

# Banking Union in Historical Perspective: The Initiative of the European Commission in the 1960s–1970s\*

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## Abstract

This article shows that planning for the organization of EU banking regulation and supervision did not just appear on the agenda in recent years with discussions over the creation of the eurozone banking union. It unveils a hitherto neglected initiative of the European Commission in the 1960s and early 1970s. Drawing on extensive archival work, this article explains that this initiative, however, rested on a number of different assumptions, and emerged in a much different context. It first explains that the Commission's initial project was not crisis-driven; that it articulated the link between monetary integration and banking regulation; and finally that it did not set out to move the supervisory framework to the supranational level, unlike present-day developments.

**Keywords:** banking union; common market; single market; European Commission; Banking Advisory Committee; supranational

## Introduction

While many developments occurred in the 1990s and 2000s (Quaglia, 2010, 2007), the 2007–8 financial crisis and the current challenges of the eurozone have given much more immediate relevance to the issue of banking regulation and supervision in the single currency area (Hennessy, 2014). Today, three main elements are nested under the umbrella term of ‘banking union’: regulation (single rulebook), supervision (single supervisory mechanism or SSM) and resolution (single resolution mechanism or SRM). Using the parlance of the 1960s, the three elements of today's banking union correspond<sup>1</sup>, *mutatis mutandis*, to the harmonization of the European Economic Community (EEC)'s member states' banking legislations, the co-operation of supervisory authorities, and winding-up procedures. In 1965, the European Commission launched a series of discussions and negotiations about the co-ordination and eventual harmonization of the banking legislations of the EEC member states, with the hope to produce a single all-encompassing directive on the topic, covering all pillars except supervision. Confronted with strong opposition from new member states (chiefly Britain) as well as the impossibility of reaching agreement *à six*, the Commission changed its tactics in 1973 and adopted a step-by-step approach, focusing on individual directives, more modest in scope. This new approach eventually led to the various directives that have been enacted since then.

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<sup>1</sup> Depending on definitions, deposit insurance is also sometimes included as a separate pillar of banking union.

The literature on the development of international and European financial regulation and supervision since 1945 does not mention this episode, focusing instead mostly on the emergence of the BCBS (Basel Committee on Banking Supervision) framework, in spite of a few limited references to the EEC story through the ‘Groupe de contact’ of banking supervisors (Goodhart, 2011; Singer, 2007; Wood, 2005). Traditional long-term accounts of European integration do not mention this episode either, whether those adopting a general approach (Dinan, 2004 and 2006; Gilbert, 2012; Moravcsik, 1998; Varsori, 2010), or those focused on financial and monetary co-operation (Dyson, 1994; Dyson and Featherstone, 1999; James, 2012a; MacNamara, 1998; Ungerer, 1997). While each of the elements of the banking union have been studied by a large body of literature (De Rynck, 2016; Enoch et al., 2014; Gros and Schoenmaker, 2014; Howarth and Quaglia, 2013; Posner and Véron, 2010; Quaglia, 2013; Véron, 2015), including deposit insurance (Fратиanni, 1995; Ayadi and Lastra, 2010; Schoenmaker and Gros, 2012) and the issue of resolution (Kudrna, 2012; Schoenmaker, 2012), these works never mention the high ambitions of the Commission in the 1960s–70s with which this article will deal. There is a common view in the social science literature that the development of European banking regulation and supervision really started only after the 1986 SEA (Single European Act) and the subsequent legislation passed on the topic.

This view is understandable, since the ambitious plans presented by the Commission in the 1960s and early 1970s were premature and by and large failed. Perhaps most importantly, the context changed to such an extent in half a century that, at first sight, looking back to the 1960s does not seem relevant: the EEC of the 1960s was not financially integrated, the banking systems of its member states were very different and it did not share a single currency. The Commission’s projects in the 1960s–70s were just a few pages in length; recent comparable regulations cover hundreds of pages. To be clear, this article does not argue that the two moments are equivalent. If the plans of the Commission in the 1960s were indeed very ambitious, they never set out, for political reasons, to create a single supranational supervisor in the EEC, like today’s SSM. Some of the issues at stake are also very different, given how much the context has changed. One of the main goals of today’s banking union is to delink the sovereigns and the banks; this was of course not so much of an issue in the 1960s, in a Europe where levels of government deficit and debt were incomparably lower if not nonexistent.

