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Banking Union — a stability-oriented macroeconomic or an efficiency-oriented microeconomic project?

Klaus Tuori

Department of Law, University of Luxembourg, Vianden, Luxembourg

ABSTRACT
The article analyses the Banking Union from an economic-constitutional perspective. It argues that the areas covered by the Banking Union fall substantively mainly under the internal market area of EU law, where the microeconomic efficiency-based rationales and objectives are essential in legal assessments. In contrast, the euro area macroeconomic and stability-oriented rationales guided the decision on the Banking Union and the allocation of banking supervision to the ECB. The article claims that these different constitutional rationales, and the constitutional locus of the Banking Union, could have implications for the broader constitutional architecture and even for the EU legal order. Indeed, the microeconomic part of the EU economic-constitutional model suits legal approach to integration, but the macroeconomic rationales have a more problematic relation with law and courts. This could call for a resurgence of the internal market perspective in Banking Union going forward to remedy some of the constitutional concerns.

KEYWORDS
Banking Union; SSM; ECB; stability; efficiency; internal market; economic constitution; constitutionalism; banking supervision; monetary policy; microeconomic; macroeconomic

1. Introduction

The Banking Union was a major change in the EU and euro area in multiple ways that are only becoming clear, when new situations define its actual content. This article focuses on one aspect of this change, namely how the Banking Union interacts with the existing EU economic-constitutional framework. The starting premise is that the Banking Union and ECB's Single Supervisory Mechanism (SSM) find their constitutional substance in relation to the broader EU constitutional framework, including its economic, institutional and political rationales and aims.

At the general level, these aims and rationales of the Banking Union stem from theoretical understanding of banking as a peculiar sector in relation to public sector involvement in economy. In addition, the institutional developments in the EU often follow a path dependency where one change creates a need for another change, and the Banking Union as a crisis solution was not an exception. One complication is that many aims and rationales can be mutually incoherent and such incoherencies are likely to increase when the analysis includes a temporal perspective and economic incentives.

CONTACT Klaus Tuori klaus.tuori@gmail.com Department of Law, University of Luxembourg, 4, rue Alphonse Weicker, L-2721, Luxembourg

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For example, many measures that reduce risks, increase stability or solve problems in the short term can have the opposite effects when their impact on the longer-term behaviour is included.

The analytical setting for the Banking Union is thus complicated by various inputs and rationales of its unique multi-country setting. The possibility suggested in this article is an economic-constitutional approach, also labelled as EU economic constitutionalism. It sees the EU economic constitutional model as a coherence-seeking framework that finds its elements not only in EU constitutional law, but also in economic, institutional and political developments. Recently, this approach has stressed the differences between the original internal market framework that relied mainly on microeconomic theory and the macroeconomic integration that gained pace with the EMU. For example, the role of law and courts changes as the EU economic-constitutional model moves towards macroeconomic issues, making it also constitutionally relevant, whether the Banking Union should be seen as part of the microeconomic or macroeconomic framework.

Accordingly, the main research question of this article is, whether the Banking Union should be primarily analysed as an extended part of the EU internal market programme or whether it falls under the EMU macroeconomic framework with a focus on regaining stability. This division also follows the demarcation between the microeconomic internal market efficiency objective and the macroeconomic stability objective. Furthermore, it can be investigated whether, if the Banking Union became a macroeconomic stability issue mainly as a reaction to a crisis, it allows a revitalisation of the internal market and efficiency-based arguments once that crisis has passed. The covid-19 pandemic measures could provide new information on the respective relevance of internal market and efficiency-based rationales and of macroeconomic stability concerns.

The article starts by laying down the main theoretical premises: on the constitutional law side mainly the demarcation between the microeconomic and macroeconomic layers of the EU economic constitutional framework and on the economic side the key aims and features of banking regulation, including the location of banking supervision. As a second step, the article addresses the evolution of the EU banking regulation from this perspective, including how the establishment of the Banking Union initially followed the logic of macroeconomic stability-oriented needs. The first two steps are then combined in discussing the constitutional issues involved, while the final conclusions take a more forward-looking perspective.

2. The theoretical premises for the constitutional analysis of the Banking Union

The theoretical premise for the economic-constitutional assessment of the Banking Union follows the approach that I have developed earlier for the assessment of the ECB and the EMU macroeconomic framework more generally that could also be coined as European economic constitutionalism.[1] The discussion on economic constitutionalism is complemented by some remarks on the economics of banking regulation as well as on the link between monetary policy and banking supervision that forms the key institutional tie between the microeconomic and macroeconomic rationales in the EMU.

