GEOPOLITICAL ECONOMY AND COMPETING CAPITALIST BLOCS IN THE EU POST-CRISIS FINANCIAL REGULATION: TWO CASES FROM THE REFORM OF THE BANKING SECTOR

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Abstract: In this contribution I will test the geopolitical-economic approach as formulated by Desai (2013) in the analysis of the EU’s regulatory response to the financial crisis by focusing on two relevant pieces of legislation in the post-crisis reform of banking governance: the adaptation of the Basel III agreement to the package on Capital requirements, composed of a regulation and a directive, and the ongoing legislative process concerning the structural reform of banks. As I try to show, the concept of “competing geopolitical bloc” derived from the work of Desai, but even detectable in some recent Neo-Gramscian literature, is useful in analysing the shortcomings of the European regulatory response to the 2007/8 economic and financial crisis.

Key words: geopolitical economy; financial crisis; banking regulation; CRD IV; Bank Structural Reform

In this paper I show how a geopolitical-economic approach can account for the shortcomings of the European response to the 2007/8 economic and financial crisis. Specifically, it helps us to focus on the competing capitalist blocs of states and social classes underlying the uneven development of EU economic integration. I propose to apply this approach to the analysis of two crucial reforms in the EU banking sector: the translation of the Basel III standards in the post-crisis reform package on capital and liquidity requirements—the Capital Requirements Regulation and Directive IV (CRR/CRD IV)—and the ongoing legislative process...
on Bank Structural Reform. Our analysis of these two important elements of the post-crisis financial reform agenda permits us to assess the usefulness of a geopolitical-economic understanding of EU politics in post-crisis financial regulation.

The paper will be divided into two parts. In the first part I will contend that the concept of the uneven and combined dynamic of the capitalist system, as reformulated in geopolitical-economic theory (Desai 2013), allows scholars to develop an adequate analysis of EU economic governance as a regional field of struggle among competing capitalisms supported by different class and national economic constituencies, mirrored in the asymmetrical power relationships among member states. The operation of capitalist classes transnationally here emerges not as an instance of a transnational capitalist class (TCC) but rather as concrete political coalitions among major and minor EU governments, each advocating a market regulatory approach suited to the expansion of the fraction of capital they represent.

In the second part I will test the above theoretical scheme through an analysis of the two elements of the EU’s reform of banking governance mentioned above: (1) the issues concerning the minimum capital requirements and the introduction of a non-risk-based leverage ratio to ensure the resilience and stability of financial institutions in stress situations, and (2) the separation of trading-related activities from the deposit-taking function in the universal banks contained in the proposal for Bank Structural Reform still under debate in the European Parliament and the Council. As I will argue, an analysis of the interests and outcomes at work in these reform processes shows the importance of a theoretical focus on the conflicts and changes among regional coalitions of leading states and influential domestic/transnational capitalist groups. In particular, we will see how competition between the UK-led and the German–French-led blocs, both reflecting different capitalist projects embedded in different social constellations of domestic and transnational economic interests, could adequately account for the watering down of the most advanced Basel III standards in the final CRR/CRD IV, as well as for the current terms of the debate in the case of the Bank Structural Reform.

A Geopolitical-Economic Approach for the EU Economic Governance

In this section my aim is to show how a geopolitical-economic approach can be extended to include the Neo-Gramscian analysis of contemporary capitalism while overcoming the theoretical biases in it which stem from its linkage to the world system tradition. The analysis of EU financial and economic governance offers a good test for such a theoretical encounter, fostering a renewed Marxian understanding of the primary economic role of states and of inter-state relations in terms of competing capitalisms in an increasingly multipolar world.
Against a “cosmopolitan” Marxism conceptualizing capitalism as a globally unified whole, as do the approaches based on the concepts of Globalization and Empire, geopolitical economy brings the theoretical focus back on the role of nation-states as primary agencies of capitalist accumulation and expansion. The capitalist system and its structural contradictions are recast in the “uneven and combined development” of competing state-capitalist patterns at a world level (Desai 2010a, 2010b, 2012, 2013). Relying on a deep reappraisal of the Marxist analysis of the grounding role of the state, as well as on evidence from historical enquiries, Desai showed the ideological nature of the approaches based on the assumption of an accomplished totality and coherence of the international capitalist regime which is unable to account for the complexity of an increasingly multipolar system. So the roots of the cosmopolitan narratives, as well as of the different strands of Hegemonic Stability Theory, upon which most of the neo-Marxist debate on contemporary capitalism has been based, are exposed in the ideological frameworks for the various and never-achieved world leadership plans of the US (Desai 2013). The alternative geopolitical-economic approach fits well with a Neo-Gramscian conceptualization of international politics and also contributes to freeing its core concepts of hegemony and historic bloc from any “cosmopolitan” world system assumption. The latter underlies the theoretical framework of founding Neo-Gramscian works in international relations (IRs). In Production, Power and World Order, Cox (1987) fundamentally shares a basic assumption of the world system theory in considering the core function of the hegemonic state in shaping the international system according to the unified global expansion of capitalism model. Against the economistic and structuralist models, Cox and his followers introduced to this theoretical framework the Gramscian-inspired concepts of hegemony and “historic bloc” to grasp the inner combination between the outward expansion of a given state’s capitalism and the institutionalization of a political and societal consensus in subordinated states as constitutive components of a world hegemony. Such a premise implicitly confines the historical stages of world capitalist development to periods dominated by successive hegemonic states. Such confinement leaves little room for a historical analysis of the dialectic of uneven and combined development between state-organised national capitalisms in shaping the world disorder in which capitalism is embedded (Budd 2013). Moreover, by treating the societal transnational consensus, expressed in a “historic bloc,” as a requirement of world hegemony, these scholars illegitimately postulated the necessary or recurrent role of international consensus building as a condition for the same capitalist expansion. In this way the core–periphery distinction of world system theory is translated into the opposition between hegemony in the core system, i.e., the hegemon and its allied states, and passive revolution in peripheral states, characterized as the affirmation of a capitalist mode of
production without societal consensus. Such a schematic representation neglects the fundamental intertwining of progressive and conservative tendencies in the class compromises under nationally and internationally oriented capitalist hegemonies. Indeed, the Gramscian concept of “passive revolution” allows us to better conceptualize a grounding feature of all the capitalist hegemonies: i.e., the top-down gradualist and “molecular” absorption of relevant societal demands needed to forge the minimum consensus required to reproduce the system of class exploitation (see Montalbano 2015; for a similar view see Desai 1994, 62–63).

