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Choosing the Lesser of Two Evils: Explaining Multinational Banking Groups' Push for Supranational Oversight in the EU

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Choosing the Lesser of Two Evils: Explaining Multinational Banking Groups' Push for Supranational Oversight in the EU

Rachel A. Epstein[1]

Abstract

For decades before the Global Financial Crisis of 2008, West European nation-states maintained close political ties to their banks. Banks enjoyed regulatory forbearance and limited competition, while states cultivated national banking champions and a ready constituency for government debt. Europe's economic crisis and the regulatory response have largely upended this erstwhile symbiotic relationship between many banks and their home states, however. In the debate since 2012 over European Banking Union, even within a framework of stricter regulation and centralized supervision in the European Central Bank, a surprising source of support for supranational authority has been from Europe's multinational banking groups. This paper explains why banks, once beholden to and beneficiaries of national regulation and supervision, have opted instead to lobby for much more European-level oversight. I argue that states sowed the seeds of their own political marginalization vis-à-vis banks by encouraging, first, banks' domestic consolidation and then their outward expansion. As banks became more international in orientation (and as a greater share of their revenue came from foreign markets) they became more interested in a single rulebook and consolidated supervisory authority, even at the expense of national forbearance. The paper thus argues that for multinational banking groups (but not their domestically-oriented counterparts) European Banking Union and "more Europe" generally represented the lesser of two evils when compared to continued national control.

Résumé

Pendant des décennies avant la crise financière mondiale de 2008, les États-nations d'Europe de l'ouest ont maintenu des liens politiques étroits avec leurs banques. Celles-ci ont bénéficié d'un assouplissement en matière de régulation et d'une concurrence limitée tandis que les États ont cultivé au niveau national des champions bancaires et ont préparé leur électorat à la dette gouvernementale. Cependant, la crise économique européenne et les réponses en matière de régulation ont largement renversé cette relation autrefois symbiotique entre

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plusieurs banques et leur État. Dans le débat sur l'Union bancaire européenne depuis 2012, les groupes bancaires multinationaux européens ont soutenu de façon surprenante l'idée d'une autorité supranationale, malgré un cadre de régulation plus strict, et d'une supervision centralisée de la Banque centrale européenne. Ce texte explique pourquoi les banques, autrefois redevables et bénéficiaires de la régulation et de la supervision nationale, ont opté en faveur de plus de surveillance européenne. Je montre que les États ont semé les graines de leur propre marginalisation politique vis-à-vis des banques, en encourageant, d'abord, la consolidation nationale des banques et ensuite, leur expansion externe. Comme les banques ont développé une orientation vers l'international (et qu'une plus grande part de leurs revenus provenaient des marchés étrangers), elles ont été davantage intéressées par un ensemble unique de règles et une autorité de surveillance consolidée, même aux dépens de la tolérance nationale. Ce texte soutient ainsi que pour des groupes bancaires multinationaux (et non pas leurs homologues orientés nationalement), l'Union bancaire européenne et "plus d'Europe" ont été généralement un moindre mal en comparaison d'un contrôle national continu.

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Introduction

States and banks have traditionally maintained close ties. States have used banks to manage their economies and soak up government debt, while banks enjoyed regulatory forbearance, restricted competition and implicit or explicit guarantees from their home markets. For these and other reasons, the political foundations of banks have been powerful and enduring, with actors on both sides of the aisle reluctant to sever relations (Pauly, 1988; Epstein, 2008; Martinez-Diaz, 2009; Epstein, 2014a).

National regulatory forbearance for banks has been a notable feature of the European landscape, and also a major source of the European debt and currency crisis. For decades before the U.S. housing market started to falter in the summer of 2006, national authorities in Europe, in concert with their banks, built banking national champions. Ensuring "home" banks were dominant in the domestic market and internationally competitive, especially with the completion of the single market in 1992, required assistance from national regulatory, supervisory and political authorities. Forms of assistance included limiting licenses to foreign interests (*Economist*, 1999), allowing thin markets for corporate control to prevent hostile takeovers (Goyer and Valdivielso del Real, 2014), protecting nationally-specific definitions of capital (Howarth and Quaglia, 2013a), using bank bail-outs to keep domestic banks domestic (Jabko and Massoc, 2012; Bayram, 2014; Donnelly, 2014) and overlooking or failing to report the sources of potential insolvency on banks' balance sheets (Bini Smaghi, 2013).