2.1 European economic constitutionalism and the demarcation between micro- and macroeconomic layers of the EU economic-constitutional framework

The European economic constitutionalism is not a strictly defined field in EU constitutional law, but rather a description of approaches that combine economic and constitutional rationales and sources to a framework that can be labelled as EU economic-constitutional framework or even the European economic constitution. One feature is a search for coherence and systematic consistency amongst the constitutional provisions (EU primary law), secondary EU legislation and institutional practices (by courts judgments and the institutional actions by the ECB, the EU Council and the EU Commission). The coherence is built on substantive understandings of the relevant economic and legal rationales, where the constitutional objectives, including how they gain their legal significance, play a critical role. This reflects the reality that the EU legal order places a major reliance on objectives, as is emphasised by the teleological, objective-driven, interpretation of EU law by the Court of Justice of the European Union (CJEU). These constitutional objectives are mainly defined in EU primary law, but also in case law and even secondary legislation. For the Banking Union, the key constitutional objectives to be analysed include the internal market objective and the financial stability objective, although the latter has a limited primary law basis.

Another feature in European economic constitutionalism is the distinction between the microeconomic and macroeconomic layers of the European economic constitutional framework. This distinction recognises that the original internal market legislation, including the four economic freedoms as well as competition and state aid rules, largely relies on microeconomic theory that analyzes the behaviour of households, companies and various markets. Individual consumption and investment decisions result in prices and quantities at the marketplace. These theories have solid bases with mainly evolutionary developments. The interaction with law generally takes the form of structural legislation, rules of the game, where law and courts can play a substantial role. This is largely the area of the integration through law approach to European integration led by the experimentalism of the CJEU.[2] In contrast, macroeconomics deals with mainly aggregate statistical variables such as inflation, GDP and public deficit, and it has been prone to major theoretical changes, even revolutions. Before the EMU, macroeconomics was tackled at the national and mainly political level, where it involved political contests and value judgments instead of technocratic or scientific application of (legal) rules.[3]

In the EMU, the role of substantive macroeconomic law has been a source of fundamental disagreement. Many scholars have stressed that the substantive legal and constitutional rules of the Maastricht Treaty could decide many outcomes also in the macroeconomic field. However, other scholars have maintained, albeit mainly implicitly, that these constitutional rules mainly allocate institutional and political decision-making competences and try to ensure accountability. Arguably, the CJEU case law has largely followed the latter approach, for example, by stating that the Treaty allows substantial discretion to macroeconomic policy-makers and does not define the content of policy fields such as monetary policy.

This is the economic-constitutional setting for the Banking Union that could be used to analyse, for example, the role played by law and courts on the basis of its constitutional objectives and also its economic theory basis. The relevant constitutional objectives

seemingly fluctuate at the intersection of internal market efficiency-based rationales and stability-driven rationales with many substantive elements on either side. Substantively, the EU banking sector, its regulation and supervision could still be seen as part of the (microeconomic) internal market, although the euro area macroeconomic stability considerations have eclipsed the EU-level objectives for the present.

2.2 Banking regulation relies mainly on microeconomic rationales

Similarly, the economic theory basis of the banking regulation has elements of both microeconomics and macroeconomics with a complex relationship, even a tension, between efficiency and innovation, on one hand, and stability and safety, on the other hand. What distinguishes banking from most other industries, is that broader instabilities can have even devastating consequences. Indeed, the justifications for banking supervision, and generally for the special treatment of banking sector stem from a few features. One is the role of deposits in facilitating payments in the economy. Most transactions in the economy take place between two or more bank accounts, and the trust in the safety of these accounts facilitates the functioning of the economy. The same deposits form the basis for bank loans through a process called maturity transformation; many short-term deposits are transformed into fewer longer-term loans. This mismatch can lead to bank runs, if worried depositors withdraw their deposits at the same time, thus making a solvent bank illiquid and forcing it to fire-sales of assets in reduced prices that, in turn, can make it insolvent. Such bank runs lead to unnecessary social welfare losses, and thus three types of institutional solutions have been developed: central bank liquidity provision, deposit insurance and prudential supervision.

Liquidity provision has been a central banking function from the early days, when the Bank of England began to provide solvent banks with liquidity through its ability to create central bank money, and it remains a key central banking function even nowadays. Deposit insurance was largely an innovation of the Great Depression. Depositors no longer need to react to rumours by withdrawing their deposits, because their deposits are guaranteed. However, both liquidity provision and particularly deposit insurance remove incentives from depositors and other creditors to monitor and control banks properly. This is where banking regulation and supervision step in to avoid excessive risk-taking by banks.

Most of these issues are rationalised by microeconomics. It is the behaviour of banks and their clients that need to be guided towards safer practices. However, the macroeconomic link exists as well, both stemming from the impact of macroeconomic shocks to banks and also from macroeconomic repercussions of bank failures. At a general level, the hypothesis could be that, if the optimal remedy is a macroeconomic measure such as overall capital provisions or cutting of interest rates, the ultimately rationale is a macroeconomic one. And if the root cause is in microeconomic behaviour and incentives, that defines the level of correct policy responses. However, these general rationales do not specify the institutional locus of supervision that is discussed next.