Apart from these theoretical biases, the first generation of Neo-Gramscians laid the grounds for an insightful understanding of historic blocs as complexes of states and social classes and primary agencies in international politics. In that same tradition, some scholars have focused more deeply on the alliances and conflicts between state powers and capitalist groups, both domestically and transnationally oriented (Overbeek 2000; van der Pijl 1998; Arrighi 2010), as constitutive of the same-class formations. Yet, most of this literature implicitly treated the emergence of an Atlantic transnational capitalist class TCC as a “proxy” of the declining US hegemony in building up a new “neoliberal” consensus against a post-war Keynesian model in crisis. In the vacuum created by the inability of the allegedly hegemonic state to provide “public goods” for orderly world capitalist development, the agency of the TTC, as bearers of the most internationalized productive and financial capital circuits, has been assigned the role of assuring a novel form of hegemonic consensus among the leading domestic capital fractions and political élites, so that a new unified and orderly capitalist expansion under the label of Neoliberalism could take place (Gill 2008, chap. 7). Indeed such a conceptualization of the TCC has been a key feature of the neo-Marxist theses on Globalization which assume, theoretically (and politically), a demise of the role of states, as well as of class conflicts at a domestic level (Robinson 2004). According to the latter scholarly strand, the TCC is the historical result not of an inherently conflictual process of class formation in contemporary capitalism, but rather a smooth incremental process or an already accomplished fact, constituting the engine of a global capitalism definitively overcoming interstate conflicts. Against this position, some scholars representing the so-called Neo-Gramscian “Amsterdam school” reframed the relationships between the domestic social classes and the more transnationalised fractions of capital in terms of conflicting “hegemonic projects” (van Apeldoorn 2004). Such an approach emphasizes struggles and compromises among competing blocs of states and classes even as it assumes that leading domestic and/or transnational interests define different hegemonic “attempts” to organise a unified world capitalist model. The latter Neo-Gramscian approach fits with a geopolitical-economic framework in that both focus on conflicting capitalisms as constitutive of the world multipolar system and on the primary agencies of
states in the international politics. But if the Neo-Gramscians gave more attention to the blocs of domestic and transnational class interests, paying less attention to the specific role of states in the formation of competing “hegemonic projects,” a geopolitical-economic approach could better reframe that same notion of historic bloc in terms of competing blocs of states/classes. In this view, such blocs are the proper object of analysis and the relevant actors at the international level. Therefore, against assumptions about an already unitary and coherent transnational class representative of capitalist globalization, geopolitical economy can see various transnational hegemonic projects as those of regional historical blocs. The transnational dimension does not exclude the domestic one but entails it. Domestic class fractions may be more or less embedded in the transnational circuits of capital accumulation, but all are rooted in political and societal domestic contexts in which they build up the necessary hegemonic conditions of any outward expansion.

The EU polity represents a good candidate to test the geopolitical-economic approach. Beyond the mainstream intergovernmental and neo-functional grand theorizing, a focus on the regional blocs of state/classes takes into account both recurrent and changing patterns of transnational coalition building among leading member states and influential class agencies in shaping EU economic integration. Besides its different epistemological grounds, geopolitical economy differs from liberal intergovernmentalism in its class analysis of the states’ interest formation, grounded on the antagonism and mediations between capital and labour (the most rigorous theoretization being that of Moravcsik 1998), and its focus on the transnational patterns of state/class alliances. Viewed thus, the more transnationalised groups are better able to construct cross-border alliances with foreign member states to win their support in influencing EU policy making. Similarly, the proposed approach differs from the varieties of capitalism literature in focusing on the social conflicts and compromises sustaining and changing the institutional patterns of a national capitalist regime and exploring the contingent and contradictory processes of states’ interest formation against the rationalist assumptions of the latter approach (see Hall and Soskice 2001 for a representative work). Differently from neo-functionalism and other approaches stressing the role of supranational and transnational actors, geopolitical economy treats nation states as the fundamental decision-makers in the EU system, so that both the relevant economic and institutional actors need to build a consensus with the leading EU member states in order to attain the desired goals (see, for example, Sandholtz and Stone Sweet 1998).

According to the theoretical approach here devised, the driving forces of EU integration lie in the contingent encounters between the positions of the economically leading member states (rooted in domestic class struggles and compromises) and those of the more advanced and transnationalised capitalist groups. The
contingent and changing contours of coalitions between and among these make European integration a complex and often contradictory process, mirroring the member states’ leading social forces and strategies in the world competition of capitals, while the gradual institutionalization of a supranational polity prompts the fixation of asymmetrical power relationships, creating an uneven playing field among EU state actors. The case of post-crisis financial governance, as we will see, offers an example of this “uneven and combined” framework characterizing EU economic integration.