West European banks long benefited from the modes of regulatory forbearance outlined above. And the banks, with their states, had also long resisted the pooling of regulatory and supervisory authority at the European level—despite economists' warnings that monetary union without banking union was a dangerous proposition (Eichengreen 1993). The central argument of this paper, however, is that traditional bank-state ties in Western Europe have changed. Europe's multinational banking

groups, which hold the bulk of the continent's banking assets, have started to lobby, not for national shelter, as in the past, but centralized oversight, in the ECB through the implementation of Europe Banking Union.

In essence, I argue that it was through a particular brand of banking nationalism that West European states sowed the seeds of their own political disenfranchisement vis-à-vis their banks (see also Epstein and Rhodes, 2014; on banking nationalism, see Véron, 2013). Western Europe's banking nationalism was meant to create banking behemoths, too big to take over and also internationally powerful. This strategy succeeded, in so far as West European foreign ownership levels remained low while bank internationalization grew (see Figures 1 and 2 on foreign ownership levels in East and West Europe; see Grossman and Woll, 2013 on banking sector internationalization in Europe compared to the U.S.). But in the process of supporting domestic bank consolidation, limiting internal competition and supporting banks' outward expansion, states were also helping to change banks' basic orientations, loyalties and obligations. As banks became less dependent on revues from home markets, they also became less beholden to national regulatory and political authorities. Or, alternatively, as banks became more internationally active and used implicit home backstops to undergird risks abroad, states became more willing to cede regulatory control.

Fundamentally, Europe's multinational banking groups, which are mostly from Western Europe, would benefit from the lower compliance costs associated with a single supervisor. They have also sought to escape nationally idiosyncratic capital and liquidity rules that stop them from moving resources around freely within their conglomerates. According to banks, such rules have locked resources in some over-capitalized markets, leaving other markets starved of new lending. From the banks' perspective, avoiding 1) regulatory fights along national lines, 2) lending targets in their "home" markets during downturns, and 3) the moral suasion to purchase more of their own sovereign's bonds are all desirable aspects of severing bank-state ties in

Europe. While on some level states might appreciate no longer being on the hook for bank bail-outs that ruin public finances, an enormous loss of control is also implicit in such a change.

To be clear, I am not arguing that all European banks share a preference for centralized supervisory authority under the ECB. Rather, it is those banks with major international operations that have the most to gain through the supranationalization of oversight. Domestically-oriented banks are not in a position to enjoy the same cost-savings from a single regulatory interface and are also less concerned about streamlining their internal capital markets if they are not engaged in cross-border lending. However, it is notable that the European Banking Federation has come out strongly in favor of European Banking Union—which is explained by the dominance of Europe's multinational banking groups there. Moreover, interview data, presented in more detail below, demonstrates that some large individual banks indicated a preference, even during the acute phase of the Global Financial Crisis in 2008-9 before banking union was under discussion, for a standardized set of rules.

A second caveat about the analysis is that I am not arguing that Europe's multinational banking groups have prevailed with respect to standardization. The implementation of Basel III in Europe through the Credit Requirements Directive IV was *not* in the end, designed according to a maximum harmonization principle (Howarth and Quaglia, 2013b), thus leaving some national discretion on capital rules (ESRB, 2014). And given that the UK, Sweden, and most importantly for Europe's multinational banking groups, several of the East Central European countries, are opting out of European Banking Union, the degree of banks' internal capital market flexibility is still in question. But I do contend that banks' changing orientations, loyalties and business strategies eased the path to European Banking Union since 2012. Thus it was not just the severity of the European debt and currency crisis that led to a significant new pooling of sovereignty in the governance of finance. Rather, it was the changing structure of the European economy itself, particularly in the

organization of finance and its internationalization, with the euro in an important supporting role.

In the rest of the paper, I provide some preliminary evidence for the claims above. I first argue that banking sector protectionism has been a core feature of West European policy. I also show that banking nationalism in Europe was not just about keeping foreign interests to a minimum in home markets, but was also in the service of promoting international expansion. That expansion was strongly facilitated by the end of the Cold War, post-communist transition and EU accession for 11 East Central European countries since 2004. Western financial institutions from small and overbanked markets suddenly had a place to go, with 100,000 million new prospective clients, in addition to opportunities for funding foreign direct investment. I give three distinct examples, then, of how banks with newly found international reach expressed their growing interest in centralized and simplified supervisory and regulatory power, at the expense of national control, and one example of a state, Germany, opting to relinquish control of some of its biggest banks.

