Special Edition on Constructing Banking Union: Introduction

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European Banking Union arguably represents the most important step in European economic integration since the launch of Monetary Union. Little wonder, then, that this major deepening of integration sparked a lively academic debate and triggered an ever-growing number of publications from different disciplinary backgrounds.

The first wave of publications on European Banking Union (BU) provided us with overviews on the legal changes; they discussed at length the economic rationale underpinning BU; and they traced the political dynamics of establishing BU discussing key explanatory factors (for overviews, see Binder and Gortsos 2015; Busch and Ferrarini 2015; Castañeda, Mayes and Wood 2015; Howarth and Quaglia 2013 & 2014). This literature reflected BU's foundational phase between 2012 and 2014 when the major texts enshrining BU in law were negotiated and adopted. This special issue is located at the intersection of this first phase and a second stage of research covering different topics as regards to the functioning of BU. New research questions are triggered by the — so far still limited — experiences regarding BU's implementation and current operation. Based on this empirical evidence, contributions to this second wave of BU-related research try to identify potentially dangerous lacunae and design faults, contributing to the ongoing reform debates.

Two contributions in this special issue look back at the establishment of BU and major controversies and conflicts surrounding it, not the least between the two core member states of the euro area, Germany and France. Joachim Schild's (2018) contribution looks at the protracted and conflict-ridden process of negotiations — notable for the absence of strong Franco-German leadership — that left important matters undecided: notably, European-level deposit insurance and a fiscal backstop for Banking Union. Germany and France, the key actors in BU negotiations, did not share a clear common purpose on any of the main elements of BU. Analyzing their divergent preferences sheds light on the origins of the often messy compromises and complicated institutional setups characterizing the current design of BU, including the decision-making process to resolve banks.

Ioannnis Asimakopoulos' (2018) contribution is also dedicated to the 'construction' phase of BU as he looks at the use of international law — instead of EU law — in the establishment of the Single Resolution Fund (SRF). He points to the legal implications of this political choice to make use of an international agreement (IGA) instead of Union law, and notably the weak enforceability of the arrangements on the SRF. The use of international law, successfully advocated by Germany, allowed the largest euro area member states — first and foremost Germany — to retain control both of the setup and the use of the SRF. Opting for an IGA for the provisions on the transfer of national funds to the SRF sidestepped the European Parliament and gave the largest national contributors to the fund a veto power during the negotiations. The same holds true for the future potential use of ESM funds for direct bank recapitalization in case the SRF resources turn out to be insufficient. According to Asimakopoulos (p. XX), this provides an example of 'nationalised European Integration' 'since economically stronger countries can fully control and influence resolution procedures and structural measures taken in poorer countries for the sake of integration' in case ESM conditionality applies.

David Mayes (2018, p. XX) compares the current state of affairs in BU, that "reflects the political constraints and the path of history", with a full-fledged optimum structure that might have emerged if BU designers had had the opportunity to start from scratch. He contrasts a comprehensive structure of a banking union, taking the US as an example, with the new European system with all its "omissions" and "inelegant features". One key difference he identifies can be found in the key role the US Federal Deposit Insurance Corporation (FDIC) plays as a resolution agency with strong financial resources. There is no equivalent to be found in European Banking Union. Furthermore, Mayes points to the danger of the BU "breaking up rather than reinforcing the EU" (p. XX). This is due to the new fault lines between euro-ins and euro-outs as BU implies the exclusion of the most important financial centre in Europe: London. Risks to financial stability also stem from the SSM covering only banks and not all major financial institutions such as insurers and shadow banks the operation of which might undermine financial stability. In the narrower realm of BU, other lacunae can be identified. There is no regulation in place regarding the structure of banks in order to separate banking from trading activities following the recommendations of the Likkanen report; and the negotiations on a European Deposit Insurance system failed to make much progress (see also Donnelly 2018b; Howarth and Quaglia 2018). Meanwhile the Commission even dropped its legislative proposal addressing the first issue of stabilizing banks by protecting the deposit taking arm of banks and retail-banking from risk-taking in investment banking and market-making trading activities.

Based on his assessment of risks and omissions in the BU's design, Mayes presents an agenda of what needs to be done to move BU closer to a comprehensive structure. However, he notes his pessimism as regards to the willingness of politicians to embark on the road towards new reforms, without the incentive of an immediate crisis. Hence, the "vulnerabilities from the incomplete union and the untested tools will remain" (Mayes 2018, p. XX).

Zdenek Krudna and Sonja Puntscher Riekmann (2018) analyze the number of national options and discretions (O&Ds) in transposing and applying the new rules enshrined in the EU's single rule book that applies to the EU-28. These O&Ds provide a source of fragmentation as they allow a persistent level of regulatory differentiation in the Single Market. The ECB's initiative to reduce O&Ds by way of harmonization launched in 2016 only applies to the significant banks under its direct supervision. This intended reduction of O&Ds for significant banks under ECB supervision will add a twenty-ninth regulatory regime on top of the 28 different national regulatory regimes resulting from the differentiated use of national O&Ds by EU member states.

The authors show that there is a systematic differentiation between the advanced market economies of the EU-15 and the emerging markets of the new post-communist member states. The latter try to stabilize their banking systems, heavily relying on foreign capital, by using available options and discretions to protect capital and liquidity in local subsidiaries of foreign banking groups under their host supervision. These differences notwithstanding, the authors are relatively optimistic with regard to the prospects for O&D harmonizing reforms inside Banking Union.

Shawn Donnelly's (2018a) contribution evaluates first experiences with the implementation of rules and the working of new institutions, taking the example of bank bail-outs in Italy and Portugal to avoid resolution using the new bail-in tool. His contribution sheds light on a weak spot of Banking Union, specifically the possibility open to member states — here Italy and Portugal — to circumvent the application of bail-in rules and instead continue to bail out banks using taxpayers' money. Donnelly underlines the leeway available to member states and their competent national authorities to bail out national banks and to keep them under national control and ownership. They can also count on an accommodating stance of the Commission. This stance has, according to Donnelly, far reaching consequences as it "means fewer resolutions than originally envisaged, continued state aid and poor prospects for a Single Resolution Mechanism (SRM) with full supranational powers" (p.XX). The available evidence so far as to how the Commission applied the rules when it allowed the Italian and Portuguese governments to bail out troubled banks testifies to a roll back of the agreed principle of bailing-in private investors. Hence, the "doom loop between banks and sovereigns persists" in Italy and Portugal (Donnelly 2018a, p. XX).

Taken together, the contributions to this special issue provide us with a nuanced picture of Banking Union's construction problems, lacunae, and governance structure design faults. Banking Union resembles an unfinished cathedral. Given its problematic architecture, there remain important stability risks.

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