets worldwide.⁷⁰

Another development illustrating the BIS’s leadership role in thinking about how to best approach financial stability is its development of policy rules for capital controls in November 2017 which help generate converging expectations on how to apply such controls.⁷¹ Given their increased use during local financial stability crises, and the IMF’s warming to capital controls during crises,⁷² the standards help steer the behaviour of financial sector actors, and most importantly, set and maintain the terms of international financial interdependence.

In this context, the BIS is best thought of as a body which does the real, overarching thinking behind financial stability in the GFSA, linking and weighing all the parts of the puzzle into a larger picture. It cannot be considered macro economically conservative in principle, but pragmatic. This means that there is greater flexibility in the rules and orientation of the Bank than one would find in EMU rules and regulations.

The BIS hosts a number of committees beyond the FSB that focus on key parts of the GFSA puzzle: the Basel Committee on Banking Supervision (BCBS); the Committee on the Global Financial System (CGFS); the Committee on Payments and Markets Infrastructures (CPMI); the Markets Committee and the Irving Fisher Committee on Central Bank Statistics. The Markets Committee and the CGFS have similar functions to the FSB’s SCAV—they monitor developments, risks and vulnerabilities and think through possible solutions to them. CPMI is an important player in promoting ideas regarding payment and clearing systems and has taken on a prominent role together with IOSCO (a non-BIS institution discussed below) in conceiving and designing central counter party infrastructures that make it possible to ensure financial stability in a highly securitised environment. This means that BIS and its committees are doing much of the work that is required to provide financial stability, particularly in banking, in a highly securitized environment.

⁶⁷ European Central Bank (2015) *Financial Stability Review*. Frankfurt, p. 48.

⁶⁸ Randow, J. and Look, C. (2017) ECB’s Follow-the-Fed Strategy Set to Change on QE. Bloomberg, 25 October.

⁶⁹ Failed attempts at tapering here. Khan, M. (2017) ECB dilemma looms over pace of expected QE tapering. *Financial Times*, 26 October.

⁷⁰ Eichengreen, B., & Gupta, P. (2015). Tapering talk: The impact of expectations of reduced Federal Reserve security purchases on emerging markets. *Emerging Markets Review*, 25, 1-15; Aizenman, J., Binici, M., & Hutchison, M. M. (2014). The transmission of Federal Reserve tapering news to emerging financial markets (No. w19980). National Bureau of Economic Research; Lavigne, R., Sarker, S., & Vasishtha, G. (2014). Spillover effects of quantitative easing on emerging-market economies. *Bank of Canada Review*, 2014(Autumn), 23-33.

⁷¹ Pasricha, G. K. (2017). *Policy Rules for Capital Controls*. Basel: BIS Working Paper 670

⁷² Moschella, M. (2015). The institutional roots of incremental ideational change: The IMF and capital controls after the global financial crisis. *The British Journal of Politics & International Relations*, 17(3), 442-460; Eichengreen, B., & Rose, A. (2014). Capital controls in the 21st century. *Journal of International Money and Finance*, 48, 1-16. Ban, C., & Gallagher, K. (2015). Recalibrating policy orthodoxy: the IMF since the great recession. *Governance*, 28(2), 131-146; Moschella, M. (2015). Governing Cross-border Capital Flows: The Dynamics of Capital Account Policies. In Giliberto C., Howlett, M. & Ramesh, M. *Varieties of Governance*. London: Palgrave Macmillan, 27-50

3.3 *Basel Committee on Banking Supervision*

The Basel Committee is a small (24 members), self-appointed group of central bankers and bank supervisors that sets standards by consensus on how much cash banks should have on hand at any given time, what counts as cash, how losses are insured, how banks are governed to avoid risky behaviour, and how financial instruments can be used to minimise the likelihood that an economic shock leads to collapse. Supported by the BIS, it is nevertheless fairly independent.⁷³ Unlike most other ISSBs, it does not engage broadly with stakeholders but is more selective.⁷⁴ While this promotes consensus, it does not guarantee it. Disagreements between the United States and Europe have led to disappointment in some cases regarding Basel Committee rules,⁷⁵ specifically on leverage on bank balance sheets.

The BCBS deals with regulations designed to make banks resilient from economic shock, and well-governed. This amounts to standards covering capital adequacy standards, bank governance and the relationship between banks and their regulators. It is central to efforts to get the global economy safe again, with implications for EMU banks and member states. Its links to EMU are made through terms of banking union, to stabilise EMU.

A central mission of the Basel Committee after the onset of the GFC was to revisit the existing rules known as Basel II and upgrade them in light of the fact that their observance had led to financial collapse in 2008. These standards had promoted the use of quantitative risk management that is at the core of the securitisation process (which in turn was at the core of the financial crisis)⁷⁶ and its stabilisation.

Basel III negotiations focused on forcing global systemically-important banks (G-SIBs) to raise more capital than had been the case under Basel II and to hold it in reserve against future calamities (core equity tier 1 capital (CET), total-loss-absorbing capital (TLAC), minimum reserves and eligible liabilities (MREL), and a liquidity coverage ratio (LCR) that includes a definition of high-quality liquid assets (HQLA). All of these standards are fairly detailed and serve as a template for European capital requirements for larger banks.

EU-US divisions made common standards impossible in the field of leverage, however. Leverage refers to the amount of debt a bank incurs in order to do business. Because banks in Europe are much more highly leveraged than their American counterparts, and because the US government identified high leverage as a source of vulnerability to economy shock that had to be reduced, agreement was not possible.⁷⁷

⁷³ Young, K. L. (2012). Transnational regulatory capture? An empirical examination of the transnational lobbying of the Basel Committee on Banking Supervision. *Review of International Political Economy*, 19(4), 663-688.

⁷⁴ Underhill, G. R., & Zhang, X. (2008). Setting the rules: private power, political underpinnings, and legitimacy in global monetary and financial governance. *International Affairs*, 84(3), 535-554; Pagliari, S., & Young, K. L. (2014). Leveraged interests: Financial industry power and the role of private sector coalitions. *Review of International Political Economy*, 21(3), 575-610.

⁷⁵ Lall, R. (2012). From failure to failure: The politics of international banking regulation. *Review of International Political Economy*, 19(4), 609-638; Helleiner, E. (2014). *The status quo crisis: Global financial governance after the 2008 meltdown*. Oxford University Press; Baker, A. (2013). The gradual transformation? The incremental dynamics of macroprudential regulation. *Regulation & Governance*, 7(4), 417-434.

⁷⁶ Shin, H. S. (2009). Securitisation and financial stability. *The Economic Journal*, 119(536), 309-332; Crotty, J. (2009). Structural causes of the global financial crisis: a critical assessment of the 'new financial architecture'. *Cambridge journal of economics*, 33(4), 563-580; Goodhart, C. A. (2008). The background to the 2007 financial crisis. *International Economics and Economic Policy*, 4(4), 331-346.

⁷⁷ Donnelly (2018).

The consequences of the Basel Committee's efforts are new regulations intended to force banks to seek and hold higher levels of capital, to hold new kinds of capital (borrowing that converts to capital in a crisis) and to change the kind of borrowing they undertake (safer) to do business.