2.3 The role central bank as a key institutional issue

The discussion on assigning banking supervision either to the ECB or to a specialist organisation follows a longer debate, in which the main arguments have largely remained

the same on both sides, and both systems have continued to exist.[4] Central bank-based supervision generally covers only some types of supervisory functions, namely traditional banking supervision, labelled micro-prudential supervision, and macro-prudential supervision. The former focuses on individual banks to ensure their solvency through risk reporting, on-site inspections, monitoring capital buffers and risk management practices. Macro-prudential supervision was added to the toolbox some two decades ago to detect sources of systemic risks and to reduce them through appropriate market infrastructures and also cyclical capital buffers. In contrast, when central banks conduct banking supervision, investor protection and also customer protection issues are often the responsibility of other institutions.[5] Hence, the Banking Union followed the classical model of central bank supervision with a fragmented overall supervision structure.[6]

Combining monetary policy and banking supervision in the same organisation can be argued both on the monetary policy and on banking supervision grounds, where the former mainly follows macroeconomic and the latter microeconomic rationales. Indeed, the conduct of monetary policy can benefit from banking supervision mainly by gaining information particularly in crisis situations. For example, the assessment of the liquidity needs in financial crisis (interbank market) might benefit from supervisory information.[7] In particular, emergency liquidity assistance, a central banking function as such, needs verifying that an illiquid bank is solvent and thus worthy of emergency funding.[8] This crisis management argument was mentioned, for example, by the US Federal Reserve: 'having the legal authority to directly obtain information – through on-site examinations or otherwise – can prove critical to understanding and responding quickly to a financial crisis'.[9] However, there is no evidence that central banks with supervision have been more successful in liquidity management or in their monetary policy.[10]

The information synergy can support banking supervision as well, because central banks could have useful information on economy and financial markets developments.[11] In particular, central banks could have expertise in detecting systemic risks. For example, the European Systemic Risk Board was established under the aegis of the ECB to 'contribute directly to achieving the objectives of the internal market'.[12] It was initially seen as an internal market issue with a leadership role for the central bank, revealing that systemic risks contains both microeconomic and macroeconomic aspects.

The arguments against central banks' supervisory functions have centred on a few themes: the conflict of objectives, reputation risk, risks for longer-term financial stability, and reduction in transparency and accountability. The conflict of objectives in supervision and monetary policy became more visible, when economic theory advocated price stability and central banking independence. The idea is that a clear and controllable mandate and objective reduce the (social) cost of achieving price stability. If price stability objective is compromised by supervisory objectives, that can reduce the public trust in central bank and price stability. Arguably, this problem can be worse in the euro area, where banks differ in their balance sheets and income structures across countries.[13] As monetary policy decisions can take place at politically loaded circumstances, the perceived credibility and impartiality of the central bank is critical and could be risked by supervisory responsibilities.[14]

However, a similar risk for monetary policy can stem from broader financial stability consideration, if the central bank is perceived to come to the rescue in financial market distress, a so called *Greenspan put*.[15] This rescuing of markets can even contribute to

reckless market behaviour and subsequent boom and bust cycles. However, it is a moral hazard problem stemming from the central bank reaction to financial instability not necessary from its supervisory responsibility.

In all, various theoretical premises for the banking supervision and Banking Union in particular give rise to both microeconomic and macroeconomic rationales. It is therefore, the actual developments that provides additional understanding.

3. Development towards and in the EU Banking Union – from microeconomic to macroeconomic and to ...

The development towards unified markets for EU financial services can be traced back to the Treaty of Rome and its provisions on the freedom of capital movement, to establish branches, and to offer services across borders. However, only after the 1986 Single European Act, the integration of financial services gained more pace with a help of a few key directives.[16] Consequently, the home-country rules were applied to banking operations in other Member States,[17] labelled as the European banking passport and home-country supervision.

Critically, the Maastricht Treaty did not change this internal market approach, as even the introduction of the euro in 1999 maintained the EU internal market approach to the single market for financial services. The EMU macroeconomic framework held the premise that banking supervision and regulation were excluded from the ECB's macroeconomic monetary policy competence. The separation between euro area monetary policy and mainly national banking perspective was underlined by the ECB's limited supporting role in financial stability. National responsibility over financial stability and banking supervision were mainly complemented with enhanced co-operation between EU supervisors and increasing international dimension particularly through the Basel Committee.[18] The most concrete link to monetary policy was through the payment systems, where the ECB's oversight function and its own TARGET payment system connected it with microeconomic banking markets.

