

Inter-European conflicts torpedo plans for banking union

Stefan Steinberg
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Discussions between European Union finance ministers on creating a banking union for the euro zone broke down last Tuesday, after vigorous disagreements between leading European states.

Opposition to plans for a banking union were led by German Finance Minister Schäuble, who made clear that Berlin would not bow to pressure for comprehensive supervision of all European banks by the European Central Bank (ECB). He told the meeting: “It would be very difficult to get approval from the German parliament if supervision involved all German banks”. Achieving the level of ECB supervision demanded by France—i.e., to include all of the continent's 6,000 banks—could take over a decade, Schäuble added.

Schäuble said he wanted a clean separation between the ECB's banking oversight function and its control of monetary policy—that is, its setting of interest rates and printing of money to control the money supply.

The European Commission launched the original proposal for a banking union in June. The EC wanted the European Central Bank to receive new powers to supervise the accounts of European banks, help the wind-up of bankrupt financial institutions, and facilitate the bailout of surviving banks.

In line with the plans for a banking union, European leaders agreed in September to set up a new permanent bailout fund for the euro zone, the European Stability Mechanism, with a lending capacity of €500 billion.

While proponents of such a union tried to present it as a means of reining in “speculative excesses” by the

banks, the reality is quite different. A European banking union has the full support of the continent's major banks. The bitter conflicts which erupted at Tuesday's finance ministers meeting centred on which nation's banks would profit from the lucrative returns involved in financial speculation in the euro zone.

The most vehement opposition to a European banking union came from the City of London, where the bulk of EU financial transactions are concluded. The City regards increased ECB powers as a direct threat to the role of British banks and companies in Europe. Discussing the importance of British investments in the EU, a recent article in the *Financial Times* referred to the EU market as “The City's golden ticket”.

Europe already has a European Banking Authority (EBA), which currently oversees European banks. It is based in London and subject to influence from the British banking community.

According to one British source, plans for new ECB powers meant that the EBA risked “becoming an arm of the ECB”.

In an editorial last week, the French daily *Le Monde* described the conflict over a banking union as “a battle between the City and Paris”. The governor of the French Central Bank, Christian Noyer, also made clear a week ago that he opposed British dominance of euro zone financial transactions.

“We're not against some business being done in London, but the bulk of the business should be under our control”, Noyer told the *Financial Times*. Noyer is also on record this year arguing that rating agencies should cut Britain's rating before that of France,

because the UK had “as much debt, more inflation and less growth than us”.

The British banking lobby and media reacted furiously to Noyer's comments. British Prime Minister David Cameron has warned he is prepared to veto a European banking union, should British interests be overlooked.

Germany, like France, also wants to increase its share of the European financial cake at Britain's expense. Nevertheless, it was the differences between continental Europe's two leading powers that torpedoed the negotiations on Tuesday.

France has made it clear that it expects Germany, as Europe's largest economy, to play the leading role in the financial bailout of southern Europe's increasingly shaky banking system.

French finance capital has nearly \$700 billion invested in southern European banks and is determined to secure their investments. It wants the ECB to more regularly provide loans to help support vulnerable banks. This is where Berlin drew the line, with Schäuble refusing to approve banking union plans that could end up giving the ECB a blank cheque for further bailouts.

With national elections approaching next year and facing substantial opposition from its own coalition partners, the German government is adamant it will not provide new money for European bailouts. The German central bank, the Bundesbank, has also repeatedly expressed its opposition to any sort of banking union which would force the ECB to take a more active role in directing monetary policy across the continent.

The main objection by Berlin at the finance minister's meeting was to French insistence that the ECB be empowered to oversee the books of all of the 6,000 banks in the euro zone.

Germany has dozens of smaller regional savings banks (Sparkassen), which play an important role in financing businesses at a local and state level. These banks fear the implications of ECB supervision. In its

first proposal on the subject, the German Finance Ministry actually proposed that banking supervision by the ECB be limited to the continent's 25 biggest banks.

Speaking on behalf of small German banks, Karlsruhe Ettlingen savings bank CEO Michael Huber told the *Financial Times*: “You don't impose the safety rules you'd need for a 2,000-passenger cruise ship on a yacht taking five people up the coast”. He added, “There would be enormous administrative costs that I would have to pass on ... it would hit *Mittelstand* [i.e. mid-sized] companies and the local economy”.

This summer, European heads of state originally proposed finalising the basis for a banking union by the end of 2012. The failure of Tuesday's talks means that its formation is now likely to be postponed until next year.



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