The effects of these changes are still ongoing, and have yet to be fully phased in (2019) by the time of writing. But the initial effect is that banks have become more conservative in their capital structure and in their lending. This increase in resilience comes at the price of lowering money creation through business loans, which in turn leads to a reduction of economic and employment growth; and by implication, to lower bank revenues and increasing bank fragility as a *chronic* condition.⁷⁸ This has had two implications. The first is that economic growth (in the Eurozone particularly) is hit by a double whammy of public sector retrenchment and declining credit levels as banks reduce their loans. The second, as the FSB has noted in its reviews on shadow banking, is that shadow bank's lending activity is growing at a stronger rate than that of traditional banks.⁷⁹

Bank supervisors have also been confronted with the challenge of banks becoming increasingly fragile due to long-term weakness of the economy, at the same time that they are trying to improve their resilience through increased capital buffers. Assets turn more frequently into non-performing loans (NPLs), financially fragile sovereigns put the investment grade status of treasury bills in question in some countries, and banks and sovereigns in some countries find themselves periodically cut off from financial markets, which increases their fragility. For this reason, bank resolution and the treatment of NPLs has come onto the radar for bank regulators. However, this research has been located in the BIS (specifically the Financial Stability Institute),⁸⁰ and most importantly the International Association of Deposit Insurers (IADI, below).

In banking, the macroeconomic effect of macro prudential regulation is a trade-off: better bank resilience against future, indeterminate credit events paid for with a reduction of credit in the general economy, at least in the short to medium term. This trade-off was seen in 2017 in a European dispute referred to the Basel committee on whether European banks would have to treat government bond assets from certain countries like Greece or Italy as safe or risky. Germany had brought up the issue as a quid pro quo for discussing the establishment of a European Deposit Insurance Scheme for the Eurozone. While the Eurozone crisis demonstrated that the bonds were in fact risky, Basel rules still allowed banks to determine themselves that the bonds were safe, even after review in Basel III. Doing so would absolve banks of any legal responsibility to raise capital against the likelihood of default. In addition to bank lobbying, the hostility of the US Trump administration to sharpened rules⁸¹ was followed by stalemate. In late 2017, the BCBS ruled that it could not rule on the question,⁸² demonstrating the limits of consensus-based decision making on sensitive topics.⁸³

Otherwise, Basel standards form the core for European capital adequacy standards, embodied in the Capital Adequacy Directive IV and the Capital Requirements Directive (2013). These standards

⁷⁸ Allen, B., Chan, K. K., Milne, A., & Thomas, S. (2012). Basel III: Is the cure worse than the disease?. *International Review of Financial Analysis*, 25, 159-166; Naceur, S. B., Marton, K., & Roulet, C. (2018). Basel III and Bank-Lending: Evidence from the United States and Europe. *Journal of Financial Stability*.

⁷⁹ Financial Stability Board (2017) Global Financial Stability Report. Basel.

⁸⁰ Baudino, P. and Yun, H. (2017) *Resolution of non-performing loans - policy options*. FSI Insights on policy implementation 3. Basel: October.

⁸¹ Binham, D. (2017) Basel puts new banking policy initiatives on hold until 2019 pending review. *Financial Times*, 25 April.

⁸² Maxwell, M. & Smith-Meyer (2017) Basel banking reform talks to prevent future financial crises fail again. *Politico*, 16 June.

⁸³ BCBS (2017) The regulatory treatment of sovereign exposures - discussion paper. Basel, 7 December; [Donnelly 2019 [check later in proofs]

adopted Basel initially for nearly all banks, but then later in 2017 carved out exceptions for smaller banks to relieve pressure on their finances. CAD IV and the CRR then formed a core measuring stick by which the ECB could determine whether a bank was sufficiently capitalised or whether it had to be resolved (shut down)(discussed below).

3.4 *IADI: International Association of Deposit Insurers*

In the aftermath of the GFC, various national authorities worldwide reacted to protect deposits in differing ways, and with differing effects. A result of the process led to the following conclusions about how Deposit Insurance (DI) contributes to financial stability. Reimbursement should be set so that it covers the maximum number of depositors (reducing the likelihood of a panic), at a reasonable amount (many systems found they had too little coverage to contain panic) but not an unlimited volume of deposits (to contain taxpayer costs and encourage large institutional depositors to monitor bank behaviour). Furthermore, DI should be paid for by banks before crises to act (ex ante funding) as countercyclical shock absorbers in time of crisis, and paid out as quickly and simply as possible. All of these core principles are reflected in European deposit insurance regulations. DI also can and should be deployed as part of resolution. Resolution involves winding down a bank without causing collateral damage to other institutions. Asset separation, sale, and transfer are standard tools that can be used swiftly to ensure that bank customers are moved to another institution without the delays or uncertainties of regular insolvency law. This means that the rights of shareholders, creditors, and other counterparties can be set aside. In the wake of the GFC, many countries found themselves learning by doing, and agreeing that banks should pay ex ante into resolution funds to be used to prevent contagion effects from bank failure, much like deposit insurance, to minimise the pressure on central banks and national treasuries to bail out banks, particularly ones considered too big to fail (TBTF).

The International Association of Deposit Insurers (IADI) was formed in May 2002 to enhance the effectiveness of deposit insurance systems by promoting guidance and international cooperation. Members of IADI conduct research and produce guidance for the benefit of those jurisdictions seeking to establish or improve a deposit insurance system. Members also share their knowledge and expertise through participation in international conferences and other forums. IADI currently has 83 members who represent deposit insurance organisations. IADI is a non-profit organisation constituted under Swiss Law and is located at the Bank for International Settlements in Basel, Switzerland. The supreme authority in all matters of the Association is the General Meeting of its members. IADI is governed by the Executive Council, composed of individuals elected by the Members. Members of the Executive Council must comply with IADI's Code of Conduct. The Executive Council is structured as a working body with broad participation encouraged by means of a committee structure that is largely self-reliant. All members of the Executive Council serve on at least one of the Association's four Council Committees, and perhaps also Technical Committees, to which other Members and Associates may join. In addition, Regional Committees have been created for Africa, Asia-Pacific, the Caribbean, Eurasia, Europe, Latin America, the Middle East and North Africa, and North America, to reflect regional interests and common issues through the sharing and exchange of information and ideas.⁸⁴

⁸⁴ <https://www.iadi.org/en/>

IADI consulted with the European Commission regarding Core Principles, along with the European Forum of Deposit Insurers, the FSB, IMF and World Bank. Those principles were formed parallel to the EU's own legislation, the Deposit Guarantee Systems Directive 2014/49/EU.

IADI is also supported by the Bank for International Settlements, and promotes policy learning, exchange of views and best practice, and generates principles of good deposit insurance.⁸⁵ In addition, it deals with bank resolution, questions of public backstops (government financial assistance to the financial sector to prevent systemic collapse). Its purpose is to design principles of deposit insurance and resolution mechanisms based on mutual exchange and policy learning so that when a bank collapses, it does not lead to a chain reaction of bank failures (financial contagion) or bank runs (in which depositor fears of bank failure lead them to withdraw deposits, causing the bank to fail).

Finally, IADI also concluded that deposit insurance should also be buttressed by a public backstop to be called on in time of systemic crisis. A properly-designed DIS should minimise the need for public backstops, and minimise the likelihood of contagion, thereby also reducing the likelihood of expansionary monetary and policy to compensate for losses, but cannot handle all eventualities.

3.5 *IOSCO & CPMI*

IOSCO, the International Organisation of Securities Exchange Commissions, deals with financial markets (traditionally stock and bond markets), including shadow banks (hedge funds, special purpose vehicles), credit rating agencies, securitisation, and (jointly) central counterparts. IOSCO dates back to 1983 as a US-backed initiative to spread the acceptance of open, transparent financial markets and prudential regulation. It is the most open of the ISSBs, with most countries represented. Before the GFC, its ethos was one of promoting open and frank discussions about financial market developments, regulation, and promoting policy learning and experimentation. Principles of securities regulation were considered to be the extent of their soft law ambitions, as it was feared that anything further would stifle debate and learning. After 2008, however, IOSCO came under pressure from the G20 and the FSB to upgrade its legal output to cover most of what did not fall under banks or insurance. This has led to research on (dealing with) hedge funds,⁸⁶ as well as principles for dealing with credit rating agencies⁸⁷ and fintech⁸⁸ alongside its traditional areas of business, in addition to the new work in central counter parties (see further section 4).