During the Great Financial Crisis (2008–10), the combination of national and EU level as well as also the microeconomic approach to banking prevailed. The deficiencies in banking supervision and regulation were addressed through improvements in the EU framework, and these mainly internal market-based proposals largely followed broader international reforms to regain banking sector viability. A key initiative was a single rulebook of prudential requirements for banks in all EU Member States, Bank failures remained a national responsibility and they were paid for by taxpayers of the bank's home country with occasional EU-level pressure for bail-outs.[19]

3.1 Sovereign debt crisis made financial stability an over-riding objective

The national and secondarily EU-level approach did not survive the sovereign debt crisis of the euro area. The initial attempt to tackle financial instability as an EU banking issue relied on the newly established European Banking Authority, but its EU-wide bank stress tests[20] failed to restore confidence. At the same time, the links between financial stability considerations, the ECB's monetary policy measures, banking sector viability and particularly between banks and public finances in some Member States became to be seen as an

existential issue for the euro area. Critically, the ECB as the main EU macroeconomic actor became heavily exposed to Member States public finances that, in turn, were affected by their banking sector conditions.

In 2012, a so-called four presidents report for 'the completion of the Economic and Monetary Union (EMU)' proposed to include the Banking Union in the EMU macroeconomic management framework.[21] It detailed mainly microeconomic reforms: the Single Supervisory Mechanism (SSM), enforced Capital Requirements Regulation and Directive, and a euro area resolution authority.[22] The main macroeconomic issues related to the 'financial stability of the euro area as a whole' as the key rationale and the engagement of the main euro area macroeconomic institutions in the reforms, by allocating banking supervision to the ECB, and by allowing direct bank recapitalisation by the European Stability Mechanism (ESM).

This inclusion of the euro area macroeconomic governance to the ultimately microeconomic banking sector regulation followed a peculiar route. First, public debt problems in individual Member States became euro area-wide problems, when country defaults were considered too risky, initially in the case of Greece in May 2010. If a default was not an option and market financing was not available, the Member States in trouble needed to be rescued ultimately by other Member States. Second, when banking problems were the root causes for public debt problems as in, for example, Ireland and Spain, they became euro area problems. Hence, such banking problems were to be addressed by the euro area stability fund (ESM). Consequently, national sovereignty in banking matters, including supervision, lost its justification. The macroeconomic link between euro area monetary policy and banking supervision thus originated from the connection between banks and individual Member States' public finances.

The actual reforms were implemented in a surprisingly short time period and they were justified mainly by the macroeconomic stability concerns. Many constitutional questions, even related to the overall functioning of the economic-constitutional model, such as accountability and legitimacy, were pushed aside by the needs of urgency. For example, most questions arising from combining monetary policy and banking supervision in the specific EMU context remained substantively unaddressed.[23]

3.2 The first years of Banking Union – macroeconomic rationale in action?

The Banking Union has formally remained more or less the same since its launch in 2014. It consists of institutional and regulatory powers at the EU (and euro area) level in three areas: the single rulebook, the single supervisory mechanism and the single resolution mechanism. Deposit insurance was not included as a uniform euro area deposit guarantee scheme due to political reasons.[24] The single rulebook contains the main regulation that all financial institutions in the EU must comply with, and it can be classified as internal market-based framework that aims at creating an efficient and uniform regulatory framework through capital requirements for banks, protection for depositors, and prevention and management of bank failures.[25]

The SSM is a euro area construction, even though some non-euro EU countries have joined mainly as a precondition for the adoption of the euro. However, in practice, the microeconomic internal market perspective is prominent, as the ECB's supervisory tasks

include supervisory reviews, on-site inspections, granting and withdrawing banking licences, ensuring compliance with EU prudential rules and setting capital requirements.[26]

Similarly, the Single Resolution Mechanism covers only banks in the SSM and it was rationalised by broader financial stability concerns.[27] It aims at directing resources to the heart of the problem and thereby avoiding prolonged and politicised euro area banking failures. The earlier experiences at the euro area of solving banking problems via indirect and politicised processes, as in the Greek crisis and also in the Irish case, acted as warnings. Accordingly, the Single Resolution Board[28] was given a wide discretion in preparing bank resolutions. The Single Resolution Fund has collected funds close to the target of 1% of deposits, although such funds would suffice only in fairly limited banking problems. Broader or systematic financial instability could need the ESM resources.

The practise does not as of yet provide firm conclusions, whether the Banking Union is dominated by micro- or macroeconomic rationales. The macroeconomic stability concerns related to national malpractices were arguably alleviated by the transferral of supervision to the ECB, even if the ECB's comprehensive assessment of banks has also raised some criticism. The bank recapitalisations with the ESM funds have been relatively limited, where the main case was for Spain already in 2012–13 with eventually 41 bln euros disbursed. The quick improvement of that situation could be seen as sign of success, as nearly a half of loans have been repaid early. Additionally, the actual programme countries have used ESM funds also to recapitalised their banks. These programmes are formally completed, and hence the macroeconomic stability concern is large abated although the repayment of ESM loans will start only later this decade. More generally, the availability of the ESM for banking sector recapitalisation could act as a mainly macroeconomic tool to ensure that banking problems in Member States do not lead to market concerns over public debt sustainability.