Financial Regulation and “Geopolitical-Economic Blocs”

The EU’s pre-crisis financial regulatory framework has generally been depicted in the literature as dominated by a neoliberal model of governance, promoted by Wall Street and London, based on a light-touch and market-based regulation of the financial markets mirroring the US-led financialization of the world economy (as relevant examples, see Bieling 2003; Posner and Véron 2010), gradually overcoming Europe’s originally more production-focused financial system in a “battle of the systems” (Story and Walter 1997). These studies typically underestimate the extent to which the emerging features of the EU’s financial sector are responses to international competition, as well as to the changing features of national industrial systems. The label neoliberalism functions much as Globalization in fostering the appearance of a coherent and uniform model of financial capitalism successfully imposed by the US on domestic economies of subordinated states. A closer look at the empirical literature on EU financial governance, however, shows how the building up of a single market of financial services has taken place not as an entirely US- and UK-led process against the resistance and defensive positions of other EU member states but as a complex set of compromises among national financial market models competing within the EU framework for a favorable position in the regional and international markets (Quaglia 2010; Moloney 2012; Ferran 2012). Yet, neither the most recent pluralistic approaches (for a review see Helleiner and Pagliari 2009), nor the state/financial industry nexus conceptualized by the “competition politics” (Mügge 2006), could adequately account for societal struggles and political compromises involving both capital and labour, as well as corporate and non-corporate diffuse interests, which underlie the formation of the governments’ positions. As a result, societal cleavages and conflicts underlying the states’ varying interests in financial regulation and the relevance of regional coalitions involving both states and transnational classes receive little attention. The latter point has been scrutinized by a growing literature on the emergence of a transnational private governance as the basis of the “market-based approach” of the pre-crisis global financial architecture (Nölke and Graz 2007; Underhill and Zhang...
2008; Nölke and Perry 2008), taking place “in the shadow of the state” (Helleiner and Pagliari 2010, 48; see also Abdelal 2007). A similar state- and class-based approach has been proposed by Macartney (2009, 2011) in his original “varieties of neoliberalism” approach to economic and financial governance. Though it provides a crucial basis for an encounter between the Gramscian and the geopolitical-economic strands, the latter fundamentally shares a “cosmopolitan” bias in describing each competing capitalist model as a “domestic variety” of an overwhelming neoliberal framework. Even in this way neo-liberalism, like the category of Globalization, becomes too large a label which risks overshadowing the inner specificity of the conflicting blocs of interests or, alternatively, excessively blurring the same peculiar features of the US and UK Neoliberalisms, which are implicitly treated as the “pure form” of neoliberalism (Macartney 2009, 458–59). Moreover, such an approach seems to underlie the dangerous equation between class power in contemporary capitalism as such, and neoliberalism, so that any deviation from a neoliberal pattern of economic regulation comes to be reduced to a breach of the same capitalist class power. But, as we will see, that could not be the case: a deep shift from the “neoliberal” regulatory and supervisory approach in the financial governance can be supported by the same capitalist states and classes in order to resolve the crisis of a previous accumulation regime without implying any shift in the distribution of class power. Against any simplistic reductionism, the overall neoliberal agenda in EU financial governance must be regarded as a detectable pattern in a set of variegated political compromises grounded in the conflicting interests and alliances among the different financial/industrial capital fractions embedded in the domestic state/society configurations.

The hegemonic role of the US–UK financial bloc at a transatlantic level can be assessed in the general regulatory and supervisory approach embedded in the realization of the Financial Services Action Plan (FSAP) for the creation of a European single financial market (Quaglia 2010). In the context of a G7 agenda for a new financial architecture weakening its regulatory priorities after 2001, the FSAP was launched to complement the broader “Lisbon Agenda” for a common regulatory and supervisory framework to enhance cross-border operations and competition in EU financial services. In the years of financial integration prompted by the FSAP, the majority of EU states experienced different degrees of growth in financial services’ share of GDP, a growth in capital markets and an increasing reliance of national banking systems on securitization activities and other market-based sources for financing productive sectors (European Commission 2007). If a US-led market-based framework characterized the FSAP agenda and its concrete outcomes, such a process has been neither linear nor homogeneous across the EU space. The impact of international credit expansion and the rapid development of financial operations and innovative products reacted with continental
relationship-based (as opposed to market-based) financial systems grounded in close relationships between banks and industry. In this context, the loopholes and possibilities for regulatory arbitrage left by difficult and downward compromises in the FSAP process, which made the EU system vulnerable to increasing financial market operations, must be understood as a result of competitive conflicts among national strategies for restructuring domestic finance-industry relationships. The unevenness in financial services integration in the EU has been particularly evident in the case of Germany, where the conservative behaviour of a traditional savers-oriented system of publicly owned Landesbank and mutual banks had to be balanced with the pressures from the emerging transnational German financial groups pushing for a more UK-style approach (Zimmermann 2012, 488–89). Even if the German financial market grew more slowly compared with other EU member states, the interconnectedness of its banking sector in the circuits of world financial capital has been evident in the development of European financial champions like Deutsche Bank, Commerzbank and Allianz, as well as from the systemic role assumed by structured financial products in domestic private and public-owned banks. The Basel II standards on capital requirements and their translation into EU policy are a good example of how the combination of the US-UK approach and the willingness of the continental EU member states to retain national regulatory and supervisory power fostered a differential modernization of the banking sectors in the various member states, the absence of regional coordination in risk management and oversight, and the growing interdependence between domestic funding channels and the transnational circuits of securities markets (Claessens and Underhill 2010). The low-minimum capital thresholds, the non-mandatory character of tougher prudential measures, the lack of countercyclical measures and liquidity standards, the large reliance on internal risk assessment methods and the long phasing-in arrangements contained in the first directive on capital requirements—transposing the Basel II international agreement—allowed a largely under-regulated expansion of new sources of credit, securitization and financing instruments for both the private and public sectors, decisively contributing to the credit boom and asset price inflation in the pre-crisis period.