IOSCO is the broadest organisation in terms of membership in the global financial stability architecture. Nearly all countries have representatives in it, and decisions are still taken by consensus. It sees the open nature of the organisation and the general nature of its principles and guidelines as a strength that encourages open debate and mutual learning about financial market trends, strengths, weaknesses, opportunities and threats that would prove more difficult if negotiations were to ensue about binding and extensive standards. In this sense, IOSCO has remained more aloof than the other ISSBs in relative terms about developing clear regulatory standards.

IOSCO is headed by a General Secretary, and organised since 2012 into a Board that steers the organisation's activity. It consists of 18 permanent and 16 rotating members. France, Germany, Italy, the Netherlands, Spain, and the UK (still a member at the time of writing) are permanent Board members from the EU. Formal decisions are taken by the President's Committee, which is in fact the

⁸⁵ IADI (2014) *IADI Core Principles for Effective Deposit Insurance Systems*. Basel: November.

⁸⁶ IOSCO (2009) *Hedge Funds Oversight: Final Report*. Madrid: June.

⁸⁷ IOSCO (2015) *Code of Conduct Fundamentals for Credit Rating Agencies*. FR05/2015. March.

⁸⁸ IOSCO (2017). *IOSCO Research Report on Financial Technologies (Fintech)*. Madrid: February.

General Assembly. The work of IOSCO is handled by a series of Committees, each with the task of seeking out consensus on how standards and guidelines might look, and how they might be different in different settings. The most important overall is the Technical Committee, which meets at different places worldwide to gather differing views in a broad-based consultation process. The Emerging Markets Committee deals both with the sometimes more lively and volatile nature of financial markets in those countries, and the more challenging nature of complying with standards appropriate elsewhere. The Assessment Committee brings together experts in the area of supervision. Regional Committees (which includes the European Regional Committee with 22 non-EU members and 28 EU members) debate and consult on generally accepted interpretations of general standards in their regions. Finally, there are a number of Consultative Committees (Issuer Accounting & Disclosure; Secondary Markets; Market Intermediaries; Enforcement & Exchange of Information; Investment Management; Credit Ratings Agencies; Commodities Derivative Markets; Retail Investors) that provide a sounding board for IOSCO on the substantive standards that the organisation is considering adopting, whether at an initial or more advanced stage of debate.

Both the European Commission (represented by DG FISMA) and the European Securities and Markets Authority (ESMA) are associate members of IOSCO since 2012, which provides them with the opportunity to participate and speak, but not to vote. This puts them in the same category as the Financial Services Authority of Monaco and Kazakhstan, who are the other two associates. The Commission's request to sit on the Board was denied. In contrast, all EU MS are ordinary members. Six are permanent board members.

IOSCO works together with CPMI (Committee on Payments and Market Infrastructures) at the Bank for International Settlements (BIS) to develop standards on central counterparties (CCPs). With this in mind, they jointly developed Principles for Financial Market Infrastructures (PFMI) in 2012. CCPs are required to assess what level of finances are required to manage liquidity and credit risk. CPMI and IOSCO introduced stress testing in 2012 and reviews in 2015 and 2017. This work was further enhanced by an April 2015 work plan on CCP resilience, recovery and resolvability.

CPMI and IOSCO are central to improving the stability-oriented features of the GFSA that make securitisation a major component of the global economy. It therefore has implications for the global supply of liquidity. IOSCO standards on securitisation are therefore central to new EU plans to stabilise and rejuvenate the EMU economy through Capital Markets Union (a securitisation plan to spin off toxic assets from zombie banks, and issue new loans to the economy) rather than a Fiscal Union.

3.6 *The OECD*

The Organisation for Economic Cooperation and Development (OECD) is an intergovernmental organisation that is devoted to a wide range of economic, social and technological policy issues related to competitiveness and quality of life, and related issues of public governance that impact the adoption of improvements in a positive or negative way. Its relevance to financial stability is centred on the issues of public finance, macroeconomic (im)balances on the various forms of structural adjustment that can make national economies sustainable. It provides economic policy analysis and performance surveillance, plus cutting edge analysis of future trends and best practice. On principle its guidelines and principles stick to formulae that focus on common ground between members. However, it also issues country reports (general, and macroeconomic imbalances) and economic performance data (national accounts).

OECD has 36 members. European Commission representatives participate alongside Members in discussions on the OECD's work programme, and are involved in the work of the entire

Organisation and its different bodies. While the European Commission's participation goes well beyond that of an observer, it does not have the right to vote and does not officially take part in the adoption of legal instruments submitted to the Council for adoption. The Council is the main decision-making body, representing all members of the organisation. It may adopt legally binding decisions and enter into agreements with members, non-Members and other international organisations. In addition, the Council may issue recommendations. Decisions are taken on the basis of consensus. 250 specialised bodies, called Committees or specialized bodies are in charge of the substantive work of the organisation.⁸⁹

OECD research into the impact of Growth Policies on Macroeconomic Stability⁹⁰ underline that growth policies follow a combination of an accommodative monetary policy indicated by low interest rates (given contemporary low inflation levels), close attention to avoiding fiscal and macroeconomic imbalances, plus structural adjustments and strategic investments in new sunrise sectors. While these growth policies are generally beneficial, they can backfire if combined with rigidities in labour and product markets. OECD research is therefore necessarily granular and pragmatic, stressing a combination of growth-inducing and structural adjustment features. Concerned with macroeconomic imbalances, it is also the place where illusionary growth is called out as a risky path to recovery. This takes place in light of recent attention to asset price bubbles in the housing and raw materials sectors. Overall, OECD recommendations are not specifically contractionary, but focused on sustainable growth, without front-loading macroeconomic contraction measures.

3.7 IMF

The International Monetary Fund (IMF) and its staff provide for financial stability in two separate ways: by providing lines of credit to national governments in financial distress (or at risk of becoming so); and by assessing the health of national economies and financial sectors (surveillance). The former task has been the IMF's core contribution to global financial stability since its inception in 1945. The latter dates back to 1952, when the IMF first introduced a policy of imposing conditions in return for financial assistance.

The IMF is a large international organization with 189 state members, including all EU Member States. At the top of its organizational structure is the Board of Governors, consisting of one governor and one alternate governor from each member country, usually the top officials from the central bank or finance ministry. The Board of Governors meets once a year at the IMF–World Bank Annual Meetings. Twenty-four of the governors serve on the International Monetary and Financial Committee (IMFC), which advises the IMF's Executive Board on the supervision and management of the international monetary and financial system. The day-to-day work of the IMF is overseen by its 24-member Executive Board, which represents the entire membership and supported by IMF staff. The Managing Director is the head of the IMF staff and Chair of the Executive Board and is assisted by four Deputy Managing Directors.⁹¹

The IMF⁹² has a key role in approving capital controls, debt forgiveness, and promoting bazookas (countercyclical public backstops) that EMU does not provide. Its policy focus has adopted

⁸⁹ <http://www.oecd.org>.

⁹⁰ Sutherland, D. and P. Hoeller (2014), "Growth Policies and Macroeconomic Stability", *OECD Economic Policy Papers*, No. 8, OECD Publishing, Paris; OECD (2014), "How do growth-promoting policies affect macroeconomic stability?", OECD Economics Department Policy Notes, No. 22, February 2014.