The microeconomic perspective has dominated the actual conduct of the SSM, although the ECB as the ultimate banking supervisor in the euro area maintains the institutional link to macroeconomic management. In fact, the leadership of the ECB over the national supervisors[29] was more complete than many observers initially thought, which highlighted the aim of a fresh start for the euro area prudential supervision, and indirectly for the credibility of the euro area banking sector.[30] On the negative side, the ongoing non-existence of euro area interbank markets proper indicates a limited success from internal market and microeconomic perspectives, where the reliance on the ECB's operational framework remains a negative factor. In sum, the first years of the Banking Union did not firmly determine its main constitutional locus.

3.3 The impact of the pandemic

The EMU pandemic responses included mainly monetary policy-related measures. However, the ECB's SSM also announced temporary reliefs on capital and operational requirements that allowed banks operate temporarily below a specified minimum level of capital in addition to relaxation of the countercyclical capital buffers and various flexibilities in actual supervisory practice.[31] This was a common theme among many central banks and supervisors. On the surface, it was based on the needs of the macroeconomic situation. The ECB, and for example, the US Federal Reserve and the Bank of England were relaxing supervisory criteria in order to help banks to function as normally as possible and

to ensure that even excessive liquidity needs could be met. These relaxations eased banks' capital situation and workload during that very difficult period. The excessive liquidity creation was quite unique monetary policy, as it was not traditional emergency liquidity assistance to individual banks but a similar measure at the level of the whole banking sector.

The relaxations in supervisory criteria and excessive special liquidity could raise some concerns that the macroeconomic and broader societal considerations overshadowed the traditional prudential supervision perspective. Indeed, if supervisors are seen to react to heightened risks by imposing less stringent rules including capital requirements, this can become counterproductive for their credibility in ensuring the safety and soundness of banks, and thus even problematic for functioning of the banking sector. However, although the supervisory relaxation, liquidity provision and even the ECB's public finance backstop could be seen as promoting macroeconomic stability at the time of an exceptional economic crisis, they could have been positive also for the internal market and efficiency. Considering that any exact supervisory limit is artificial in any case, it is the breach in itself that is most indicative of problems. A breach indicates an inability of the institution to manage its business in a prudent manner. In contrast, a breach caused by a completely unanticipated shock such as the pandemic might not indicate anything alarming about banks' capabilities. In such circumstances, the relaxations of supervisory or rating criteria and also collateral requirements might have prevented unnecessary difficulties for banks, when the root cause was the pandemic and its containment measures. The temporary (and short) duration of the external shock also supported the efficiency argument, and the measures were designed accordingly. Hence, the overall pandemic response could ultimately be rationalised also by internal market and efficiency arguments.

In conclusion, the Banking Union has its institutional and constitutional starting point in the macroeconomic problems it aimed to resolve, when existential threats for the euro area elevated banking issues as part of the broader financial stability considerations, similar to and linked to public finance adjustments in many Member States. Accordingly, the actual transferral of supervisory (and resolution) responsibilities from the national to the euro area level transformed banking supervision and financial stability from a microeconomic and mainly EU-level internal market issue to the EMU macroeconomic management. As long as financial stability concerns were pressing, the microeconomic efficiency and the integration-based project had to give away and the euro area considerations also eclipsed the EU-level objectives. However, the pandemic reactions could be assessed somewhat differently, and in any case, substantively the EU banking sector, its regulation and supervision are still also part of the (microeconomic) internal market, creating an ambivalence as to the role of law and courts.

4. Constitutional issues concerning the Banking Union

4.1 The arguments for a euro area banking union

The restructuring of the euro area banking supervision and financial stability framework stemmed from a perception that national responsibility had failed with severe consequences for the euro area. Problems in some euro area banking sectors were having

macroeconomic consequences.[32] The reforms of the EU and global frameworks were not considered sufficient to address threats to financial stability in the EMU, as the link between public finances and banks had become a stability risk for the whole euro area.

One peculiar feature was the vicious cycle between public debt and banks that was a creation of crisis resolution. Public finance problems led to banking threats, most fundamentally in Italy and Spain, because banks had hoarded excessive amounts of domestic government bonds with the funding and incentives provided by the ECB monetary policy.[33] When these bonds declined in value, banks were facing huge losses that risked further fragmentation of the euro area financial markets and effective transmission of ECB monetary policy.[34]

Hence, although the problems in euro area banks related both to EU internal markets and to euro area macro-economic management, the latter became the focus of the most existential problems and thus the primary field of solutions. The Banking Union was introduced as a solution to the pressing problems at the macroeconomic level. The institutional arrangement for tying EMU macroeconomic crisis management and fundamentally microeconomic financial market supervision was constitutionally 'creative'. The ability of the ESM, a non-EU (macroeconomic) stability fund of the euro area Member States, to fund bank recapitalisation[35] was made conditional on the transferral of banking supervision to the ECB and to the euro area level. That was formalised in secondary legislation by considering the ECB's supervisory responsibility 'a special tasks' in the field of banking supervision according to Article 127(6)TFEU.

