

EU BANKING UNION. A HYMN TO IMPERFECTION

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Telos: When the agreement was reached on the EU Banking Union in late 2013, Italy’s then-Minister of the Economy claimed it was a “historic achievement”. Three years later, the DG of the Bank of Italy said that the Banking Union had “increased uncertainty in the banking sector in Europe”. In your view, has the Banking Union helped restore confidence in the financial sector or has it exasperated the difficulties of struggling banking systems in peripheral Member States like Italy?

Nicolas Véron: The Banking Union has greatly helped to bring back confidence into the Euro-area banking sector, and to gradually address the remaining pockets of financial fragility – as evidenced by the recent announcements about Banca Popolare di Vicenza, Monte dei Paschi di Siena, and Veneto Banca. Even though action on these banks has been delayed for too long in my opinion, it is highly likely that it would have been delayed even further in the absence of the single supervisory mechanism. To be sure, the Banking Union is imperfect. It is only a partial union, with a strong supervisory system led by the European Central Bank, a slightly less strong resolution system centered on the Single Resolution Board, and a number of missing pieces – including, but not limited to, a European deposit insurance scheme, harmonised regimes for bank insolvency proceedings, and regulatory limits on banks’ exposures to individual euro-area sovereigns in order to further weaken the bank-sovereign vicious circle that almost destroyed the Euro back in 2011-12. But even in its current unfinished status, the Banking Union has made the Euro area much more resilient. It is a great success for Euro area policy. There has been considerable recent progress in the two Member States where banking sector problems have taken longest to address, namely Portugal and Italy. In my assessment, by the end of this year the banking sector in these two countries will no longer be considered a “zombie banking system”, even though there may remain problems among some of the smaller Italian banks, which are not directly supervised by the ECB. Overall, this will have positive impact on economic growth that will start being visible from 2018, echoing the pick-up of growth in Spain following the extensive clean up of that country’s banking system back in 2012. Of course we will never know for sure what would have happened in the absence of Banking Union, but I for one have no doubt that the outcomes would have been less favorable for every single Euro area Member State, and of course for the Euro area as a whole.

NPLs are still a major issue for the Italian banking system. How effectively do you think the Italian Government has dealt with this issue and how would you explain the reluctance of foreign operators in investing in the Atlante fund?

Maybe foreign investors are keener to invest directly into Italian assets rather than through a fund whose creation has been widely described in the media as politically driven. There is a clear acceleration of purchases of Italian NPLs by specialised investors since the start of 2017, which to me illustrates that there is a functioning market for such assets. The experience from Italy and elsewhere is that if a bank is adequately capitalised, it can deal with NPLs, either by selling them or securitising them or working them out internally. The problem is not so much aggregate numbers of NPLs on a country-wide basis, but the fact that some banks have been severely undercapitalised and reluctant to acknowledge their losses as some assets decreased in economic value. The ECB as a supervisor could have forced quicker recognition of these losses, but better late than never.

In your view, will Brexit create a more favourable context to economic and political integration between the remaining Member States or not?

At the time of the vote a year ago, there was uncertainty about this, but now it is evident that the choice of the British voters is not being echoed in other Member States. To the contrary, perceptions of the European Union and of European integration have become more positive in the EU27 in the last 12 months. To be sure, the Union is facing many challenges, and there is no case for feeling complacent given lingering economic and social difficulties in several Member States, including Italy. But its resilience in the face of the shock of the Brexit vote has been remarkable, including in terms of preparing the bilateral negotiation with the United Kingdom. As during the euro area crisis, it turns out that for all its dysfunction, EU integration is generally viewed as better than the alternatives when it comes to making a serious choice. From this perspective, I view the UK situation as rather unique and not a template for other countries. Only time will tell for sure, of course.

In 2012, it was a widespread view that the election of a Socialist President in France would to some extent balance Merkel’s conservative approach and pave the way to more growth-oriented policies EU-wide. The actual influence exerted by President Hollande was probably much smaller than most European Socialists had expected. Is there any basis to say that the election of President Macron can bring about substantial change?

One of many lessons of this year’s electoral cycle in France is that the left-right divide is no longer the dominant lens through

which to analyse political divisions in Europe. Attitudes towards defining themes such as globalisation, migration, social change and European integration are less shaped by that divide than they were in the past. I believe the election of President Macron has opened a window of opportunity for reform at the EU level, especially but not only in terms of the functioning of the Euro area. While we are not yet ready politically for a comprehensive fiscal union, it seems to me that a lot of progress can be made especially as regards the policy framework for financial services, with a balance of more risk-sharing, for example with a single deposit insurance scheme, and more market discipline, including the introduction of well-calibrated sovereign exposure limits with appropriate transitional arrangements. I for one am cautiously optimistic that progress will be made in this regard, between the German election in September and the next European parliamentary election in 2019. There are multiple obstacles of course, but in my opinion, none of them is insurmountable. I am also optimistic that a more benign economic climate will gradually reassure citizens, in Italy and elsewhere that we are all better off in a united Europe than we would be on a fragmented continent in which each country would be antagonising its neighbours.