⁹¹ www.imf.org.

⁹² Feibelman, A. (2016). Law in the Global Order: The IMF and Financial Regulation. *NYUJ Int'l L. & Pol.*, 49, 687.

lessons from the 1997 crisis that have led it to stress budget retrenchment and structural adjustment policies less vigorously and to allow for more growth-oriented parts of the macroeconomic policy mix.⁹³ In light of the Eurozone crisis, it has found itself in two different roles. It is a critical part of the Troika that provides advice on financial assistance under the ESM (Art. 13(1), (2), and (7) ESM Treaty) and provides loans to programme countries cut off from financial markets. It also provides policy advice on public backstops, fiscal and monetary policy, and debt sustainability for program countries (receiving ESM assistance). These policy advices are in line with the rest of the GFSAs and leading in the macroeconomic policy field in that they support a common public backstop to the Eurozone, (not just provided by the ECB), and have been pragmatic about the introduction of capital controls and the use of debt forgiveness in the absence of such a backstop.⁹⁴

In light of the Eurozone Crisis' practical developments in 2015, the IMF' found itself in the difficult position of being at odds with the Eurogroup, which is not as such part of the Troika, but is an effective veto player in talks over financial assistance and conditionality. IMF advice to reduce demands on Greece went unheeded to the point that the IMF nearly withdrew from the arrangement.⁹⁵

The EU is not a member of the IMF. IMF influence on the EU, however, has been clearly visible over the past years. As shown in a study by Bergthaler, this is visible in three different ways: 1. certain obligations under the IMF's Articles may have a direct binding effect on the EU, to the extent that the EU assumed the Member States' competences under the TFEU related to obligations under the IMF's Articles; 2. in the Member States' exercise of their rights and obligations under the IMF's Articles, IMF law interacts with and impacts EU law indirectly by way of EU Member States; and with respect to the specific field of financing and financial operations, EU law absorbed and was receptive to 'borrow' concepts and terminology from IMF law; and 3. IMF law and EU law started to use similar concepts.⁹⁶

3.8 *Interim Conclusions: the GFSAs and Macroeconomic Policy*

The GFSAs have been remarkably active since 2008, and by some measures, extremely effective in preventing a sharp, global shock from developing into a global depression. What the sections above leave unrecorded is the role of the United States, and the Federal Reserve in particular, in getting the ball rolling in the early stages of the crisis to ensure that key central banks, the ECB included, were providing enough extra cash to their distressed economies and governments.⁹⁷ They also leave untouched the fact that these GFSAs bodies are relegated to the sidelines in the event of a major dispute between Europe and the United States.⁹⁸

After that moment, however, it was up to the G20, who made it up to the institutions of the GFSAs to sort out the mechanisms of recovery, resilience, and future crisis prevention. The GFSAs' effort to upgrade financial stability and resilience is taken to take two separate moves: by upgrading regulatory standards and through those standards the safety of the banking, securities and insurance markets (in that order); and by linking them together in the pursuit of macro prudential insights,

⁹³ Farnsworth, K., & Irving, Z. (2017). Deciphering the International Monetary Fund's (IMFs) position on austerity: Incapacity, incoherence and instrumentality. *Global Social Policy*, 1468018117729821;

⁹⁴ Moschella, M. (2015). The institutional roots of incremental ideational change: The IMF and capital controls after the global financial crisis. *The British Journal of Politics & International Relations*, 17(3), 442-460; Ban, C., & Gallagher, K. (2015). Recalibrating policy orthodoxy: the IMF since the great recession. *Governance*, 28(2), 131-146;

⁹⁵ Drezner, D.W. (2015). The IMF clears its throat very, very loudly on Greece. *Washington Post*, 15 July.

⁹⁶ W. Bergthaler, 'The Relationship Between International Monetary Fund Law and European Union Law: Influence, Impact, Effect, and Interaction', in Wessel & Blockmans (Eds.), *op.cit.*, pp. 159-198 at 195.

⁹⁷ Drezner, D. W. (2014). The system worked: Global economic governance during the great recession. *World Politics*, 66(1), 123-164.

⁹⁸ Coffee Jr, J. C. (2013). Extraterritorial Financial Regulation: Why ET Can't Come Home. *Cornell L. Rev.*, 99, 1259.

regulation and financial sector compliance. The first of these implies upgrading common standards of regulation and practice, while the second reflects a shift to macro prudential regulation beyond the simple use of monetary and fiscal policy to even out economic cycles and absorb systemic shocks to the global economy.

The use of macroeconomic policy in contrast, remained officially the remit of the G7 and the G20, where a dispute between Germany and the other members could be managed. This did not prevent key GFSM institutions, however, particularly the IMF and the OECD from advocating the use of expansionary monetary and fiscal policy resources, and their creation in the case of the Eurozone, to provide the ultimate backstops for financial stability. This included advice on the micro prudential innovations for the European banking sector and EMU as a whole, discussed further below.

All in all, there is a significant body of, primarily soft, law coming from international standard-setting bodies, the FSB included, that have implications for EMU and how it is further stabilised. There are also peer review mechanisms intended to ensure that member states transpose those expectations into national hard law. It is also expected that they are reflected in EU law as it retrofits EMU to be more stable. As will be seen hereafter, however, the EU has been highly selective in how it does this based on its own internal disputes. National politics (or in the case of the EU, international politics) filters international soft law.

4. An Influence of International Law and Policies on the EMU?

4.1 Soft Law and its Implications

In the context of the present chapter, it is important to note that the extent that international law and standards in financial stability impacts EMU, it does so by a combination of technical standard setting and a broad application of data collection, rather than norm setting and diffusion over choices in macroeconomic policy, regulation and surveillance. Indeed, the focus on ‘soft law’ is a clear element of financial regulation and has extensively been analysed over the past years.⁹⁹ On the basis of existing research, the reasons to opt for soft law are also quite clear and they range from financial topics mostly being in the hands of the executive branch,¹⁰⁰ a preference for more flexibility, to the involvement of various state and non-state actors.¹⁰¹ More in general, the highly technical nature of

⁹⁹ Zaring, David. "Finding Legal Principle in Global Financial Regulation." *Va. J. Int'l L.* 52 (2011): 683; Brummer, C. (2010). Why soft law dominates international finance—and not trade. *Journal of International Economic Law*, 13(3), 623-643; Lee, L. L. (1998). The Basle accords as soft law: Strengthening international banking supervision. *Va. J. int'l L.*, 39, 1; Morgan, G. (2008). Market formation and governance in international financial markets: The case of OTC derivatives¹. *Human Relations*, 61(5), 637-660; Abbott, K. W., & Snidal, D. (2000). Hard and soft law in international governance. *International organization*, 54(3), 421-456; Arner, D. W., & Taylor, M. W. (2009). The global financial crisis and the financial stability board: Hardening the soft law of international financial regulation. *UNSWLJ*, 32, 488; Verdier, P. H. (2013). The political economy of international financial regulation. *Ind. LJ*, 88, 1405.

¹⁰⁰ Galbraith, J., & Zaring, D. (2013). Soft law as foreign relations law. *Cornell L. Rev.*, 99, 735.