The establishing of the euro area banking supervision could be debated, but all the key arguments related to the crisis at hand, not to the longer-term considerations. Also, the practice of Banking Union has arguably weakened the arguments, as the banking crisis has passed and also the role of the ESM in bank capitalisation turned out to be limited. Hence, the case for euro area instead of EU Banking Union remains open to debate, although for the time being it is mixed with the question of assigning banking supervision to the central bank instead of a specific (EU) institution.

4.2 Accountability, transparency and legitimacy in the Banking Union

The discussion on EU or euro area Banking Union can be seen as a prelude to broader constitutional questions. Indeed, the main constitutional issues and concerns related to the Banking Union stem from its unusual and complex legal, institutional and economic setting. For example, the Banking Union has led to implementation of EMU-based law in areas that had previously been covered by internal market legislation. The use of ultimately political and discretionary concepts and objectives, mostly strikingly financial stability, in a similar manner as more legally sound legal objectives, has raised new problems for the legal order itself.[36] Indeed, the macroeconomic and even political rationales have arguably penetrated the EU legal order through the legal objective of financial stability. This could call for careful assessments concerning legal certainty and even the rule of law.

However, for the present article, the most interesting constitutional concerns relate to legitimacy, accountability and transparency of the Banking Union. The legitimacy of the conferral of the main responsibility for banking supervision to the ECB is a difficult question that goes beyond the constitutionality of the conferral using Article 127(6)

TEFU. Arguably, the ECB's extensive independence and distance from the democratic decision-making is an exception that was defended by economic considerations supporting independent conduct of monetary policy.[37] This exception made in the Maastricht Treaty hardly extends to banking supervision.[38] In addition, the Banking Union has led to an extensive concentration of social power in the hands of an extremely independent institution, as was also pointed out in a report *Limits and opportunities for the ECB in the multi-tiergovernance*.[39]

Furthermore, the SSM regulation insisted that a 'shift of supervisory powers from the Member State to the Union level should be balanced by appropriate transparency and accountability requirements',[40] but the Treaty only provides accountability means for common monetary policy. And these accountability mechanisms are designed for the monetary policy as the key macroeconomic policy area that is fundamentally different from the SSM that should be covered by the normal principles of (EU) administrative law under the broader democratic accountability model. Consequently, the ECB's supervision needed new procedures to become accountable towards the European Parliament and national parliaments.[41] The mechanisms in place could be considered creative, if at the same time perhaps arbitrary. The main accountable organ, the Single Supervisory Board, is not a formal decision-making body nor an organ that is recognised by EU primary law. The issues related to non-euro area counties in the SSM are even more complicated, but outside the scope of this article.

The broader accountability concern with the Banking Union is related to the concept of central bank independence. In the case of the ECB, this extensive independence rested on the idea of a clear and controllable objective of price stability that was the basis for the ECB's accountability and ultimately democratic legitimacy. Theoretically, this model is best suited for a narrow model of central banking, where the primary objective is clearly set and the means for achieving the objective are foreseen or even enumerated. Any balancing act between the various objectives can make the ECB's mandate excessively vague to guarantee both the ECB's independence and its accountability.

Furthermore, central bank independence and accountability rely on another concept with great constitutional relevance, namely transparency. Contemporary monetary policy assumes that transparency actually helps by engaging the general public and financial markets in common understanding of the most suitable monetary policy actions.[42] As a consequence, central bank independence, accountability, transparency and the effectiveness of monetary policy form a natural combination. Banking supervision is different in this regard, because it requires a high level of professional secrecy that does not allow the same transparency as the conduct of monetary policy.

Finally, the conflict of objectives between monetary policy and supervision has the potential of becoming a fundamental problem for the Banking Union. Although timely monetary policy reaction to financial instabilities can facilitate speedier recovery during financial crises, also the conflicts of interest are likely to cross national boundaries. For example, if the ECB is perceived to risk price stability in order to save banks in some countries or to avoid supervisory failures becoming visible, the damage to its reputation and credibility could be difficult to repair.

In conclusion, the constitutional issues related to the combination of independence, accountability, transparency and ultimately democratic legitimacy formed a delicate balance in the case of monetary policy, which is difficult to extend to banking supervision.

The Banking Union, and particularly its reliance on macroeconomic stability rationales could be considered a disruption to the balance that will require further understanding. And this is even before considering the conflict of interest between monetary policy and banking supervision.

Conclusions

The Banking Union is a work in progress, where its future direction could be affected by its economic-constitutional locus that, in turn, will have an impact on the aforementioned constitutional questions. I described, how the pre-crisis banking regulation relied on a combination of EU level and national approaches that both had mainly microeconomic aims such as efficiency and integration of financial services. These internal market-based aims were side-tracked when the pressing problems stemming from the sovereign debt crisis and its handling stressed broader euro area macroeconomic and stability-based arguments. This transformation of EU banking, its supervision and regulation, still prevails with the ECB's banking supervision responsibility. However, and regardless of its origin as a macroeconomic stability project, many microeconomic efficiency rationales could re-emerge going forward.

