Chapter 6
Does the Regional Economic Integration Lead to Banking Union? The European Case

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ABSTRACT
In 2012, the European Commission created a roadmap towards a European Banking Union. The aim of this EBU is to ensure financial stability in Europe. The proposed framework by the European Commission is based on three pillars: a Single Supervisory Mechanism (SSM), a Single Resolution Mechanism (SRM), and a single deposit guarantee mechanism. The EBU project is a step towards a better functioning EMU in the future. However, there are several controversies on this project. The main concerns are conflicts of interest between monetary policy and banking supervision, and cooperation between ECB and other banking authorities. If the EBU is a necessary step, it is not a sufficient one to resolve all financial issues in the EMU and in Europe.

INTRODUCTION
The global financial and economic crisis in 2009 has pointed out failures of financial services supervision. In Europe, this crisis was first reflected by a banking crisis. Europe has implemented a broad rescue plan for banks in the amount of 1,700 billion euros, or 13.6% of European GDP. This plan has mainly included guarantees of interbank loans and funds to recapitalize banks. The global crisis was also reflected by a sovereign debt crisis in Europe caused by deterioration in public accounts: the EU public deficit increased from 0.9% of GDP in 2007 to 6.5% of GDP in 2010, and the EU public debt increased from 58.9% of GDP to 80.7% of GDP in the same period. Thus, these crises have highlighted the weaknesses of the European governance, in particular for the Economic and Monetary Union (EMU). The first responses of European authorities concerned fiscal policies:
within the European Semester, the new reforms of the Stability and Growth Pact (SGP) tend to increase fiscal discipline and improve enforcement mechanisms. The European Commission analyses the fiscal and structural reform policies of every Member State, provides recommendations, and monitors their implementation. To strengthen the implementation of the European Semester, the Commission may rely on two European legislative package called “Six pack” and “Two pack”. The Commission has now the opportunity to request corrections to projects of Member States and to apply sanctions more easily. Moreover, the European monitoring now includes global imbalances. The Macroeconomic Imbalance Procedure (MIP) is a surveillance mechanism that aims to identify potential risks early on, prevent the emergence of harmful macroeconomic imbalances and correct the imbalances that are already in place. Parallel to this monitoring and to respond to the crisis, the EU has established a European system of financial crisis management in the euro area: the European Stability Mechanism (ESM) is a permanent firewall for the eurozone to safeguard and provide instant access to financial assistance programs for member states of the eurozone in financial difficulty, with a maximum lending capacity of €500 billion. It replaced two earlier temporary EU funding programs: the European Financial Stability Facility (EFSF) and the European Financial Stabilization Mechanism (EFSM).

However, the issue of banking sector was not dealt so deeply until 2012. The chosen way was an intermediate step with the founding of the European System of Financial Supervisors (ESFS) in 2011. The ESFS is made up of: i) the European Systemic Risk Board (ESRB) which is in charge of monitoring and analyzing any risks to the stability of the financial system arising from macroeconomic developments and developments within the financial system as a whole (macro prudential supervision); ii) the three European Supervisory Authorities (ESAs) which interact with the existing national supervisory authorities in order to ensure the financial soundness of the financial institutions themselves and to protect users of financial services (micro prudential supervision). Owing to this fragmented structure and face to a deeper fiscal and monetary integration, the European Commission proposed a European Banking Union (EBU) to reach a Genuine Economic and Monetary Union (Van Rompuy, 2012). This proposition is based on a single supervisory mechanism for banks led by the European Central Bank (ECB), a single bank resolution mechanism and a common deposit protection. On 15 April 2014, the European Parliament adopted several texts launching the EBU.

This chapter addresses the relevance of the EBU: Does the EBU can prevent and mitigate the crisis? How would the EBU affect the monetary policy? The chapter is organized as follows: section 1 provides an overview of theoretical and empirical justifications of the EBU, section 2 presents the EBU, and the section 3 debates on the EBU highlighting controversies and limits.

THEORETICAL AND EMPIRICAL JUSTIFICATIONS OF THE EBU

Ensure Financial Stability

The final aim of the EBU is to contribute to the financial stability objective. Financial stability can be defined as a condition in which the financial system is resistant to economic shocks and is fit to smoothly fulfil its basic functions: the intermediation of financial funds, management of risks and the arrangement of payments. The recent economic and financial crisis is a global crisis which emphasized the role of systemic risk on the conditions of an international financial system. Under these conditions, an international supervision seems to be relevant. Cechetti, Fender, and McGuire (2010) concern the necessity of international exchange