¹⁰¹ Robilant, A. D. (2006). Genealogies of soft law. *The American Journal of Comparative Law*, 54(3), 499-554; Pauwelyn, J., Wessel, R. A., & Wouters, J. (Eds.). (2012). *Informal international lawmaking*. Oxford University Press; Raustiala, K., & Slaughter, A. M. (2002). International law, international relations and compliance. Princeton Law & Public Affairs Paper No. 02-2; Goodman, R., & Jinks, D. (2004). How to influence states: Socialization and international human rights law. *Duke Law Journal*, 621-703; Hafner-Burton, E. M., Victor, D. G., & Lupu, Y. (2012). Political science research on international law: the state of the field. *American Journal of International Law*, 106(1), 47-97; Kratochwil, F. V. (1991). *Rules, norms, and decisions: on the conditions of practical and legal reasoning in international relations and domestic affairs*. Cambridge University Press; Steinberg, R. H., & Zasloff, J. M. (2006). Power and international law. *American Journal of International Law*, 100(1), 64-87; Radaelli, C. M. (1999). Harmful tax competition in the EU: policy narratives and advocacy coalitions. *JCMS: Journal of Common Market Studies*, 37(4), 661-682.

a policy area may define the ‘governance arrangement’ that is being chosen to make international cooperation possible.¹⁰²

This is not the place to revisit the classic, extensive, and ongoing debate on soft law in international legal scholarship. In general, soft law has been defined as “rules of conduct that are laid down in instruments which have not been attributed legally binding force as such, but nevertheless may have certain (indirect) legal effects, and that are aimed at and may produce practical effects”.¹⁰³ The absence of ‘legally binding force’ is indeed a common way of distinguishing soft law from hard law. As argued by one of the present authors elsewhere, however, this characteristic is confusing and does not seem to do justice to the fact that these norms (as *law*) form part of the legal order and that they commit the actors involved.¹⁰⁴ The following description by Saurugger and Terpan is therefore more helpful:

“Soft law refers to those norms situated in-between hard law and non-legal norms [...]. Hard law corresponds to the situation where hard obligation (a binding norm) and hard enforcement (judicial control or at least some kind of control including the possibility of legal sanctions) are connected. Non-legal norms follow from those cases where no legal obligation and no enforcement mechanism can be identified [...]. In-between these two opposite types of norms lie different forms of soft law: either a legal obligation is not associated with a hard enforcement mechanism or a non-binding norm is combined with some kind of enforcement mechanism.”¹⁰⁵

The absence of judicial control as well as, more generally, the absence of procedural rules, allegedly provides freedom to the actors to be more flexible as to what they agree on and how they arrange that. And, indeed, in principle international actors are free to choose their own means of committing themselves and in establishing the legal nature of an instrument.¹⁰⁶ In international law, the potential problems caused by a move from hard to soft law have been highlighted,¹⁰⁷ while it has at the same time been pointed out that a ‘turn to informality’, should not *per sé* have negative consequences for, for instance, the legitimacy of norms when ‘thin state consent’ (the traditional basis for international agreements) is being replaced by ‘thick stakeholder consensus’ (resulting from the participation of not just governmental actors).¹⁰⁸

In the case of EMU, the ‘soft law’ standards seem to have allowed the EU to pick and choose what seemed to work best in a highly politicised policy area. Economic and Monetary Union will be 20 years old in 2019. As the contributions to the present Volume testify, it has been a great achievement for the European Union, but an incomplete construction that has been fought over,

¹⁰² R.A. Wessel and E. Kica, ‘Political Economy and the Decisions of International Organizations: Choosing Governance Arrangements through Informality’, in A. Fabbriotti (Ed.), *The Political Economy of International Law: A European Perspective*, Cheltenham/Northampton: Edward Elgar Publishing, 2016, pp. 127-158.

¹⁰³ L. Senden, *Soft Law in European Community Law*, Portland, Oregon: Hart Publishing, 2004, at 112.

¹⁰⁴ See in particular on the use of institutional legal theory to define what belongs to a legal order also R.A. Wessel, ‘Resisting Legal Facts: Are CFSP Norms as Soft as They Seem?’, *European Foreign Affairs Review*, 2015, pp. 123-146. See for a description of other international arrangements also D. Shelton, ‘International Law and “Relative Normativity”’, pp.137 (at pp.161-162), in M.D. Evans, *International Law*, 4th edn. Oxford University Press 2014, at p.159: “any international instrument other than a treaty containing principles, norms, standards, or other statements of expected behaviour”.

¹⁰⁵ S. Saurugger and F. Terpan, ‘Studying Resistance to EU Norms in Foreign and Security Policy’, *EFA Rev.*, Special Issue (2015): 1-20, at 5. See also F. Terpan, *Soft Law in the European Union - The Changing Nature of EU Law*, *European Law Journal*, 2015, 21 (1), pp.68-96.

¹⁰⁶ Also the Court of Justice of the European Union is of the opinion that the intention of the parties “must in principle be the decisive criterion”. Case C-233/02, *France v. Commission*, para. 42.

¹⁰⁷ See for instance A. Peters, ‘Soft Law as a New Mode of Governance’, in U. Diedrichs, W. Reiners and W. Wessels (eds.), *The Dynamics of Change in EU Governance*, Edgar Elgar Publishing, 2011.

¹⁰⁸ Pauwelyn, Wouters, and Wessel, *op.cit.*

modified and expanded over time.¹⁰⁹ As the EU has stumbled from one crisis to another since its establishment, the Eurozone in particular has adopted some of these standards and involved institutions according to a logic of political utility.¹¹⁰ Rather than technocratic expertise, which is what the international institutions and standards promote, the adoption procedure periodically selects or rejects these standards on the basis of political criteria.¹¹¹ These sometimes reflect the priorities of the EU's most powerful member states – when adopting international standards or not is controversial – and sometimes a broad consensus that deviations are desirable. Notable is that some of these standards are now enshrined in treaties and funds (EFSF, ESM, SRF) designed to buttress EMU financial stability, but from outside the EU legal framework, by virtue of international treaty and intergovernmental agreement (IGA), where they remain non-justiciable by the CJEU. This has been the result of a political demand from Germany, which sought to impose more stringent legal obligations on EU Member States and their EMU and related policy issues than those Member States would allow under EU voting rules. The result is that each national government is responsible for promoting financial stability, that private investors are forced to pay as well for financial collapses alongside sovereigns, and that the EU's fiscal capacity remains severely constrained. The legal instruments to ensure responsible sovereignty of the Member States is anchored in these non-EU instruments.

The EU has selectively adopted international rules on financial stability. While in some cases EU rules are basically a copy of an international norm (a good example being Regulation 1060/2009, which clearly reflects the IOSCO Code of Conduct on CRA regulation¹¹²), counter examples may be found in the rejection of IMF and OECD advice on the provision a public backstop to EMU, the selective emulation of macroeconomic policy advice by the IMF in EMU member state budget surveillance (European Semester and the Macroeconomic Imbalances Procedure) and in the selective use of Basel Committee banking standards and recommendations on capital adequacy (in the context of establishing banking union to stabilise EMU). In the case of Capital Markets Union, which is designed to stabilise EMU in ways that Banking Union did not, it remains to be seen how the EU will adopt (parts of) standards, recommendations and insight from IOSCO. The same selective adoption applies to standards brought forward by the FSB, which brings these micro prudential standards together.

Some, but not all the standards and approaches have been used as blueprints for stabilising EMU after the onset of the Eurozone crisis in 2010. In some cases, the EU has promoted the development of these standards, in others used them to resolve disputes over how to proceed. And in others, EU politics rejected the advice of these bodies to stabilise EMU with new innovations. In general, however, substantive influence of international (soft) law on EMU rules remains very

¹⁰⁹ See additionally Chang, M. (2016). *Economic and monetary union*. Palgrave Macmillan.

¹¹⁰ Donnelly, S. (2005). Explaining EMU reform. *JCMS: Journal of Common Market Studies*, 43(5), 947-968.