The assumed strength of the Banking Union was the clear break-away from earlier harmful national practices. In that regard, the progress can be assessed positively. The SSM has established a uniform framework for banking supervision, which has most likely improved financial stability in the most vulnerable Member States. The Single Resolution Mechanims has acted on a few cases (actual resolutions only with Sberbank subsidiaries and banco Popular), which does not yet provide a firm basis for analysis. Timeliness of these actions could be deemed positive for financial stability, while the continuous recourse to national measures remains a concern. In all, after almost a decade, it is possible to argue that broad financial stability has improved since the Banking Union was established. How much of this is attributed to the Banking Union and how much simply to elapsed time, is hard to judge. Indeed, in comparative terms, the euro area financial and particularly banking sector stability has hardly outperformed other major markets neither have banking sector profitability and productivity.

A potential weakness going forward could be an excessive focus on stability that can lead to a neurotic banking sector. The new multi-layer supervisory structure in the SSM might be excessively focused on short-term stability considerations, not least because supervisory failures could be seen as major reputational risks for the ECB. This could push the general balancing act in the supervision between stability, efficiency and innovation towards stability and derail efficiency and innovation. Banks should arguably be at the heart of the capitalistic allocation of risks and opportunities that promotes innovation and growth that are incidentally key aims of the internal market programme as well. The time period of assessment is too short, but at least bank lending in the euro area has lacked behind most other areas, and the ECB has been forced to recourse to some relatively extreme measure to 'force' banks to lend (T-LTRO). Also, bank profitability in the euro area is still low and trails other major banking markets, which is both an efficiency but also a stability concern.

The challenges of the covid-pandemic were responded to with a large variety of measures. The main Banking Union and financial stability-related measures were relaxation of supervisory criteria and the PEPP as the backstop for bond market pricing and liquidity. However, although these measures could be seen as promoting macroeconomic

stability during an exceptional economic crisis, there could be a positive side for internal market and efficiency as well. Therefore, the broader covid-19 response, including the PEPP, aimed at reducing risk premia and self-reinforcing negative paths, and facilitated a market-based recovery going forward, partly by giving banks some extra leeway.

The overall conclusion on the Banking Union after nearly a decade leans towards a declining albeit still substantial macroeconomic stability rationales. The potential impact of a stability-based Banking Union on the internal market needs further analysis. In the medium-term, the euro area-based banking supervision could increase economies of scale and concentration in the banking sector. A major downside has been the reliance on macroeconomic tools to promote growth that could indicate a tendency to fight short-term risks through tolerating increased longer-term risks. Consequently, risks might have piled up at the macroeconomic level, making the economy particularly vulnerable to macroeconomic shocks, particularly inflation. From an economic constitutional perspective, this is a problem, even a failure.

Notes

1. For a more through description, the reader is directed to Tuori and Tuori (2014), *Eurozone Crisis* and Tuori (2022), *The European Central Bank and the European Macroeconomic Constitution – From Ensuring Stability to Fighting Crises*, CUP.
2. See, Cappelletti, Seccombe, and Weiler (1986), *Integration Through Law*, and many others.
3. For a more through description, see Chapter 3 The Principles of the European Macroeconomic Constitution in Tuori (2022) *The European Central Bank and the European Macroeconomic Constitution*..
4. European Central Bank (2001), 'The role of central banks in prudential supervision', https://www.ecb.europa.eu/pub/pdf/other/prudentialsupcbrole_en.pdf.
5. Ibid., 3.
6. Masciandaro (2004), 'Unification in financial sector supervision: The trade-off between central bank and single authority'.
7. The Board of Governors of the Federal Reserve System (2010), 'The Public Policy Case for a Role for the Federal Reserve in Bank Supervision and Regulation', 6.
8. European Central Bank (2001), 'The role of central banks in prudential supervision', 4, https://www.ecb.europa.eu/pub/pdf/other/prudentialsupcbrole_en.pdf.
9. The Board of Governors of the Federal Reserve System (2010), 'The Public Policy Case for a Role for the Federal Reserve in Bank Supervision and Regulation', 8.
10. For example, the German Bundesbank or the Swiss National Bank did not engage in supervision and even the Eurosystem did not see major benefits for monetary policy stemming from supervision. European Central Bank (2001), 'The role of central banks in prudential supervision', 4, https://www.ecb.europa.eu/pub/pdf/other/prudentialsupcbrole_en.pdf.
11. European Central Bank (2001), 'The role of central banks in prudential supervision', 4, https://www.ecb.europa.eu/pub/pdf/other/prudentialsupcbrole_en.pdf.
12. 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. OJ L 331, 15.12.2010, p. 1–11.
13. Goodhart and Schoenmaker (1995), 'Should the Functions of Monetary Policy and Banking Supervision Be Separated?'.
14. See, for example, Bank for International Settlements Central Bank Governance Group (2009), *Issues in the Governance of Central Banks*, 151.
15. The term 'Greenspan put' was initially financial market jargon, but it was picked up by academia as well. See, for example, Stiglitz (2010), *Freefall*, 135.