Banking Sector Protectionism in Western Europe

Low levels of foreign bank ownership in the eurozone's largest economies and West European banking sector fragmentation along national lines more generally are the consequences of purposeful banking sector protectionism. In this paper, I demonstrate that purposeful banking sector protectionism in fact exists. But I also argue that paradoxically, even as states encouraged banking giants with national identities, those same states were orchestrating their own political marginalization. As banks grew through domestic consolidation and then, more importantly, through international expansion, they became less beholden to home political authorities, less responsive to home political entreaties, and more interested in standardized

regulations and centralized supervision for the purposes of managing their own resources and maximizing profitability.

While East Central Europe (ECE) opened its banking markets to foreign investors in the 1990s and early 2000s in the context of post-communist transition and EU accession (Epstein 2008), western Europe's largest economies protected high levels of domestic control (see figures 1 and 2).

Figure 1.
CEE Countries, New Members 2009

Country	Percentage
Bulgaria	84
Czech Republic	85
Croatia (membership in 2013)	91
Estonia	98
Hungary	81
Latvia	69
Lithuania	91
Poland	72
Romania	84
Slovakia	92
Slovenia	29

Source: EBRD, 2009

Figure 2.
Older EU Member and the U.S. 2009

Country	Percentage
Austria	20
Belgium	50
Cyprus	19
Denmark	20
Finland	65
France	6
Germany	12
Greece	14
Ireland	56
Italy	6
Luxembourg	95
Netherlands	2
Portugal	15
Spain	2
Sweden	0
United Kingdom	15
United States	18

Source: Claessens and Van Horen, 2012

One example of such protectionism comes from Italy. In 2006, Mario Draghi was the relatively new governor of the Italian central bank. His predecessor there, Antonio Fazio, had been forced from office when he was caught on tape trying to thwart the Netherlands' ABN Amro from taking over an Italian bank in 2005, Banca Antonveneta, in favor of an Italian takeover instead by Banco Popolare Italiana.

Fazio was apprehended violating the law, eventually made to resign as a consequence, and the foreign takeover ultimately went through. In response, Draghi's position, which he made clear at the beginning of his tenure, was that the banking sector could expect no similar assistance from him or from anyone else at Banca d'Italia.

But by 2011, however, Draghi's earlier stridency had apparently been overstated. Just months before assuming the ECB presidency, Draghi also found himself trying to protect the assets of a domestic financial institution against foreign control. UniCredit, a major Italian-owned, primarily corporate bank wanted to off-load its asset management division, Pioneer Investments. But instead of allowing it to be sold to French or British interests (who had submitted bids), Draghi urged a merger with Italy's Intesa Sanpaolo Eurizon Capital Fund instead. One of Draghi's stated concerns was the preservation of deep domestic markets for Italy's government debt. And in fact, to the extent any EU member can make the case that political interference with bank mergers and acquisitions is to "ensure sound and prudent management of the credit institution," they are allowed to do so (Grossman and Leblond, 2008: 5).[2] In the end, no deal for Pioneer was agreed—with domestic or foreign buyers—so Pioneer remained with UniCredit. The first episode outlined above is in one sense peculiarly Italian, in so far as Fazio's banking sector protectionism was allegedly as much about personal gain as it was about preserving the Italian market. Draghi's intervention was more representative, though, for the dependence it revealed of the Italian government on local credit institutions—something that proved important for many governments' relationships to their banks through the debt and currency crisis.

[2] The relevant directive is the 2006 Banking Directive, Article 19. On Fazio's resignation, see 'Fazio shamed out of office at last,' *Economist*, 19 December 2005. On Draghi's objections to foreign ownership of Pioneer, see Mike Foster, 'Italian protectionism forces UniCredit to abandon Pioneer sale,' *Financial News* 8 April 2011. Available at: http://www.efinancialnews.com/story/2011-04-08/sale-of-pioneer-by-unicredit-has-been-called-off?ea9c8a2de0ee111045601ab04d673622. Accessed 26 July 2014.