Recent developments in the eurozone have also revived the debate about the link between monetary integration and banking regulation/supervision. It is commonplace to say that the euro suffers from a number of initial design failures, and in particular the absence of a common supervisory and regulatory framework. The Maastricht Treaty negotiations famously sidestepped these issues (James, 2012a, pp. 292, 313–17). This article examines this question by exploring a time frame – the 1960s and 1970s – when both monetary integration and the harmonization regulation/supervision were intensely discussed, and sometimes even explicitly linked to each other.

In doing so, this article is part of an ongoing wider effort to show how economic history can shed light on present-day policy-making (James, 2012b). In the past few years, a range of articles and books have linked previous developments to contemporary challenges, in particular by looking at two phases: the inter-war period, to explore the lessons that can be drawn from the Great Depression/gold standard analogy (Bholat, 2014; Bordo and James, 2010; Eichengreen, 2015), and the development of European monetary co-operation

since the 1960s, to investigate the root causes of some contemporary disagreements and the origins of EMU's (economic and monetary union's) design failures (Eichengreen, 2012; James, 2012a; Mourlon-Druol, 2014). As David Bholat puts it, 'the past is a rich resource that can be exploited for precedents or alternative possibilities to the contemporary conventional wisdom, giving pause for policy-makers to reflect on why an issue perceived as a problem today was non-problematic or differently problematic in the past' (Bholat, 2014, p. 172). Harold James explains that 'history (...) tells us multiple equilibria stories' (James, 2012b, p. 1025). The case study analysed in this article typically follows that template, as it investigates similar discussions to those of the present day seen in a different context, with different results and, most interestingly, different assumptions.

This article uses the classic historical methodology of trying to understand the different sort of paths that the development of European banking regulation and supervision could have taken through a systematic exploration of unpublished primary source material. This article is based on a wide range of hitherto unexploited primary sources from the European Commission, the Bank of England, the Bank of France and the UK National Archives. These documents contain detailed verbatim accounts of meetings and multiple administrative notes detailing the policy-makers' intentions, interpretations, and reactions. The varied nature of this corpus of primary sources helped to cross-check the unfolding of events as well as the scope and nature of the plans discussed.

The recent endeavour to create a eurozone banking union is often presented as an unprecedented step; this article contends that this is not the case, and compares and contrasts this effort with an earlier plan of the European Commission to harmonize European banking regulation and supervision. This article first examines the plans that the European Commission started devising in the 1960s, their aims, and the Commission's strategy to implement them. It then explores the Commission's motivations, and underscores how strikingly different they were from present-day preoccupations. It finally highlights the historical innovation that moving the European supervisory framework to the supranational level represents, in contrast to what the plans of the Commission set out in the 1960s and 1970s. This article focuses on banking regulation and supervision, which, as Quaglia notes (Quaglia, 2007), was much more developed than other financial services (insurance and securities). Taken together, these three aspects help shed light on current developments by re-framing them in a longer-term perspective.

## **I. A Banking Union Before a Monetary Union**

There is a common view in the literature according to which international banking regulation and supervision discussions started with the emergence of the BCBS framework in the mid-1970s (Kapstein, 1989; Schoenmaker, 2013); this view suggests that in an EU context, they only started after the 1986 Single European Act, and the subsequent liberalization of capital movements (Bach and Newman, 2007; Jabko, 2006; Posner, 2007). If Goodhart does refer to the EEC-centred 'Dondelinger group', or Groupe de Contact, as a forerunner to the BCBS, he does not detail the first discussions on the topic that the European Commission initiated in the mid-1960s (Goodhart, 2011). The first and second banking directives (1973 and 1977, respectively) are sometimes mentioned, mostly in legal studies (Dragomir, 2010; Louis, 1995). Both of these biases - the near-exclusive focus on Basel and post-1986 EEC developments - are certainly justifiable. Basel became the centre of attention in the

following decades and outlined the most influential regulatory framework; while the most important EU directives were only enacted after 1986. A corollary to this BCBS focus is the view that international regulatory/supervisory co-ordination essentially derives from a non-binding set of informal rules, instead of a formal, written, legal framework (Schoenmaker, 2013, pp. 8–9) that is more typical of what the EU produces. In order to qualify these views, this first section sets out the content of the project that the Commission devised in the 1960s–70s – exposed in a written, legal framework – and the reasons behind it – EEC-centred instead of global.

