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CEPS Commentary

Thinking ahead for Europe

CENTRE FOR EUROPEAN POLICY STUDIES

Institution-Building in Action

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The response of the EU institutions to the crisis has so far been rather weak. The key bank rescue packages were decided at the national level with only minimal coordination from Brussels. Their implementation has been spotty and most rescue packages were effectively rubber-stamped (under great political pressure) by the Commission's services, which are supposed to protect the internal market from distortionary state aid.

Following publication of the de Larosière report, however, the EU machinery has swung into action and is now delivering concrete proposals for the much-needed new European architecture for financial supervision. The Commission's proposals of May, endorsed by the European Council of June, are not revolutionary in the sense of creating new powers for supervision at the EU level, not even for the large banks of clear systemic importance. However, what is now on the table *is* potentially of immense importance as it is the EU that will create a number of new institutions and one should not underestimate the importance of this development. The history of the EU has shown repeatedly how the existence of strong institutions can fundamentally alter the distribution of power and thus affect policy.

Let us consider what is being proposed.

On micro supervision: Three new agencies will be set up, which will look after the stability of banks, securities markets and the insurance sector. Each agency will have its own staff and an independent director, supposedly chosen on the basis of open competition. It is true that these agencies will not be involved in day-to-day supervision nor have the power to impose their will on member states (except if the latter disagree among themselves), and they will only be poorly coordinated among themselves. But their task will be to create a single rule book, which is a key first step towards levelling the field in the financial sector and reducing regulatory competition in Europe. The decision-making bodies of the three agencies will be composed only of representatives of national interests, namely the heads of the national supervisory agencies, but decisions will be taken on the basis of qualified majority voting (QMV), which means in practice that it takes a coalition of at least three member states to block a decision. This should be sufficient to ensure rapid progress on this front since the raison d'être of the presidents and their staff will be to advance this agenda.

The trend towards an increasing influence of these three European agencies will of course be strengthened by their power to impose binding arbitration in case of a major disagreement among (national) supervisors. Since such disagreements are more likely to arise during times of tension or crisis, this implies that when the next crisis comes, these new agencies could play a

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pivotal role. Indeed the Council Conclusions of 18-19 June say: “The European Council invites the Commission to make concrete proposals for how the European System of Financial Supervisors could play a strong coordinating role among supervisors in crisis situations ….” (followed by a long series of caveats).

The opposition of the UK has been sidelined with the typical European method of a vague, but important sounding reassurance: “Recognizing the potential or contingent liabilities that may be involved for Member States, the European Council stresses that decisions taken by the European Supervisory Authorities should not impinge in any way on the fiscal responsibilities of Member States.”

This statement amounts to not only a truism but, at the same time, something of a deception in that the EU takes decisions all the time that have an impact on expenditure. (The EU sets rules on permissible VAT rates, for example, and even humble decisions on road safety standards can imply higher expenditure.)

The key weakness in the set-up whose outline is now gradually emerging is the coordination among the three ‘pillars’, i.e. the three authorities within the European System of Financial Supervision (ESFS), which exercises little real authority. However, each of the three pillars is likely to evolve over time into a strong authority.

Macro-prudential supervision. The European Systemic Risk Council (ESRC) will not have any real power and since it will have two representatives per member country, it will resemble more a mini parliament (with about 60-70 around the table) rather than an effective guardian of financial stability. However, the Commission’s proposal foresees a “steering committee” composed of eight members, two of whom would be from the ECB and a further three would be the heads of the three new EU supervisory agencies mentioned above. This smaller group, dominated by persons representing EU, and not national, points of view, will in all likelihood dominate the ESRC given that it will in most cases have all the necessary information at its disposal and a dedicated staff to carry out the necessary supporting analysis. Moreover, the full ESRC is supposed to take decisions by simple majority on a one man (= one member country) one vote principle.

All of this package could be decided on the basis of QMV, which means that from this point onwards no single member country can stop the entire process. Two key elements need to be preserved at all cost: 1) the combination of a single rule book with powers of binding arbitration and 2) the combination of an independent staff with majority voting.