Banking sector protectionism on a more systematic level has been an enduring feature of West European economic governance. In 1999, the *Economist* wrote that in "some countries inside the European Union, financial regulators strive diligently to prevent foreigners from buying local banks" (1999, p. 58). Though by 2010s foreign bank ownership had increased in Western Europe (Goldstein and Véron, 2011: 6) it was also the case that monetary union "encouraged national authorities to protect their systems by limiting the licenses given to foreign banks" (Bini Smaghi, 2013: 82). But it wasn't just via regulation that west Europeans protected their banks. In the eurozone's 3rd and 4th largest economies, Italy and Spain, studies have documented how bank privatization proceeded in parallel with a drive to limit competition (Pérez, 1997; De Cecco, 2009). Politicians, with local bankers, orchestrated domestic bank consolidation and supported international expansion of their banks to create financial institutions that were impervious to foreign takeover by virtue of their size (Guillén and Tschoegl, 2008; Deeg, 2012). The situation in Spain as Europe's single market was being "completed" between 1986 and 1993 was typical:

> Market saturation and the competitive threats that European integration posed were the dual engines of internationalization. Spanish banks were still small relative to their European counterparts, and this played a key role in their strategic thinking. As one Santander executive put it, "We were a takeover target. We needed to grow. We went on a shopping spree" (Guillén and Tschoegl, 2008: 74).[3]

The eurozone's first and second largest economies, Germany and France, also underwent domestic bank consolidation. Then, in addition, they used their thin markets for corporate control to prevent foreign takeovers. Goyer and Valdivielso

[3] In Europe, other banks that followed a strategy of becoming too big to takeover (with some proving more effective than others) included BBV, Argentaria and BCH, all of Spain; ABN AMRO of the Netherlands (Guillén and Tschoegl, 2008: 74); CreditAnstalt-BankAustria, Erste and Raiffeisen of Austria, KBC of Belgium (Epstein, 2014b); and UniCredit and Intesa Sanpaolo of Italy (Deeg, 2012).

del Real (2014) show that France has used deviations from the one share, one vote principle to protect, in addition to direct political intervention in markets. Germany, meanwhile, relied on ownership concentration and friendly acquisitions—even when the latter was extremely costly, as in Commerzbank's takeover of Dresdner Bank just as the financial crisis was getting underway. While in France the state has openly intervened to protect the financial sector, in Germany the state's role was more muted—at least until a series of national bank bail-outs in the context of the U.S. financial crisis. And while Germany's public sector banks have become more subject to market rules through EU regulations, they also stilled enjoyed, after the financial crisis, a series of implicit public subsidies (Howarth and Quaglia, 2014). Even the UK - not a eurozone member - which has relatively high levels of foreign bank ownership because of its status as a financial center, has protected its small and medium sized enterprise (SME) lending segment from foreign ownership by using state directives (Busch, 2009; Macartney, 2014).

West European banking sector protectionism of the kind outlined above suggests the following paradox: that politicians have frequently advocated financial integration and pan-European banking supervision, but have even more assiduously fought it in practice. The paradox is not limited to the EU's biggest economies. A recent study that examined how banking sectors affect bank bail-outs across four European countries revealed the degree of internationalization in West European banking sectors. In no fewer than twelve EU members (all in Western Europe), we find levels of banking sector internationalization that are higher than in the United States—and in multiple cases, significantly higher (Grossman and Woll, 2013: 10, Figure 3).[4] This is true of even relatively small European states, including Greece, Ireland, Austria and Portugal—countries that had historically also maintained a critical mass of domestically-controlled banks.

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[4] 'Internationalization' is measured by the sum of external assets and liabilities as a percentage of GDP. Thus it is indicative not only of international activities but also of the size of the sector relative to the economy.

In spite of national political and regulatory participation in banking sector protectionism, the subsequent phase in European banking—in which sometimes very small financial institutions ultimately developed significant regional or even global reach—shifted banks' interests away from those of their home authorities (see also Spendzharova, 2014). While some highly internationalized banking sectors remained dependent on home governments and taxpayers for extraordinary levels of assistance in the 2008-9 crisis (which amounted to 229.4 per cent of GDP in Ireland's case), there was no correlation between banking sector internationalization and the cost or extent of bank bail-outs (Grossman and Woll, 2013: 10-11). With broad internationalization in banking activity, banks became increasingly rooted in the fortunes of their foreign markets.