The eruption of the financial crisis cast doubt on these regulatory arrangements and European finance needed to rebuild on new foundations the geopolitical blocs underpinning its accumulation strategies. Policy-makers and regulatory agencies in the states most severely hit by the crisis rapidly espoused and brought to international regulatory and standard-setting bodies the need for a shift in the micro-/macro-prudential regulation and oversight of the financial institutions and instruments (Baker 2010, 2013). As national states heavily intervened to bail out defaulting banks with tax payers’ money, the financial sector’s responsibilities came under hostile public scrutiny which threatened its privileged and “behind the scenes”
relationship with national and European policy-makers. The financial crisis thus led to a legitimacy crisis of the previous market-based financial governance (Helleiner 2010; Helleiner and Pagliari 2009), making it necessary for the financial industry to find a new strategic role in the states’ capitalist blocs. Thus, the post-crisis regulatory response at the EU level is better analyzed in terms of a strategy directed at restoring the financial market’s functioning as a condition of its further expansion, at the same time countering and neutralizing attempts to reduce the size and structural power of transnational financial capital. If the “neoliberal” strategy of financial governance caused enormous economic losses which also affected its broader legitimacy and policy influence, a new “macro-prudential” model could represent a viable trade-off to restore market positions and regain legitimacy.

The EU’s post-crisis financial reform process can thus be analyzed through the lens of the conflicts and compromises between leading geopolitical-economic blocs and the transnational-oriented financial interests in their attempts to reconstruct, on a new basis, a renewed alliance of national European financial capitals aimed at enhancing their respective positions against the risks of most intrusive regulation or even structural changes in the dominant power relationships at domestic and international levels. The cases of capital requirements and Bank Structural Reform are illuminating instances of this exercise because they involve fundamental issues of bank lending and financing of investment in businesses and the real economy and the politically sensitive issue of too-big-to-fail banks.

The New Capital Requirements (CRR and CRD IV)

The revision of the Basel II framework on the capital adequacy standards has been an overriding issue on the international regulatory agenda. The looseness in the thresholds and composition of the minimum internal capital, together with over-reliance on credit rating agencies and the variety of internal risk assessment models permitted, were targeted by policy-makers and regulators as fundamental vulnerabilities conditioning the wave of banks’ failures after the bursting of the subprime bubble. The G-20 summit of Pittsburg in 2009 put the need for new standards on the quantity and quality of bank capital and the prevention of excessive leverage on the international agenda (G20 2009). Under this strong political mandate a new round of negotiations began among public authorities and the financial industry within the Basel Committee on Banking Supervision aimed at delivering a new set of international standards for financial institutions to be phased in by 2012.

This quest for tighter international rules required balance between setting up global common standards and their implementation in divergent domestic banking systems and socioeconomic contexts. The new Basel III standards (approved in 2010) set the overall frame of the first stage of negotiations in the EU on the
changes in capital adequacy requirements. The two main factions in contention on this issue were the US–UK-led and the Germany–France-led blocs, reflecting the different interests embedded in domestic financial and economic systems and distinct transnationalised market strategies. The diverging interests of these blocs can be more or less directly linked with differences in their links with industry and SME, their access to funding and entire national economic systems. In the following section I will distinguish the positions of these two competing blocs and the socioeconomic interests that underlie them while assessing the transnational strategy of each. Given the length and complexity of the final capital adequacy requirements package, I will focus on two of its more contentious elements only: the core minimum capital requirements and the leverage ratio.

The two main Basel III measures here taken into account entailed

(a) raising the minimum threshold for common equity Tier 1 Capital (CET1, composed of equity instruments of the highest quality) to 4.5% of risk-weighted assets (RWA), from the minimum of 2% of RWA established in Basel II, deducting from the computation the “silent participation” of state shares in private/publicly owned banks, as well as the shares of the banking groups’ insurance subsidiaries, while allowing possible adaptations for non-joint stock companies (BCBS 2010, 12–13) and

(b) introducing a new non-risk-based leverage ratio as systemic countercyclical provision to limit banks’ and investments firms’ risk-taking on the basis of internal risk-weighting assessment.

Continental banks, especially in Germany and France, stood to lose considerably from the equity requirements of Basel III because of their large non-equity core capital structures (based on mixed equity and non-equity shares unlike UK banks with their largely equity capital), the importance of the hybrid private/public banks (particularly in Germany, with the Landesbanken playing a central role in the regional economies), and the inclusion of the insurance subsidiaries shares in the minimum requirements (especially in France) (see Howarth and Quaglia 2013). Basel III did not envisage maximum capital requirements, an omission supported by the UK so as to allow for higher capital requirements which would make the British financial sector more attractive for investors and give it a competitive advantage over banks of other member states. By contrast, Germany and France pushed for such a measure so as to level the playing field with UK banks.

