Banks and money markets back plans for European banking union

Stefan Steinberg
26 September 2012

Last month, the president of the European Central Bank (ECB), Mario Draghi, sent stock markets and bank shares soaring by declaring his readiness to buy unlimited amounts of government bonds on the so-called secondary market, i.e., not just directly from governments, but also from private investors and banks.

Following this promise by the central bank to inject unlimited sums of fresh money into their vaults, major banks and financial institutions are pushing for the ECB to be given powers similar to those of the US Federal Reserve, which pumped trillions of dollars into the financial markets to bail out US banks in the wake of the 2008 Lehman Brothers crash.

This is the logic behind the call by leading banks for the establishment of a banking union in Europe. While European politicians seek to portray a banking union as a means of curbing excesses by the banks, the reality is very different. The banking union will be a means of increasing European financial institutions' access to public treasuries. It will facilitate a new round of bailouts, to be paid for by the continent's working population.

European banks and money markets also hope that such a union will increase their international competitiveness, enabling them in particular to challenge the dominant role of US finance capital.

At the start of September, Deutsche Bank Co-Chief Executive Jürgen Fitschen told a bankers' conference in Frankfurt that Germany should support the idea of a banking union and grant powers to the ECB to oversee the activities of all European banks.

A European banking union is also a "dream" option for Europe's bond markets, including UK markets, argues Ralph Atkin in the *Financial Times.* Atkin acknowledges that due to the low interest rates introduced by the ECB and other central banks across the globe, "corporate debt market teams at global investment banks are on a roll", and have enjoyed a "feast" in recent months.

Atkin also notes that the euro-denominated debt market still pales in comparison to transatlantic transactions, totalling only about a third of the US market since the launch of the euro in 1999. He hints that a banking union in Europe would help European banks cut into America's lead.

At the same time, he reveals that both the US and European corporate sectors face a "'wall' of financing requirements in coming years". Atkins cites a report from Standard & Poor's which states that the sum of $8.6 trillion is required to refinance euro zone and UK debt by 2016. Building a banking union is a key element in facilitating such fresh injections of capital into the markets, Atkin declares.

The details of the new powers and funding arrangements for the ECB are currently being thrashed out in a series of meetings between bank lobbyists, non-elected Brussels bureaucrats and leading European politicians. Proposals for the banking union made by the European Commission were discussed and hotly contested at a meeting of European finance ministers in Cyprus in mid-September, with major divisions emerging between euro zone members over which countries are to bear the main financial burden.

The European Commission has proposed that the ECB be given new powers to intervene on three fronts to assist the banks.

First, the ECB is to be made responsible for examining the books of euro zone banks, supplanting the existing system of national supervision and regulation.

Second, the ECB will be allocated a new fund (a so-called bank resolution fund) guaranteed by euro zone member states, with which it can wind down insolvent banks.

The third and most controversial proposal is that the ECB be empowered to establish a new funding arrangement that will offer guarantees to the deposits of investors in European banks—a “unified deposit-guarantee scheme.”

At the Cyprus meeting, France, Spain, Italy and Belgium made it clear that they wanted to move towards a banking union with a fully fledged deposit guarantee scheme as soon as possible, i.e., by the end of this year. France also favours empowering the ECB to inspect the books of all of Europe’s more than 6,000 banks.

The chief opposition to the French proposals came from Germany. German Finance Minister Wolfgang Schäuble has repeatedly thrown cold water on hopes of quickly setting up a banking union.

Germany has dozens of small regional savings banks and cooperatives, a number of which are known to be the repositories of large amounts of toxic debt. The German Finance Ministry, therefore, is opposed to granting the ECB comprehensive oversight powers and has proposed that it supervise just 25 major European banks.

More significantly, leading figures in Berlin, including prominent politicians from the government camp and German Federal Bank (Bundesbank) officials, have expressed their vehement opposition to new powers for the ECB. They argue that a European banking union would lead to the mutualization of euro zone debt and empower the ECB to influence national budgetary and fiscal policy. As a result, they maintain, German investors and taxpayers would be forced to bail out insolvent banks in other countries.

Commenting on German opposition, the chair of the European Parliament’s Economic and Monetary Affairs Committee Sharon Bowles stated this month: “But they (the Germans) are shying away from mutualization and all you are left with is supervision, which if left on its own would have more drawbacks than benefits. It could split the single market.”

In addition to the substantial divisions between Germany and other euro zone countries, conflicts are brewing with countries outside of the euro zone. European Union members Britain and Sweden have declared their unwillingness to allow their banks to be supervised by the ECB under conditions where they are denied voting rights on the ECB executive.

The project for a European banking union is fraught with conflict between the major European players. Nevertheless, as the spectre of renewed recession grows across the continent, the banks and their lobbyists are exerting enormous pressure for European politicians to arrive at a solution in the best interests of the financial markets.

The importance for the banks and the money markets of establishing a banking union with the power to override national budgetary policy was summed up by one economic advisor to the Brussels bureaucracy. “People have been living under the illusion that banking union is a substitute for fiscal union”, declared Paul De Grauwe. The professor from the London School of Economics went on to let the cat out of the bag. “It’s about money and having access to taxpayers’ resources. There is a risk it will be half-baked if it does not have a fiscal backstop.”