Bank Internationalization and Shifting Loyalties

Three examples of the diversification of banks' interests away from domestic markets and into foreign ones are from Erste, Raiffeisen (both of Austria) and UniCredit (of Italy), among the biggest foreign investors in central and east European banks. From the onset of post-communist transition and the completion of the single market in the early 1990s, these banks all developed significant revenue streams abroad. Additional evidence of their new, foreign loyalties emerged in the 2008-9 phase of the financial crisis when there were widespread fears about west European banks "cutting and running" from eastern markets (Epstein, 2014b). Banks "cutting and running" from ECE would have visited incalculable damage on Europe's emerging economies, but also threatened west European state finances and by extension, the euro. Fears of financial instability were compounded by West European domestic lending targets for assisted banks (*Economist*, 2009; IIF, 2009) and West European regulatory demands that banks shore up capital and liquidity positions at home (Bakker and Gulde, 2010).

Unusually, however, the major banks took exception to the urging of a "home bias" in lending during the crisis.[5] In a letter from six major European banks to the European Commission and the then French economy minister, Christine Lagarde, bankers raised the issue of the problem of financing for the real economy in central and eastern Europe, noting that countries such as Austria, Italy, France and Germany had taken measures to "sustain the flow of credit to their respective national economies." More critically, however, they then went on to observe that the "more national dimension of these measures is going to enlarge disparities in credit availability between countries and could be ineffective in sustaining the European Economy as a whole."[6] For banks earning between a third and three quarters of their revenues from foreign markets, it is not surprising that they should resist a national logic in addressing an economic crisis.[7]

A second kind of evidence that shows how bank internationalization has changed multinational banking groups' loyalties and orientations is in the conflicts between banks and home regulators during the crisis. In 2011, the *Financial Times* reported that the three big Austrian banks' exposures in the East amounted to more than Austrian GDP and the credit ratings agencies were threatening a downgrade for Austria (Frey, Buckley and Wagstyl, 2011). In response, the Austrian National Bank and the Austrian Financial Market authority unilaterally imposed higher capital requirements on these banks, as well as limits on loan-to-deposit ratios (110 percent on any new lending in eastern Europe) (Austrian National Bank (OeNB) and FMA, 2011). Because the new regulations were issued without consulting the banks, the

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[5] Normally, foreign banks do cut and run in economic crises (see Roubini and Setser, 2004), in part because of national political pressure to boost home lending (Wade, 2007). The financial crisis of 2008-9 in Europe was an exception, however, as western banks kept their exposure to east European markets (see Epstein, 2014b).

[6] The Letter is dated 27 November 2008 and was signed by the CEOs of the following banks: Erste, Raiffeisen, UniCredit, KBC (of Belgium), Societe Generale (of France) and Intesa SanPaolo (also of Italy). Available at: http://www.ebrd.com/downloads/research/economics/events/Banks_letter.pdf. Accessed 17 October 2013.

[7] Epstein interview with a Raiffeisen banker, 19 April 2012, Vienna.

east European hosts of Austrian banks or even the European Commission, there was plenty of fury to go around—in part because the measures were discriminatory.[8] Not only would Austria's banks be at a competitive disadvantage by being required to fulfill Basel III's capital requirement rules six years ahead of the general deadline, but there was no 110% loan-to-deposit-ratio limit for domestic lending in Austria. Ultimately Austria's regulator backed down, and the measures became unenforceable guidelines rather than firm rules.

Increasing conflict between banks and their home authorities should not be confused with improved relations between foreign banks and their host supervisors, however. Bank-host tensions illustrate the extent to which multinational banking groups stand to gain from a single regulatory standard. With respect to their East European markets, bankers complained that "capital mobility in eastern Europe is dead." By this they meant that host countries either increased or newly enforced liquidity and capital requirements in ways during the crisis that made it very hard for multinational banking groups either to move resources out of those markets, or to make independent decisions about dividend or bonus payments.[9] Another banker noted that it took him "nine years to persuade the Serbian authorities that I should be able to take my own profits out of their country."[10] Strains within Western Europe have also driven banks toward banking union. In the fall of 2011, German regulators ordered UniCredit to stop borrowing from its subsidiary in Germany: "The move angered Italy's central bankers and sent the relations between financial authorities into a nose dive" (Enrich and Galloni, 2011).