Together with the new capital requirements, largely based on the banks’ internal risk-assessment, the introduction of a non-risk-weighted leverage ratio was promoted by the ECB as “the primary regulatory tool for bank capital” (OECD 2013, 2) to balance the risk-sensitive modeling and arbitrage on which Basel II
was grounded. Such a measure was strongly criticized by the majority of the member states, with the business interests of Germany and France in the forefront. The regulators and the financial industry both pointed to the costs of a massive deleveraging in still-recessionary conditions, as well as to the dangers of a uniform non-risk-based ratio applying across differentiated national banking sectors, and of the consequences for bank lending to the industrial sector and SMEs.

A flexible approach to and revision of the main Basel III innovations was advocated by a large “Continental bloc” of domestic banking interests, with Germany and France in the forefront as the leading EU states, meeting at the same time the preferences of most of the transnational financial fraction. The Commission’s open consultations from 2009 to 2011 on the changes to introduce to existing capital adequacy requirements rules witnessed a predictable coalition of financial and industrial interests and national governments across continental Europe expressing an almost unanimous opposition to the most rigid provisions contained in Basel III.

In an analysis of the depositions during the consultation process, two main positions emerge: a) a large coalition of domestic and cross-border finance/industry interests, led by Germany and France, proposing to water down the Basel III measures on Capital requirements and the leverage ratio and to fine-tune them at EU level, and b) a narrower coalition, led by UK authorities, fostering a coherent adoption of the key measures in the Basel III agreement. The Germany and France-led bloc reflects both their domestic banking structures (focused on business funding through bank lending) and the interests of European cross-border banking groups striving to loosen the most rigid regulatory requirements. They commonly oppose “one-size-fits-all” measures and the overly burdensome capital adequacy requirements which restrict investment in the real economy and prolong the recession. They blame the restriction of the instruments eligible as the core tier 1 capital for especially undermining the publicly owned German banks and the French bank/insurance conglomerates. While the French financial authorities asked for a level playing-field taking into account European specificities of non-joint stock companies and financial conglomerates in the definition of the core tier 1 capital (French Ministry of Treasure et al. 2010, 11), the German Ministry of Finance proposed to relax the Basel III requirements and to adopt a “principle-based” approach “without reference to any specific instruments”, an approach “which is neutral with respect to the legal form of institutions” (German Federal Ministry of Finance 2010, 9).

Even more categorical was the German–French position on the leverage ratio, with the German delegation’s deposition affirming in bold type that it opposed “the introduction of a binding leverage ratio,” denouncing its design as amplifying the risk of credit crunch during times of high losses. “Had this leverage ratio been binding during the crisis,” it added, “the losses made during the crisis would have forced institutions to reduce their leverage even more than they have already been forced
to do in order to cope with the risk-based minimum capital requirements” (German Federal Ministry of Finance 2010, 13). French authorities opposed the binding leverage ratio on more or less the same terms, asking that it be treated “as an undisclosed pillar 2 indicator for supervisors in their dialogue with financial institutions” (French Ministry of Treasury et al. 2010, 2). These criticisms substantially overlapped with those expressed by the German and French banking associations (see ZKA 2010, 24–25, 47; FBF 2010, 11, 28; Groupement National de la Coopération 2010, 5) and articulated by the European Banking Federation, which—already during the Basel III negotiations—harshly denounced the introduction of a leverage ratio as a “step backwards,” in sharp “contradiction with the spirit and purpose of the Basel II rules” in that it “removes the incentives for institutions to improve their risk management practices” (EBF 2010, 114). Together with domestic banks’ umbrella organizations, even the representatives of most European transnationalised banking groups sought a flexible and differentiated approach to the implementation of Basel III. So the European Roundtable on Financial Services stressed the strict relationship between the banking and productive sectors in the European domestic financing systems, based on banks’ credit rather than capital markets as in the US case, in order to warn about the detrimental effects of the new restrictions for the real economy (EFR 2010, 2–3). As one might expect, given the inner links between financial and industrial capital in continental Europe, German and French business organizations aligned with domestic banks’ interests (see FGI 2010; MEDEF 2010). As the Federation of German Industries clearly pointed out, the rigid transposition of the Basel III leverage ratio into the new capital adequacy requirements package, as originally proposed by the Commission, would “[put] German banks at a greater disadvantage than other European and Anglo-Saxon banks” (FGI 2010, 4). Interestingly, the position of the trade unions did not conform to those of the business sector to constitute a broad category of the “producers’ interests.” For example, the Austrian Federal Chamber of Labour issued a detailed position paper on the CRD IV proposal in which it recognized the need to include capital of non-joint stock companies in the core capital requirements (provided that it met the Basel III core tier 1 criteria), while strongly supporting the introduction of a narrowly defined leverage ratio as a measure to address the shortcomings in the internal risk modeling, “thereby limiting the risk of too big/interconnected to fail and of too big to be rescued” (BAK 2010, 10).

For their part, UK financial authorities were the main promoters of the tighter definitions of core tier 1 capital thresholds and the introduction of a non-risk-sensitive leverage ratio. In its written response to the 2010 consultation, the UK Treasury—in concert with the Bank of England and the FSA, agreed with the core capital adequacy criteria and asked that “[n]on-joint Stock (NJS) companies should also be required to meet these criteria in full,” while also warning that the latter
“need to work for NJS companies” (UK Treasury 2010, 12). In the same way, the UK strongly supported the imposition of a binding leverage ratio “serving as a mitigant against both over-reliance on an individual bank’s modelling and measurement of risk, and also excessive, unsustainable growth in absolute balance sheet size,” so asking for it “[to] be a mandatory element in Pillar I of the CRD” (2010, 15–16). In taking these positions, the UK was joined by EU member states with relatively deleveraged banking sectors, like Italy (see Banca d’Italia 2010, 7).