Heipertz, M., & Verdun, A. (2010). *Ruling Europe: The politics of the stability and growth pact*. Cambridge University Press; Hodson, D. (2016). Eurozone governance: From the Greek drama of 2015 to the five presidents' report. *JCMS: Journal of Common Market Studies*, 54(1), 150-166.

¹¹¹ Donnelly, S. (2018) ECB-Eurogroup conflicts and financial stability in the Eurozone. *Credit and Capital Markets* 51(1): 113-126; Donnelly, S. (2014). Banking Union in Europe and Implications for Financial Stability. *Studia Diplomatica. LXVII*, 2, 21-34.

¹¹² See J. de Haan and F. Amtenbrink, 'Credit Rating Agencies', *DNB Working Paper*, No. 278, 2011 (https://www.dnb.nl/en/binaries/Working%20Paper%20278_tcm47-246556.pdf)

limited.¹¹³ The following sub-sections will, nevertheless, briefly highlight some examples of institutional links in relation to some key policy areas.

4.2 *EMU-GFSA Links in Macro and Micro Prudential Surveillance*

Certain European institutional initiatives in the area of surveillance are clearly influenced by global institutional developments. The European Systemic Risks Board (ESRB) and the European Financial Stability Facility (EFSF) were established in 2011 and mirror the Financial Stability Board, plus the main ISSBs: the BCBS, IOSCO and IAIS. The EFSF consists of three European Supervisory Authorities: the European Banking Authority (EBA: responsible for collectively recommending improvements to how the EU adopts and applies Basel Committee capital adequacy standards; conducting stress testing of banks; and working together with the ECB to develop and apply a Single Rulebook on banking supervision); the European Securities and Markets Authority (ESMA: responsible for collectively recommending improvements to how the EU adopts and applies law and regulation regarding securities markets); and the European Insurance and Occupational Pensions Authority (EIOPA: which does the same for insurance markets). The European Surveillance Authorities (ESAs) do not have formal lawmaking powers, but recommend to the Commission, which does.¹¹⁴ They have more formal powers in coordinating and supervising implementation by national authorities within the context of EU law.¹¹⁵

The influence of developments at the global level is clearly visible on the ESAs having a mildly contractionary effect in the banking sector in the medium term as efforts continue to increase resilience. In the securities sector, the effect is currently accommodating, and intended to lay the groundwork for future expansion, but is also working on measures to increase safety and resilience. This can be seen in both the EU's Capital Markets Union (CMU) project,¹¹⁶ and the 2012 regulation of Central Counterparties,¹¹⁷ as the infrastructural backbone of financial stability in the derivatives trading sector. In this area, the EU is fully in line with the GFSA's proposals, but not in a way that provides cohesiveness to the Eurozone itself.

The ESRB both mirrors the FSB and works somewhat differently from it. Like the FSB's relationship to the BIS, the ESRB is hosted by the ECB. Decisions are adopted by the General Board, consisting of the ECB's President and Vice President, the heads of the EU's national central banks, representatives of the Commission and ESAs, and representatives from two ESRB committees: the Advisory Technical Committee and the Advisory Scientific Committee. Unlike the FSB, it provides a wider range of overarching advice to EU institutions regarding state of the art in financial stability research and policy learning, future challenges, and best practice in macroeconomic and

¹¹³ Mügge, D. (2014). Europe's regulatory role in post-crisis global finance. *Journal of European Public Policy* 21(3): 316-26; Posner, E., & Véron, N. (2010). The EU and financial regulation: power without purpose?. *Journal of European Public Policy*, 17(3), 400-415; Newman, A., & Bach, D. (2014). The European Union as hardening agent: soft law and the diffusion of global financial regulation. *Journal of European Public Policy*, 21(3), 430-452.

¹¹⁴ Simoncini, M. (2015). Legal boundaries of European Supervisory Authorities in the financial markets: Tensions in the development of true regulatory agencies. *Yearbook of European Law*, 34(1), 319-350.

¹¹⁵ See also Chapter... (Part 8) Volume on the EFSF and the ESA's.

¹¹⁶ Véron, N. (2014). *Defining Europe's capital markets union* (No. 2014/12). Bruegel Policy Contribution; Howarth, D., Quaglia, L., & Liebe, M. (2016). The political economy of European capital markets union. *Journal of Common Market Studies*, 54(S1), 185-203; Quaglia, L., & Howarth, D. (2018). The policy narratives of European capital markets union. *Journal of European Public Policy*, 25(7), 990-1009;

¹¹⁷ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories Text with EEA relevance.

microeconomic developments, supervision and regulation.¹¹⁸ As an overview body, it shares with the ECB a mission to work on the linkages between macroeconomic and microeconomic parts of the regulatory and policy puzzle, and to map possible strategies forward.

In this context, the ESRB works together with the EFSF bridge to supervision, resolution, deposit insurance, with the ultimate goal of enhancing financial stability and systemic resilience. The latter involves in particular ending a negative feedback loop between financially fragile sovereigns (national governments) and banks located within their jurisdictions. Unlike macro prudential bodies elsewhere at the national level, however, the ESRB is purely advisory. This applies as well to its academic advisory board. The European Supervisory Authorities (pensions, banks, financial markets) replicate the behavioural approach of their global counterparts even more strongly. This is visible in the compilation of financial stability risk dashboards in each of the authorities.¹¹⁹ This reflects a neutral approach to the issue of risk analysis that sidesteps disagreements within the Eurozone and across Europe over the relative importance of various factors in laying the groundwork for crises and engineering resilience.

4.2 *EMU-GFSA Links in Macroeconomic and Monetary Policy*

The ECB is responsible for price stability in the Eurozone, and for financial stability, particularly through the use of monetary policy. It also represents the EU at the FSB as the competent authority for monetary policy in the Eurozone. Overall, the ECB's thinking and behaviour has been close to that of its counterparts in the GFSA, and has pushed that view on the Eurozone where the Eurogroup has not been able to steer its countries out of the EZC. The Eurogroup contests this, and continues a strong narrative of how their efforts to impose austerity (fiscal contraction) are bearing fruit through economic growth and will continue to do so (expansionary contraction),¹²⁰ Europe's flat economic growth and anaemic price developments suggest otherwise.

The ECB's willingness to engage in Outright Monetary Transactions (OMT) in 2012 (whatever it takes to save the euro) and its later foray into quantitative easing therefore meant a rift between itself and the Eurogroup over monetary policy. Whereas the Maastricht Treaty explicitly forbids the ECB from purchasing treasury bills directly from Member States, the (OMT) announcement of June 2012 threatened to do just that, to which plaintiffs at the German Federal Constitutional Court objected.¹²¹

ECB attempts to convince the Eurogroup to sequence a package of growth-inducing measures, followed by structural adjustments, and then finally some austerity,¹²² have fallen on deaf ears. The ECB has the independence to determine its own policy course and has expanded that room since the EZC, but also has no means to force the Council to do what it prefers. The result is that the Council and the ECB are at odds in an extended stalemate. While the ECB seeks to keep the Eurozone afloat

¹¹⁸ Regulation (EU) No 1092/2010; of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board; of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board (EU) No 1096/2010.

¹¹⁹ Keller, A. (2013). Collecting Data: How Will the ESRB Overcome the First Hurdle towards Effective Macro-Prudential Supervision. *Eur. Bus. L. Rev.*, 24, 487.

¹²⁰ Regling, K. (2017) The ESM after 5 years: successes, challenges and perspectives. Speech delivered to the Bridge Forum Dialogue, Luxembourg, 30 November; Chazan, G., Brunsden, J. & Khan, M. (2017) Wolfgang Schäuble feels vindicated by tough bailout policies. *Financial Times*, 8 October.