To be clear, not all European banks perceive benefits in moving toward a single rule book, harmonized regulation, centralized supervision, and diminished national

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[8] Epstein's interviews with an Erste banker, 19 April 2012; an OeNB official A; an OeNB official B, 18 April 2012.

[9] Epstein's interview with an Erste banker, 19 April 2012, Vienna. See also Spendzharova (2012 and 2014) on the drive to keep national regulatory and supervisory control in countries with very high levels of foreign bank ownership.

[10] Epstein's interview with a Raiffeisen banker, 19 April 2012, Vienna.

discretion—the hallmarks of European Banking Union. In particular, primarily domestically-oriented banks, of which there are many in countries as diverse as Germany, France, Italy and Spain, will not enjoy savings from lower costs of compliance that stem from harmonization and centralization. Moreover, domestically-oriented banks care less than their multinational counterparts about being able to move resources easily within their groups because they do not have cross-national considerations. Finally, domestically-oriented banks might even find themselves at a new competitive disadvantage under European Banking Union because standardized capital and liquidity requirements are inconsistent with their nationally-distinct business models. But, as the foregoing paragraphs have shown, these exclusively domestically-oriented banks are now in the minority in terms of their assets, while the multinational banking groups dominate lobbying organizations.

Multi-national European banks have therefore launched a public relations campaign to reinforce the message that banking union should be achieved as quickly as possible to coincide with critical discussions among European leaders. In early September 2012, just before the European Commission published its proposal on establishing a single bank supervisor, the chief economist of UniCredit argued in the *Financial Times* that

> a common bank supervisor is needed because banks, like most of the corporates they serve, have long ago moved from being national to international businesses, making the existing national supervisors model obsolete.[11]

[11] E. F. Nielsen, "Banking Union is Critical for the Survival of the Eurozone," *Financial Times*, 5 September 2012.

And in mid-November 2012, just as the single supervisor discussions stalled in the council of European finance ministers, ECOFIN, Emilio Botin, the chairman of Banco Santander of Spain, also complained in the *Financial Times* that

> there is no single banking market [and] Santander has met innumerable barriers to its attempts to expand in Europe. Most Latin American countries have been more open to our investment than many eurozone member states […] Banking union is an ambitious, complex and difficult process, both operationally and politically, but we cannot afford to postpone it.[12]

The European Banking Federation (EBF) has also become a firm and consistent supporter of every move towards banking union proposed by the Commission, and advocates the further strengthening of those measures to achieve a high degree of cross-national policy harmonization. This support has been invaluable in allowing the Commission to progress from allowing national initiatives to prevail in the first phase of the crisis (before 2010) to a second phase in which the clear intent is to transfer sovereignty to the supranational level. Nevertheless, I am not arguing that multinational banking groups have gotten everything they wanted from financial regulations after the crisis. The ratcheting up of regulation, especially more robust capital requirements, necessarily cuts into bank profitability. And national discretions over regulatory standards remain (ESRB, 2014: 21). Still, from the multinational banking groups' perspective, more harmonization is preferable to less.

A fourth example of increasing distance between banks and their states comes from Germany. In this instance, however, it is not so much banks leaving states behind as it is a state abdicating responsibility for miscreant financial institutions (Cassell, 2014; Howarth and Quaglia, 2014). As Cassell explains, German Landesbanken faced new marketizing rules from 2000 stemming from a European Court of Justice ruling that limited state support for these large, public sector banks. In an effort to

[12] E. Botin, "Europe Needs Banking Union to Avert Irrelevance," *Financial Times*, 15 November 2012.

increase profitability, these banks invested in US mortgage backed securities, insurance on those instruments, as well as other financial products that did not hold their value. The consequence was over-extension and ultimate bank failure for a number of Landesbanken. Germany initially tried to exclude the Landesbanken from the ECB's new Single Supervisory Mechanism (see Epstein and Rhodes, 2014). Ultimately, however, it was agreed that a 30 billion euro asset threshold would prevail for direct ECB authority (instead of 50 billion), effectively transferring regulatory and supervisory authority of this core part of Germany's economy to the ECB.