The lines of debate on the final legislative texts voted on by the European Parliament and the Council (EU 2013) largely conformed to those on the Commission’s original proposals (see Howarth and Quaglia 2013; European Commission 2011a, 2011b). The definition of the capital adequacy ratios in the final CRR text, while maintaining the Basel III thresholds, broadened the criteria defining the CET1 capital to include other high-quality forms of capital which meet the 14 criteria for loss-absorbing capital (European Commission 2013, 15) than just “ordinary shares,” i.e., the equity shares set by Basel III. This largely eluded the Basel III prescription to phase out public “silent participation” (i.e., the governments’ lending and shares) in banks’ equity base. At the same time, the treatment of “minority interests” in the proposed regulation allowed more favorable treatment of insurance entities, put under the regime of the financial conglomerates directive (European Commission 2013, 17). Besides relaxing capital adequacy criteria, the other major innovation of a binding leverage ratio was substantially bypassed—at least temporarily—by confining it to Pillar 2 (i.e., the non-binding additional measures whose enforcement is left to the different financial institutions’ supervisors) and making its possible future inclusion in Pillar 1 (i.e., the mandatory measures) conditional on further impact assessments and reviews by the European Banking Authority (EBA). Even in this case, the possibility of a differentiated leverage ratio based on various national business models (European Commission 2013, 23–24) is left open. On the issue of harmonization, the final compromise allows a certain range of flexibility in the introduction of tougher capital requirements as systemic risk capital buffer and other prudential requirements (e.g., risk weights and large exposure limits) (European Commission 2013, 11).

In the end, a Continental bloc formed through an alliance of German and French domestic interests with transnationalised European banks found a compromise which, though not dismissing the framework of Basel III, was successful in watering down its most burdensome requirements.

The Bank Structural Reform

The project of a comprehensive reform of the banks’ business structures in the EU has been deeply undermined by national legislative initiatives in the UK, Germany

WRPE   Produced and distributed by Pluto Journals   www.plutojournals.com/wrpe/
and France, aiming to safeguard the interests of their national financial champions while appearing to address public concerns. Between them, they have made the prospects of a harmonized European-wide reform dimmer. Harmonization would represent a crucial step in the accomplishment of a European Banking Union because it directly addresses two core and interlinked issues arising from the crisis. First, it deals with the too-big-and-too-complex-to-fail banks, which required systemically important financial institutions to be bailed out by governments. It also deals with the business models of universal banks which combine routine and essential deposit-taking, lending and payment services with more risky trading-related activities. Still under EU trilogue negotiations among the Commission, the Council and the European Parliament at the time of writing, this regulatory initiatives being so substantially watered down by the leading interests of the different states’ financial actors so as to hinder a common European framework which could damage EU transnational financial firms.

In February 2012, Commissioner Barnier established a high-level expert group chaired by the governor of the Bank of Finland, Erkki Liikanen, with the mandate of providing a preliminary report on a possible reform tackling the banks’ business models at European level in order to “reduce the probability and impact of failure, ensure the continuation of vital economic functions upon failure and better protect vulnerable retail clients” (European Commission 2012). The final set of recommendations included the assignment of the banks’ “proprietary trading and all assets or derivative positions incurred in the process of market-making” into separate legal entities, although remaining in the same banking group. According to the proposal, the separation would have been mandatory only if the concerned trading activities exceeded a certain amount compared to the bank’s total assets. Even so, it would be decided by the supervisors on the ground of specific thresholds issued by the Commission, while the “small banks” would be exempted. Each of these new trading entities in the banking group would have to comply with the capital requirements in CRR/CRD IV (High Level Expert Group 2012, 101–2). While some dissent emerged in the expert group on the issue of mandatory separation (2012, 100), the final Liikanen report opened the path to a common European framework to deal with the riskiness in the structure of universal banks. Nevertheless, in the course of 2013 the governments of Germany, France and the UK approved their national laws on the structures of banking business. So when the stakeholders’ consultations on the Liikanen proposals opened, the leading EU states were already completing and implementing different national legislative solutions. By so doing these governments largely responded to the double political need to gain electoral consensus on an issue, such as the too-big-to-fail banks, which received so much attention in the post-crisis public debate, while at the same time reaching a compromise with the respective national banking sectors and
transnational financial firms. Moreover, by moving before the Commission proposals appeared, these initiatives set the terms for the European legislative process, ensuring that it had to provide a great range of flexibility and national derogations in the final EU legislation. The main features of the three reforms are summarized in Table 1.

The UK’s rigid “ring-fencing” approach mirrors the regulatory shift in its national financial authorities, while being rooted in the structure of the British banking system which, as already noted, is less reliant on deposit-taking functions than the universal banks of Continental Europe (Quaglia 2010). For their part, the German and French approach treats proprietary trading differently, permitting it to universal banks and exempting them from legal separation requirements. In the German case, the exceeding of very high thresholds for credit institutions (100 bn euros of trading assets or if the latter exceed 20% of the total assets; 90 bn euros of deposit-taking institution’s total assets) entails the separation of proprietary trading and a few other operations (high-frequency trading not constituting market-making, lending and guarantee transactions with hedge funds or with highly leveraged alterative instrument funds), while the majority of trading operations, including market-making, will be allowed for large credit institutions (Finance Watch 2013a, 5–6). In a similar fashion, Art. 2 of the French law considers several exemptions from the proprietary trading prohibition, including operations related to market-making (République Française 2013). As stated in a joint German–French deposition to the consultation, the principle underlying their national reforms has been that of ensuring financial stability and consumer protection, while at the same time avoiding any measures potentially damaging the “financing needs of the economy.” This requires preserving market-making as a “natural complement to securities underwriting” (Joint German and French Response 2013, 1).