Mariella Palazzolo

Editorial

The noun *resilience* and the adjective *resilient* recur in two crucial passages of our interview with French economist Nicolas Véron: in both cases he uses them to describe the rather unexpected and unforeseen ability of EU institutions and the continental integration process to resist and adapt, initially to turbulence in the financial markets and then to the great popular revolt against globalisation and the elite that benefit from it (excuse us for not abusing the usual term – populism – and for calling a spade a spade). It's not easy to find the Italian equivalent of resilience, but the concept is crystal-clear: despite all past events, the Euro and the European Union are still around.

The Banking Union is perhaps emblematic not only of this desire to resist to the bitter end, but also of the risks and limits involved. Most of the denigrators of the single currency believed that the banking system in peripheral countries was the weak link which would sooner or later be broken by macroeconomic imbalances in the Eurozone. The effects of the austerity measures – compression of income and a sharp rise in insolvent companies – seemed set to push the banks in peripheral countries to the edge of insolvency and re-expose them to financial speculation, leaving their ruling class no other choice but to return to their respective national currencies.

Nothing of the sort has come to pass: instead a few years after these predictions Mario Draghi can say that “the worst of the Eurozone crisis is over” and that banking and financial integration is the key to European stability. So, is everything hunky-dory? Véron doesn't neglect to emphasise the dangerous imperfections in the Banking Union, opportunely defined by the more sceptical as a lame tripod: a single efficient supervision system led by the ECB, a single resolution mechanism that still has to be proven successful, and a mechanism of mutualisation of risk that Member States have postponed till conditions improve.

Even if this approach has boosted the confidence of financial operators thanks to the introduction of greater transparency reporting, Véron believes that despite the statements of principles it cannot break the vicious circle between national banking systems and sovereign debt. We would add that both the structural adjustment effort and the correction of the banking system have been designed basing not on the integration and coordination of national policies, but rather on the imposition of harmonised rules with no risk sharing: this deficiency is anything but neutral *vis-à-vis* the links between European economies, not only because countries that are already in difficulty bear the greater brunt, but also because in the end it exasperates rather than reduces the asymmetries in the Eurozone.

In short, the European Union and the Euro are still around, but with the same old problems. What are the consequences? We'll cite just one.

Macroeconomic governance based on rules set and enforced by supranational institutions can only reduce the already slim margin of political discretion in choices affecting production, income and savings: we believe that it's no accident that the political forces still loyal to this economic integration model increasingly tend to converge towards a “single party” in which traditional identities and membership inevitably fade (see the entry: Macron). Entrenched behind the walls of their little citadel and protected by the different electoral systems that distort the popular vote, former Socialists and former Conservatives across half of Europe are celebrating the demise of the distinction between left and right; either they can't see or can't admit that the distinction is only meaningful, when sovereign Parliaments and Governments can choose between alternative policy options, in other words if they can use discretion.

In the meantime shocked commentators report on the recent elections in the United Kingdom, elections that testify to the revival of the British Left, rising out of the ashes of the old, but now outdated conflict between those who are for or against Europe. This is perhaps a sign that sovereignty and discretionary economic policies are crucial conditions to reproduce democratic dialectics, and hence the distinction between left and right. It's up to you to decide whether or not this too is a *vicious* circle.

This issue of Primo Piano Scala *c*, laced with the *salty* taste of the economic politics of recent years – and anything but seaside reading – is our way of wishing readers, Happy Holidays!

Marco Sorsini

Nicolas Véron is a French economist. He co-founded the think-tank **Bruegel** in Brussels in 2002-05, joined the **Peterson Institute for International Economics** (Washington DC) in 2009, and is currently employed on equal terms by both organisations. His research is primarily about financial systems and financial services policy, on which he has published widely since 2002. He has been a witness at numerous parliamentary hearings in the US Senate, European Parliament, and in several



European Member States, Italy included. A financial policy expert for the European Commission and Court of Auditors and a consultant to the International Monetary Fund and World Bank, Véron is also an independent board member of the global derivatives trade repository arm of DTCC, a financial infrastructure company that operates on a non-profit basis. A graduate of France's École Polytechnique and École des Mines, his earlier experience includes senior positions in the French government (just to mention one he was the corporate advisor to Labor Minister Martine Aubry in 1997–2000), and private sector in the 1990s and early 2000s (Chief Financial Officer of MultiMania/Lycos France, a publicly listed French Internet company). In September 2012, Bloomberg Markets included Véron in its yearly global “50 Most Influential” list, that features 50 individuals with ‘*the ability to move markets or shape ideas and policies*’. Bloomberg Markets made reference to his early advocacy of European Banking Union. Read his personal *blog*, we strongly advise it! Véron describes himself as a history freak, and we know his favourite food. But *hush*, that's a secret.

Mariella Palazzolo