Banking nationalism in western Europe, which was meant to allow states to retain control over financial power, has had the actual effect of first creating national banking champions that then became internationalized actors, increasingly market-oriented, with a diminished interest in privileging their home markets over foreign ones. These frayed political ties between banks and states are consistent with recent research showing increasing market pressures on banks, which to diminishing extents can serve the traditional social function of "patient capital" identified in the comparative political economy and Varieties of Capitalism literature (on the first point, see Hardie *et al*, 2013; on the latter, see Zysman 1983; Hall and Soskice 2001). With bank internationalization, the interests of key actors in the debate over banking union have merged with those of Europe's supranational institutions. With at least one potential veto-player in banking union – the large transnational banks - effectively sidelined, then, the European Commission and the ECB have had more room to maneuver in favor of deeper integration.

Alternative Explanations of Multinational Banking Groups' Support for EBU

The first objection to my argument might be that I overstate the scale of banks' support for "more Europe" in the realm of financial governance. Indeed, there could

be more variation in bank-state ties than my argument currently concedes, and it is perhaps this variation in the rupture (or the absence of it, as the case may be) that should be explained. For example, Jabko and Massoc (2012) have shown the ways in which French banks and the political authorities weather the crisis together in relative harmony. Grossman and Woll (2013) and Woll (2014) also focus on variation. A counter-example to the French case would seem to be Austria, however, where regulators continue to try to exercise increasingly intrusive controls on their banks, given their ongoing and large exposures to East Central Europe. One way to begin to address this question might be to examine the shift in the French Banking Federation's position in 2012. According to Nicolas Véron, the FBF started out expressing concern about EBU, but then found unity in supporting EBU by the second half of 2012.

A second objection to my argument would be that bank-state ties were never as mutually supportive as I've portrayed here. It is possible, even through the period of domestic consolidation, banking sector protectionism, and outward expansion, that national supervisory and regulatory authorities were trying to control banks in ways that allowed them to balance the risks banks were taking against the rewards they were reaping. Therefore, the transition to a severing of bank-state ties might not be as clear-cut or abrupt as I have presented. While Deeg (2012), Perez (1997), and Jabko and Massoc (2012) suggest the relationships have in fact traditionally been cozy, Macartney (2014) and also James (2014) show much more conflict in the UK. The explanation for variation here may be in the history of banks' international activities—with the UK having a longer and deeper record of internationally active banks, and thus more distant political ties between banks and the state.

Conclusion

The transformation of bank-state ties in Western Europe and the emergence of banking union represent very significant shifts in political and economic governance.

As I have argued elsewhere (Epstein, 2014a and Epstein and Rhodes, 2014) one logical consequence of the supranationalization of supervisory and regulatory authority in the eurozone will be much higher levels of foreign bank ownership, at least in some states. Significantly less economic policy autonomy will ensue. The reason for this is that in the decades preceding the 2008 crisis (and even during the crisis itself, see especially Donnelly, 2014) national supervisory and regulatory authorities could decide whether to wind a failing bank down, provide it with state support, merge it with another institution or sell it to foreign investors. Since West Europeans were intent on banking nationalism, winding down, support and consolidation almost always precluded the foreign investment option. With the ECB now making such decisions instead (albeit in cooperation with national authorities) it is less likely that such domestically sensitive but "inefficient" solutions will prevail. In other words, the ECB is much more likely than national authorities to impose market-elevating strategies, no matter the consequences for domestic policy autonomy—or prestige. Danièle Nouy, Chairwoman of the Single Supervisory Mechanism running the Asset Quality Review, has already said as much (*Financial Times*, 10 February 2014: 1 and 3).

It is paradoxical then, that the same multinational banking groups that since at least 2012 have been arguing for the supranationalization of oversight may be the ones to ultimately suffer the most severe consequences—the end of national regulatory forbearance and perhaps even death at the hand of the ECB. But like banking nationalism itself, time inconsistency may be playing a role. It will only be at some future point when centralized supervision and mutualized resolution compel weak banks out of the market, while forcing others into cross-border mergers and takeovers that will increase foreign bank ownership. Until then, multinational banking groups can continue to hope it won't be their number that's called.

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