Thus, the Commission’s stakeholder consultation that opened in May 2013 saw clearly distinct factions. The UK, German, and French governments underlined

<table>
<thead>
<tr>
<th>Issues</th>
<th>UK</th>
<th>Germany and France</th>
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<tr>
<td>General approach</td>
<td>Ring-fencing: structural separation of activities via a ring fence for retail banks (intra-group and inter-firm restrictions)</td>
<td>Subsidiarization: proprietary and high-risk trading placed in a separate legal entity within the banking group</td>
</tr>
<tr>
<td>Proprietary trading activities</td>
<td>Banned from the retail banks</td>
<td>Placed in the separate entity if certain risk thresholds are exceeded</td>
</tr>
<tr>
<td>Market-making activities</td>
<td>Not allowed for retail banks</td>
<td>Allowed</td>
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Table 1
the importance of their respective reforms as the pathways for the Commission to follow in the drafting of its proposals, with the national banking and industrial trade associations largely supporting their national legislative initiatives and opposing a tougher European regulatory layer (see BBA 2013; CBI 2013; FBF 2013; AFEP 2013; DK 2013). Transnational firms like Deutsche Bank and Crédit Agricole fiercely contested the Liikanen and Commission arguments, as well as the one-size-fits-all approach, proposing that any structural change should be contingent on regulatory assessments within the resolution-planning process, as regulated in the already enacted Recovery and Resolution Directive (Deutsche Bank 2013, Crédit Agricole 2013; Barclays 2013). On the opposite side, consumer associations, NGOs and trade unions largely supported stronger rules on mandatory separation between trading and retail banking activities (see Finance Watch 2013b; UNI Europa 2013; Financial Services User Group’s 2013).

In the end, the final Commission proposal contained weaker provisions than the Liikanen proposals and was closer to the existing UK, France, and German laws. However, it also subjected a broader range of trading activities to the separation requirement than envisaged by the new German and French laws. The latter point became the target of severe criticisms from the very start of the legislative process.

According to the Commission’s proposal, the Regulation on Bank Structural Reform would apply to EU credit institutions, including branches and subsidiaries (domestic and in other countries), as well as to foreign institutions located in Europe4 (European Commission 2014a, 22–23). It substantially narrowed the scope of mandatory separation in the case of sole proprietary trading activities, defined as “the desks’, units’, divisions’ or individual traders’ activities specifically dedicated to taking positions for making a profit for own account, without any connection to client activity or hedging the entity’s risk” (European Commission 2014a, 24, 27). The activities related to the buying and selling of money market instruments for cash management, as well as trading in EU states’ bonds, were thus exempted from the prohibition (European Commission 2014a, 26). As the Commission highlighted in Annex A of its Impact Assessment, the impact of such a measure would be limited if not minimal, given that the size of the proprietary trading of the large European banks has been already reduced to a significant extent and now represents a marginal business activity5 in their balance sheets (European Commission 2014b, 56–58).

The third chapter of the proposal allows other market-making, trading and investments activities to be performed by the banking groups, but subjects them to monitoring by supervisory authorities which may require their separation from the deposit-taking entities if certain thresholds are exceeded or impose other kinds of separation (European Commission 2014a, 27–29). The definitions of the metrics indicating the size, leverage, complexity, profitability, market risk and
interconnectedness (European Commission 2014a: 28–29) are delegated to the binding implementing technical standards to be developed by the EBA, the EU banks’ micro-level supervisory authority composed of representatives of national supervisors. Deposit and credit institutions are expected to be exempt from restrictions on trading in derivative instruments for risk management purposes so long as this trading takes place under the supervision of competent authorities (Art. 12), while mutual, savings and cooperative banks are allowed to retain some deposit and trading functions if the competent authority considers that they are “indispensable for the functioning of the group,” provided they have “taken sufficient measures in order to appropriately mitigate the relevant risks” (European Commission 2014a, 10). In order to be integrated with existing national legislations, the proposal considers possible derogation from separation requirements in Chapter III for credit institutions already subject to laws having “equivalent effects” to the provisions contained in the EU regulation (European Commission 2014a, 37). In this way the proposal is expected to leave substantially untouched the existing national regimes of banks’ separation, while assigning the actual definition of critical thresholds to make the separation possible or mandatory to national supervisory authorities and negotiations within the EBA, a technocratic body that is highly exposed to financial industry lobbying.