16. The main regulations were the Council Directive on Own Funds 89/29/EEC of April 171,989, Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions (OJ L 386, 30.12.1989, p. 14–22) and the Second Banking Directive 89/646/EEC of 15 December 1989 providing the single banking licence.
17. See, for example, Santangelo (1997). 'The Single Market for Financial Services: the European Response to the Process of Financial Transnationalisation'.
18. The Basel Committee facilitates cooperation on banking supervisory matters, aiming at financial stability through the quality of supervision and minimum standards for example on own capital. See https://www.bis.org/bcbs/history.htm.
19. Most notable it is claimed that the ECB put considerable pressure on Ireland to take over all the liabilities of the banks. See, for example, Brennan (2010), 'The difference between Iceland and Ireland: one letter and the ability to default'.
20. Many banking supervisors conducted stress tests to assess banks'resilience to adverse economic and financial market developments, particularly whether banks' had sufficient capital buffers to withstand foreseeable shocks. If a bank failed a stress test, it had to raise more capital, private or public, or reduce its activities. The broader aim was to restore confidence in banks. A successful example was the US 2009 tests that were followed but similar but less rigorous EU tests that might actually have reduced trust in banks and supervisors.
21. The European Council mandated the President of the European Council together with the Presidents of the Commission, the Eurogroup and the ECB to draft a plan for 'the achievement of a genuine Economic and Monetary Union' that resulted in Van Rompuy et al. (2012),'Towards a genuine economic and monetary union'.
22. Ibid., 4–7.
23. For example, the FCC judgment on the SSM followed a strange, even a false, assumption of the limits of the supervisory responsibilities that were transferred to the ECB and that have since been dismissed by the CJEU in (CJEU) of 8 May 2019 (C-450/17 P Landeskreditbank Baden-Württemberg v ECB) in comparison to 2 BverfGE 1685/14, 2 BverfGE 2631/14.
24. 'Recovery and Reform in the euro area'. http://www.ecb.europa.eu/press/key/date/2014/html/sp141009.en.html.
25. Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions. OJ L 177, 30.6.2006, p. 1–200 and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions. Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 Text with EEA relevance. OJ L 176, 27.6.2013, p. 1–337 and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC Text with EEA relevance. OJ L 176, 27.6.2013, p. 338–436.
26. Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions. OJ L 287, 29.10.2013, p. 63–89.
27. Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council. OJ L 173, 12.6.2014, p. 190–348.
28. The SRB has been operational from 2015, established by Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014, establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010. OJ L 225, 30.7.2014, p. 1–90.

29. Council Regulation (EU) No 1024/2013 and Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17). OJ L 141, 14.5.2014, p. 1–50.
30. See General legal framework of the SSM in https://www.bankingsupervision.europa.eu/legal framework/ecblegal/framework/html/index.en.html.
31. ECB Press Release (12 March 2020), 'ECB Banking Supervision provides temporary capital and operational relief in reaction to coronavirus', https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200312~45417d8643.en.html.
32. See, Fitzgerald (2014), 'Ireland's Recovery from Crisis' as well as Norris and Byrne (2015), 'Asset Price Keynesianism, Regional Imbalances and the Irish and Spanish Housing Booms and Busts'.
33. Gennaioli, Martin, and Rossi (2014), 'Banks, Government Bonds, and Default: What do the Data Say?'. Indeed, it was estimated that about half of the initial ECB 3-year LTROs went to government bonds and only slightly more than 13% to real economy lending. Whittall and Gore (2014), 'Eurozone banks' sovereign exposure hits new high'.
34. European Commission (2012), 'A Roadmap towards a Banking Union', COM/2012/0510 final, 3. http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52012DC0510.
35. See, for example, European Commission press release (2012), 'Commission proposes new ECB powers for banking supervision as part of a banking union', http://europa.eu/rapid/press-release_IP-12-953_en.htm?locale=en.
36. Tuori and Losada (2022), 'The Emergence of the New Over-riding Objective of Financial Stability'.
37. This was also noted by the German constitutional court in its Maastricht decision: '[T]his modification of the principle of democracy ... is justifiable, because it takes account of the special factor, established in the German system and also scientifically proven, that an independent central bank is more likely to protect monetary value ... while maintaining economic liberty than are sovereign governmental institutions.' FCC BVerfGE 89, 155.
38. It was not part of the German organisation of banking supervision at the time.
39. Repasi (2012), 'Limits and opportunities for the ECB in the multi-tier governance'.
40. Council Regulation (EU) No 1024/2013.
41. Fromage et al. (2019), 'ECB independence and accountability today'.
42. Some central banks have even mainly operated through communication with the public and with limited actual financial transactions or administrative measures.

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ORCID

Klaus Tuori http://orcid.org/0000-0001-7982-1191

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