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Banking Union and banking nationalism – Explaining opt-out choices of Hungary, Poland and the Czech Republic

Katalin Mérő [a,*], Dora Piroska [b]

[a] *Department of Finance, Budapest Business School, University of Applied Sciences, Budapest, Hungary*
[b] *Department of Economic Policy, Corvinus University of Budapest, Hungary*

Abstract

The purpose of this study is to understand Hungary, the Czech Republic and Poland's opt out position from the Banking Union (BU). The Banking Union is compulsory for Eurozone member states and optional for non-Eurozone member states. From the Central and Eastern European (CEE) region only Romania and Bulgaria decided to join. First, we attempt to explain this fact based on structural characteristics of the CEE banking sectors, but we find no substantial difference between the opt-in and opt-out countries' banking sectors. Second, we look at the role of state capacity in maintaining a stable banking sector, and find that state capacity is a necessary condition for opting out. Finally, using Hungary as a case study, and the Czech Republic and Poland as further examples, we argue that these countries opted out because their governments' policy preference of banking nationalism conflicts with the BU's ideals.
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1. Introduction

Banking Union (BU) is possibly the greatest single step towards tighter financial integration taken by the European Union (EU) member states since the introduction of the Euro. Based on a single rule book for all 28 member states, it establishes a single supervisory mechanism (SSM) located at the European Central Bank (ECB) and it has the promise of creating a level playing field for all major banks in Europe. The Banking Union project also encompasses a single resolution mechanism (SRM) that has the potential to disentangle the interdependence among banks and member states. Once the BU is fully functional – including the now postponed single deposit insurance system – it is hoped that there will be a more stable and secure banking system in Europe.

There is an ongoing debate on the magnitude of change brought about by Banking Union. Some contend that the creation of a common supervisory mechanism amounts to a huge loss of national control over banks (Epstein & Rhodes, 2014; Howarth & Quaglia, 2014), others however, question the magnitude of change. They argue that major change was compromised and national regulators are still in control (Donnelly, 2014; McPhilemy, 2014). We agree with De Rynck (2016) who argues that "centralising supervision and harmonising standards are a rupture with the past and introduce a new policy model" (p. 120). However, the change will not affect all member states equally. Joining the

* Corresponding author.
E-mail address: mero.katalin@uni-bge.hu (K. Mérő).

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Banking Union is only compulsory for Eurozone member states. Non-Eurozone EU members may decide to join the project or not. UK and Sweden opted out saying that the BU gives limited rights to non-Eurozone states. However, Denmark also outside the Eurozone has indicated an interest in joining the club. A few Central and Eastern European (CEE) countries with banking sectors largely dominated by Western European mother banks have taken a cautious wait-and-see approach, while others decided to join in. In this paper, we are interested in why three CEE states decided to stay outside from this potentially beneficial arrangement?

CEE non-Eurozone countries' mixed position on the BU is puzzling for at least two reasons. First, their banking sectors share several similar structural characteristics, yet their positions vis-à-vis the BU differ sharply. While Poland, the Czech Republic, Hungary and Croatia have taken a wait-and-see approach in 2014, Bulgaria and Romania declared intentions to join. Second, because these countries' banking sectors are extremely open to foreign investors, two influential Bruegel studies one in 2013 (Darvas & Wolff, 2013) and one in 2016 (Hüttle & Schoenmaker, 2016) argued that joining the BU would be beneficial for them because it could improve the credibility of national prudential arrangements. Yet, three CEE countries prefer local control over their banking sectors to ECB provided stability.

CEE policy makers' own account for the dissent was presented and analysed by the International Monetary Fund (IMF) in 2015. CEE decision makers were found to be more concerned about potential downsides of early opt-in to the BU than benefits of potential upsides. Among the downsides they emphasised those features of the BU which weakens the supervisory power of the state. They extensively criticised the current set up of the SSM for being overly complicated, for not granting the same fiscal safety guard to non-Eurozone member states and for being too expensive for what it provides (IMF, 2015, p. 38). In other words, Hungary, the Czech Republic, Poland and Croatia communicated that their reason for opting out is that they believe they can provide for the same level of stability of their banking sector as the ECB, but cheaper.

We argue that these countries opt out mainly because governments in these countries want to stay in control of their own banking sectors. We show how banking nationalism dominates policy making in CEE and that this policy choice explains their preference for keeping a distance from BU. We argue that Bulgaria and Romania opt-in because they want to compensate for the low level of state capacity to maintain financial stability by delegating banking supervision to a supranational entity. In this study, we only consider opt-out positions taken by Hungary, the Czech Republic and Poland and exclude Croatia. Even though Croatia took a similar wait-and-see approach, because it only joined the EU in 2013, we cannot exclude that it made the same decision for different reasons.

In the course of the research we conducted semi-structured interviews with officials from the Hungarian central bank, experts from Hungary and Poland and bankers from Hungary, Poland and the Czech Republic in 2015. We consulted policy briefs, policy documents, memos, and other primary sources. Our methodology is process tracing with a special focus on policy goals, policy instruments and orders of policy change, the components of policy design as defined by Bakir and Woo (2016) in the introduction of this issue. The paper is organised as follows. First, we overview alternative explanations to the dissent of CEE countries. Most of these explanations take distinct structural characteristics of banking sectors and derive the opting in and opting out choices from these characteristics. We show that these attempts not only fail to logically link different structural attributes to the chosen policy lines, but that there are no underlying structural similarities in the opt-in countries that would set them apart. As potential alternative explanation we analyse state capacity to maintain banking sector's stability. It is followed by an outline of banking nationalism, a policy choice that legitimates controversial policies that could not be pursued inside the Banking Union. Next, we present a case study of Hungary. Finally, we detail examples of banking nationalism from Poland and the Czech Republic. The last part concludes.

2. A failed attempt: structuralist frameworks

Explaining positions taken by various countries towards international rule harmonisation based on differences in their domestic structural characteristics has a long established tradition within IPE (Frieden, 1991; Frieden & Rogowski, 1996; Frieden, 2002; Garett 1992). Spendzharova (2014) based her analysis on this literature. She argued that EU countries where foreign ownership in the banking sector is high and domestic banks' internationalisation is low would prefer to preserve some national regulatory autonomy. In her analysis, all CEE countries have fallen into this category.

There are several problems with this argument, however. First, as of 2016 we know that Romania and Bulgaria opted in the BU, while Poland, the Czech Republic and Hungary registered a wait-and-see approach. In the two selected structural categories, Romania and Bulgaria are in the same category as Poland and the Czech Republic so they should

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