The Commission proposal soon faced strong opposition from the financial industry and intense lobbying pressure has been directed to the European Parliament and the Council. In November 2014 the European Banking Federation issued a report which denounced the likely consequences of the proposal including an increase in funding costs for the trading entity and for the core banking group, with highly negative consequences for the funding of the real economy (EBF 2014, 4–9). Two months later the Association for Financial Markets in Europe, one of the European associations of larger banks and investment firms, commissioned a report from PricewaterhouseCoopers, according to which the proposal would have introduced large costs for the financial industry, so as to reduce market liquidity with detrimental effects for the users and the overall real economy (PWC 2014). The latter conclusion has become the main argument for the first report of the European Parliament legislative resolution on the Commission proposal, released in January 2015 by the ECON rapporteur Gunnar Hökmark (EPP) and containing a set of 90 amendments which substantially overturned the original draft mostly in line with the fierce opposition of the financial industry. The report takes as its basis the need for a better compromise between the already introduced invasive set of prudential rules for the banking industry and the promotion of a Capital Markets Union in which the universal banks would enhance their capability to provide liquidity to restore growth and competitiveness (EP 2015, 52–54). According to the ECON report, the proposal on Bank Structural Reform
introduces a new layer of regulation too burdensome for universal banks and extremely counterproductive in that it illegitimately assumes the business model, size and trading activities of a bank to be the central issues to deal with, in order to improve the stability of the banking system. Contrary to the Commission’s basic approach, the ECON proposes a risk-based model aimed at ensuring banks’ stability in which the separation of trading and deposit-taking activities is included as one of various options for the supervisory authority and properly the last resort measure, the first ones being “enhanced supervision or higher capital requirements” (16, 27–30, amendment 19, 44, 47). Along this line of reasoning, more possibilities of derogation from the Regulation are foreseen without the approval of the Commission (7–8, amendment 4), the scope of derivatives trading allowed for credit institution is enlarged (22, 32, 33, amendments 31, 52) and the risk thresholds for the supervisory intervention are linked with the risk exposure criteria of the CRR/CRD IV (so largely referred to the banks’ internal risk modeling) (17, 26, amendments 21, 41). As Finance Watch and other consumer associations have alleged, these amendments would definitively hollow out the Commission’s proposal so as to make the Bank Structural Reform “an ineffective shell” (Finance Watch 2015).

Since the legislative process and debate are still ongoing, substantial support from the ECON parliamentary committee for the arguments of the financial industry—together with the aforementioned resistance of key states—could deeply undermine the completion of a proper European law on banking, particularly one that separates deposit taking from proprietary trading activities. In this way the “circumscribed” approach of the German and French laws will likely remain untouched by a more intrusive EU-level legislation entailing further costs and binding requirements damaging the competitiveness of the national financial/industrial capitals.

Conclusions

The above case studies offered good tests for a geopolitical-economic understanding of the EU’s post-crisis financial regulatory agenda by recasting the Neo-Gramscian concept of historic blocs to provide a framework for understanding inter-state interaction in the EU context. The outcomes of the capital requirements package negotiations on the tier 1 capital adequacy and leverage ratio, as well as the ongoing debate for a Bank Structural Reform, show how changing coalitions of leading states and transnational economic interests comprehensively explain the concrete shaping of a new regulatory consensus in European financial governance. In the case of CRR/CRD IV a regional bloc of domestic and transnational financial interests clustered around the German and French governments conditioned a
compromise through which the basic framework of Basel III has been adapted to national banking systems, while the most innovative measure of a non-risk-based leverage ratio has been not rejected as such, but included as a non-binding requirement by postponing further negotiations for its introduction to 2018. In a similar way the need to enhance consumer protection and address the too-big-to-fail issue has been actively pursued by the German and French governments with the support of the financial industry which also prioritized the need to restore investors’ and the public’s confidence in the post-crisis reform process. But in order to avoid a radical shift in the universal banks’ business structures, the German and French governments acted well before any common EU legislative framework was proposed so as to preserve the competitiveness of the respective banking sectors. This also suited the transnational financial industry, which was opposed to a further and stricter European layer of legislation undermining their market-making and trading activities, by advancing as an alternative a resolution- and risk-based approach against a one-size-fits-all model. In both cases a substantial shift from the pre-crisis financial governance approach cannot be denied. However, the nature of the shift has been not toward an international and European regulatory reform agenda but toward a renewed compromise between the states’ internal economic and societal interests and the most transnationalised European financial interests. In this new set of compromises, the balance of interests appears to be skewed, once again, to the leading domestic and transnational financial industry interests.

So neither a purely interstate perspective nor an exclusive focus on the transnational actors could account for the complex outcomes entailed in the EU reform of the banking governance. If further empirical research is indeed needed, an approach based on “geopolitical-economic blocs” promises to be a valid neo-Marxian alternative to the mainstream theorizing of EU economic and financial integration.

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Notes

1. The percentage of assets, weighted according to different risk-assessment models established under the Basel II agreement.
2. The German law was definitively approved in June 2013 (Deutscher Bundestag 2013), the French one a month later (République Française 2013), while the UK Banking Reform Act was passed in December 2013 (UK Government 2013).
3. The German law was approved in the context of the German federal election (September 2013): Merkel’s government had to rapidly counteract the competing Steinbrück’s social-democratic program on a national banking structural reform (see Buergin 2013). In the French case, the law on banking separation was one of the principal financial reforms pursued by Hollande soon after his election in May 2012.

4. The institutions in question must register, for three consecutive years, “total assets amounting at least to EUR 30 billion and trading activities amounting at least to EUR 70 billion or 10 per cent of its total assets” (European Commission 2014a, 23).

5. The Commission Impact Assessment openly states that “[t]he impact on the banking industry should also be limited, given claims that banks no longer engage in this activity to a material extent” (European Commission 2014b, 58).

6. While this article was already under review, on June 19, 2015, the ECOFIN agreed on a common negotiating stance on the banking structural reform: unfortunately I have not had the possibility to take it into account here.

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