¹²¹ See on the *Gauweiler* case, Chapter [...] elsewhere in this Volume.

¹²² Draghi, M. (2016): Introductory remarks by Mario Draghi, President of the ECB, at the Portuguese Council of State, Lisbon, 7 April 2016

and inject liquidity into the economy, the Council is determined to ratchet that liquidity down, both through more limited government borrowing and spending, and through pressure to reduce domestic credit creation (through the MIP). A linking of monetary, fiscal, structural adjustment and strategic investment policies as recommended by the ECB therefore seems to be a more promising, if politically unlikely course of action for the Council to follow.

4.3 *EMU-GFSA Links in Relation to Banking Union*

EMU's greatest problem extended beyond the solvency of national governments to include national banking systems by 2012.¹²³ This demonstrated the failure of the EBA to properly ensure supervision in the EU, so that a further step was taken to give some of those tasks to the ECB. The ECB accordingly has a second seat at the FSB in its role as supervisor for the Eurozone's largest systemically important banks. In 2012, Spain received financial assistance from its fellow Eurozone members through the European Stability Mechanism (ESM) to help recapitalize some of its banks, particularly local savings and cooperative banks that had lent aggressively before the crisis and suffered badly due to extended recession.¹²⁴ A quid pro quo from Germany was the improvement of supervision. The need to provide some kind of means for stopping financial contagion throughout the Eurozone without instituting an EMU-wide budget with cross-border transfers meant imposing controls on banks (supervision) to reduce local risks, limiting national bailouts to reduce the risk of banking problems spreading to the public sector (where they became relevant to EMU) through resolution and bail-ins of private creditors, and by providing emergency finance as a means of preventing contagion across national borders.

Banking supervision has since that time been the Eurozone's biggest institutional and policy success,¹²⁵ and it has been moving Europe closer to global expectations as for instance laid down by the Basel Committee and IADI. It has a significant contractionary effect on the economy as banks raise capital and devote attention to dealing with existing stocks of non-performing loans rather than issuing new credit. The SSM (Single Supervisory Mechanism) was added to the European Banking Authority (EBA) in November 2014 – at which point the ECB became direct supervisor to 128 Systemically-Important Banks (SIBs) (now 119), and took over the tasks of carrying out a regular Asset Quality Review, directing banks on how much capital to raise in accordance with the EU's Capital Requirement Directives, and in some cases indicating insolvency to the Single Resolution Board (below).

The EU also instituted at resolution system in 2016 – the SRM (Single Resolution Mechanism).¹²⁶ Within the SRM, the Single Resolution Board coordinates resolution plans for E-SIBs and recommends resolution to the Commission if the ECB announces the bank is insolvent. The

¹²³ Howarth, D., & Quaglia, L. (2013). Banking union as holy grail: Rebuilding the single market in financial services, stabilizing Europe's banks and 'completing' economic and monetary union. *JCMS: Journal of Common Market Studies*, 51(S1), 103-123; Epstein, R. A. (2017). *Banking on Markets: The Transformation of Bank-State Ties in Europe and Beyond*. Oxford University Press.

¹²⁴ Deeg, R., & Donnelly, S. (2016). Banking union and the future of alternative banks: revival, stagnation or decline?. *West European Politics*, 39(3), 585-604; Epstein, R. A., & Rhodes, M. (2016). The political dynamics behind Europe's new banking union. *West European Politics*, 39(3), 415-437; Howarth, D., & Quaglia, L. (2016). Internationalised banking, alternative banks and the Single Supervisory Mechanism. *West European Politics*, 39(3), 438-461.

¹²⁵ De Rynck, S. (2016). Banking on a union: the politics of changing eurozone banking supervision. *Journal of European Public Policy*, 23(1), 119-135.

¹²⁶ Howarth, D., & Quaglia, L. (2014). The steep road to European banking union: Constructing the single resolution mechanism. *JCMS: Journal of Common Market Studies*, 52(S1), 125-140.

SRM also incorporates a bail-in mechanism that reduces what banks owe to creditors in the event of insolvency and is supposed to reduce the input of public funds into failed banks (bail-out). Although the powers of the SRM to move banks toward resolution have proved disappointing, and an agreement on any sort of deposit insurance for EMU remains elusive for political reasons, the rule structure itself regarding resolution reflects standards set out by IADI. What it lacks is truly independent powers by the SRB to act swiftly and without legal recourse to dispute as IADI suggests. It also lacks any meaningfully large resolution fund, or any deposit insurance fund.

The SRM has attached to it a small (55 billion euro), ex ante, bank-funded fund known as the Single Resolution Fund (SRF). As with the ESM, a key legal feature of the SRF is that it is based on an intergovernmental agreement under international law, outside of EU law. This means that decisions are made according to the decision-making procedures of the SRF. While the SRB may make a recommendation or what amount of money should be deployed during a resolution, the Fund retains the right to decide for itself if this is appropriate. As an extra-EU entity, the Fund is not justiciable under EU law and cannot be forced to act in ways other than its shareholders wish.

4.4 *EMU-GFSA Links in Securing the Financial Market*

The European Securities and Markets Authority (ESMA) reflects its global counterpart IOSCO, and is responsible for payments systems and futures markets where asset bubbles are an issue. It is also responsible for credit rating agencies, hedge funds and other shadow banking institutions where liquidity is strong, but unconnected to the real economy. Its General Board consists of national security regulators of EU member states, plus an Executive Board, like the other ESAs. Unlike the others, however, it is a de facto independent supervisory authority. As with the others, the rules it applies are legislated through the ordinary legislative procedure. Rules are generally in line with, and often based on, international standards emanating from IOSCO.

In the context of financial stability, and the potential for macroeconomic effects, ESMA is key in the development of regulations regarding central counterparties (CCPs), which are seen as a missing link.¹²⁷ In the medium term, EU law prevents the Eurozone from ensuring that CCP clearing services take place within its territory, however. The ECB lost a key case on mandating that CCPs be located in the eurozone.¹²⁸ The Court ruled that while ECB has jurisdiction over payments systems, it does not have automatic control over all clearing systems (such as derivatives). CCPs have to have access to both: payments and security transfer systems. This was controversial since the ECB provides liquidity backstop to CCP systems. At stake was not only whether UK financial institutions could operate for the eurozone, but whether financial stability would be further ensured.

4.5 *EMU-GFSA Links in Macroeconomic Surveillance*

The EU's mirror to the OECD, G20 and IMF on proper macroeconomic policy is found in its on budget and debt rules (Maastricht Treaty criteria on debt, deficits and inflation), but also in the Macroeconomic Imbalances Procedure introduced in 2011. Member States provide Stability Reports to the European Commission, which reviews them and proposes Country-Specific Recommendations (CSRs) to the Council. The CSRs are only final once adopted by the Council and as the title implies, not legally binding

¹²⁷ Marjosola, H. (2015). Missing pieces in the patchwork of EU financial stability regime? The case of central counterparties. *Common Market Law Review*, 52(6), 1491-1527.

¹²⁸ Case T-496/11, *United Kingdom v. European Central Bank*, Judgment of the General Court (Fourth Chamber), 4 March 2015; ECLI:EU:T:2015:133.

The monitoring of the Stability and Growth Pact was transformed by name into the European Semester in 2011. It was then extended into private economic behaviour in 2011 through the macroeconomic imbalances procedure (MIP). Like the European Semester, the MIP is designed to observe, analyse and provide country specific recommendations (CSRs), but on private sector price developments. These range from inflation rates, labour costs, asset prices (to capture unstable phenomena such as housing bubbles, which played a significant role in the 2008/2009 crashes of Ireland and Spain), but also capital account balances and private debt levels. The intent of the ES and the MIP is to restrict credit growth in such a way as to prevent future asset bubbles. CSRs are not legally binding, and in practice, less than 10 per cent are actually followed up on. However, the trend toward fiscal retrenchment sets the Eurozone apart from other jurisdictions worldwide. Furthermore, in this area, the Eurozone has not taken on much of the GFSM recommendations. This can be seen in the IMF-Eurozone fight in 2015 over austerity and debt sustainability: IMF wanted more of Greece's debt forgiven, so that the bills would be payable. Eurogroup disagreed and refused to talk further reductions in debt. It can also be seen in IMF support for a common public backstop for the Eurozone to ensure automatic stabilisers are in place.

The biggest rift between the GFSM and the Eurozone is therefore between two macroeconomic visions: the GFSM has accommodated a more dovish view of macroeconomic policy – an accommodating monetary and fiscal policy – that the Eurogroup (with the exception of the ECB with regard to monetary policy) has rejected. This has nothing to do with milder economic circumstances in the Eurozone as a whole compared to elsewhere, given the severity of the Eurozone Crisis. Rather it has had to do with a division between national governments in the Eurozone. This division is partly on the issue of who should pay for financial stability, and how much. But more importantly, the debate between European countries has been characterised by a war of ideas over proper macroeconomic policy that Germany, the Netherlands and Finland within the Eurogroup have decisively won over France and much of Southern Europe.¹²⁹ The model institutionalised in the European Semester outlines a combination of budget retrenchment, debt reduction structural adjustment policies and further measures contributing to internal devaluation that help individual countries pull themselves back from the prospect of fiscal cliffs as happened in 2010-2012. The features are strongest when countries hit that fiscal cliff and seek financial assistance from the European Stability Mechanism. At that point, the Troika, supplemented by the Eurogroup, sets out these forms of internal devaluation in contract form with programme countries, rather than relying on voluntary adoption in the normal ES procedure.

That this constitutes a breach with the GFSM's interpretation of proper macroeconomic policy is signified by the IMF's repeated conflicts with the Eurozone regarding demands made on programme countries. Debt sustainability reviews regarding Greece, in the absence of a common public backstop, particularly regarding the Eurozone demand that the Greek government run a 3.5% budget surplus, are the most telling way to see that conflict. Another is the repeated call for a backstop itself.

¹²⁹ Underhill, G. R. (2011). Paved with good intentions: global financial integration and the eurozone's response. *European political science*, 10(3), 366-374.

5. Conclusion: An Interplay Between the GFSA and the EMU?

The present chapter purported to assess the influence of the Global Financial Stability Architecture on the European Economic and Monetary Union. The GFSA is complex of ISSBs, with the FSB as an umbrella, with a highly behaviouralist (evidence-based) approach. It accommodates a dovish monetary and fiscal policy stance typical of neokeynesian monetary policy. In this sense, the Washington Consensus really does appear to be dead at the global level.¹³⁰ It is alive and well in Europe however,¹³¹ for political reasons that have intensified rather than moved toward compromise within the EU. German/Dutch demands to do this have resulted in a wide range of legal rules on budgetary policy, banking supervision and resolution, that have a contractionary impact on national economies rather than accommodative ones.

The global rules are characterised by an informal, ‘soft’, nature, and allowed the European Union to be quite selective in adopting them. The overall tendency seems to be to turn some of the softer international rules into hard EU law,¹³² which has made it harder for the EU bodies and the Member States to reach compromises. As – in most cases – the EU as such is not a formal member of the GFSA bodies, it has to rely on its Member States, that are often not in agreement on the course to follow. Where this is the case, the EU’s divisions lead it to have weaker influence on the global standards they promote.¹³³

In a substantive sense, it hard to find clear examples of an influence of the GFSA on EMU rules. At the same time, it is clear that, institutionally, many of the global frameworks and their tasks, have been copied as EU bodies and play a similar role in relation to the Eurozone.

To what extent is the ‘disconnection’ between the GFSA and the EMU to be seen as problematic? Obviously, the aim of the GFSA is to enhance global financial stability and ‘cherry picking’ by the EU (mostly for political reasons related to varying views on further European integration) can not only harm the EU itself, but can also have an effect on global financial stability. The situation between the EU and the rest of the world resembles the failed macroeconomic coordination attempts of the late 1980s, when German insistence on macroeconomic prudence eventually forced its neighbours to follow, and entrenched a transatlantic rift.¹³⁴ In the wake of the Eurozone Crisis (EZC), a split developed between the GFSA and EMU over proper macroeconomic policy, so that the GFSA’s impact must be considered contingent on EU and EMU approval. While the GFSA is driven by an accommodative monetary and financial stability policy in nearly all areas,¹³⁵ EMU reforms have rendered it more restrictive – above all in the areas of fiscal policy,

¹³⁰Lütz, S. (2015). From Washington Consensus to Flexible Keynesianism? The International Monetary Fund after the Financial Crisis. *International Organizations*, 85; Ban, C., & Gallagher, K. (2015). Recalibrating policy orthodoxy: The IMF since the great recession. *Governance*, 28(2), 131-146; Clift, B. (2018). *The IMF and the Politics of Austerity in the Wake of the Global Financial Crisis*. Oxford University Press; Gabel, I. (2018). *When Things Don't Fall Apart: Global Financial Governance and Developmental Finance in an Age of Productive Incoherence*. MIT Press.

¹³¹ Lütz, S., & Kranke, M. (2014). The European rescue of the Washington Consensus? EU and IMF lending to Central and Eastern European countries. *Review of International Political Economy*, 21(2), 310-338.

¹³² Quaglia, L. (2014). *The European Union and global financial regulation*. Oxford University Press, USA.

¹³³ Quaglia, L. (2014). The sources of European Union influence in international financial regulatory fora. *Journal of European Public Policy*, 21(3), 327-345.

¹³⁴ Webb, M. C. (1991). International economic structures, government interests, and international coordination of macroeconomic adjustment policies. *International Organization*, 45(3), 309-342.

¹³⁵ Brio, Claudio (2014). The International Monetary and Financial System: Its Achilles Heel and What to do about it. Federal Reserve Bank of Dallas, Globalization and Monetary Policy Institute Working Paper No. 203. Donnelly, S. (2018) *Power Politics, Banking Union and EMU: Adjusting Europe to Germany*. Abingdon: Routledge.

macroeconomic imbalances and banking regulation. This rupture, in turn, reflects power politics between groups of states within EMU that have more to do with who pays for providing financial stability and following a narrative of proper public policy at the national level¹³⁶ than whether it provides optimal resilience. The most important of the EMU deviations has been the EMU focus on alleviating the sovereign default ('bankruptcy') of EMU member states with prudential austerity measures at the national level, rather than approaching EMU instability with common financial backstops.

The outcome of this break is a mixed picture. On the one hand, the Eurozone has introduced innovations in bank supervision and resolution that reduce the likelihood of a new financial crisis that threatens to take on systemic proportions coming from inside the banking system. On the other, robust public backstops constitute a critical component of the financial stability architecture that are clearly missing in the European case. This split between a European insistence on frugality and individual member state responsibility for financial stability and growth is reflected in the Eurozone's macroeconomic policy framework as well, which favours, though its tendency to reduce government consumption during economic downturns, a further weakening of its weakest members over time.

¹³⁶ Hodson, D., & Quaglia, L. (2009). European perspectives on the global financial crisis: introduction. *JCMS: Journal of Common Market Studies*, 47(5), 939-953.