The 1960s and early 1970s witnessed intense discussions about European financial integration, supervision, and regulation. The European Commission was the prominent steering force behind these discussions (Maes, 2006). It commissioned a group of experts chaired by Claudio Segré, Director for Studies in the Commission's Directorate-General for Economic and Financial Affairs, to study 'the problems confronting the capital markets of the Community as a result of implementation of the Rome Treaty' (Segré, 1966, p. 5; Maes, 2007, pp. 29–31). A corollary to debates about the creation of 'a European common market for capital' was the regulation and supervision of that hoped-for integrated financial market. Chapter 12 of the report specifically mentioned the need to further co-ordinate national legislations in banking regulation and supervision, as the discrepancies between them were considered to hinder the realization of a common market for capital. The Segré Report thus provided the first theoretical foundations for the entire discussions.

A web of committees and working groups was then created in order to start discussing the possibility of co-ordinating, with a view to eventual harmonization of, the banking regulation/supervision legislations of the EEC member states (Clarotti, 1982). A group named 'Coordination of Banking Legislations' was created for that purpose in 1969. The Commission's ambitions were very high, as it planned to harmonize all EEC member states' regulatory frameworks in one directive – in short, what would be dubbed today a single rulebook. In July 1972, Wilhelm Haferkamp, the European Commissioner then in charge of the discussions, wrote a draft directive on the co-ordination of legislative, regulatory and administrative dispositions concerning the access to the non-stipendiary activities of credit institutions and their exercise (Commission, 1972). The Commission's ideas concerned all sorts of issues related to banking regulation and supervision, including authorization procedures (section II, Articles 2 to 6), creation of branches (section III, Articles 7 to 9), ratios (solvency, liquidity, profitability – section IV, Articles 14 to 17), deposit insurance (article 18), activities of foreign banks in the EEC and of EEC banks abroad, credit information exchange/'centrale des risques' (that is, mutual information about large loans, article 20), and winding-up procedures and withdrawal of authorization (section VIII, Articles 24 to 27).

This project was transmitted to current member states as well as applicant countries (that is, Britain, Denmark and Ireland). When the Coordination of Banking Legislations group met up again in October 1972, applicant states took part in the meetings. But faced with the impossibility of reaching a compromise after 21 meetings of governmental experts from 1969 to late 1973, including the last eight with the nine member states, the Commission decided to change its strategy. The last eight sessions highlighted in particular the impossibility of reaching an agreement between the experts of the original member states and those of the new members. The key problem stemmed from the fact that Britain (and to a lesser extent Denmark) did not have developed formal, written banking legislation. In particular, the

discussions over the system of preliminary authorization to access banking activities posed problems, as no such system existed in Britain at all, by contrast to those already in force in some other EEC member states. Britain had by far the most developed banking system of the EEC, and the British government showed no readiness to change what it considered to be a highly successful system. An official at the Bank of England thus commented on the Commission's draft directive: 'As it stands, there is virtually no article which we can readily accept in its present form. The whole philosophy of the directive is, of course, diametrically opposed to our system of informal supervision and it is difficult to see how the present text can be amended to accommodate it'.<sup>2</sup>

When reading the records of the various meetings held about the topic in the different branches of the British administration – the Treasury, the Bank of England – but also beyond the government, such as those of the British Bankers Association (Sargent, 1982), one realizes the panic that the Commission's plan spurred in London. 'There can be little doubt that the detailed regulatory system advocated in Brussels would destroy London's advantages', wrote a British Treasury official, commenting on the Commission's directive.<sup>3</sup> The Commission then suggested the abandonment of the 'global approach' to the co-ordination of banking legislation – an approach that was meant to harmonize the EEC member states' banking regulatory framework in one directive. It suggested instead a step-by-step approach – more modest but hopefully more effective – which would spread the burden of the gradual harmonization/co-ordination of the various systems across multiple successive directives.

## II. Thinking Banking Regulation Beyond Crisis-driven Agendas

Another widespread view in the literature presents the development of international and European banking regulation and supervision as merely the product of a crisis-driven agenda. The banking crises of the mid-1970s, such as the failure of the West German bank Herstatt, or later the South American debt crises of the 1980s, prompted concerns about international financial stability that led to some regulatory/supervisory reactions. In short, the development of international/European regulation and supervision of banks proceeded *ex post*, not *ex ante*. This view is, again, largely confirmed by the developments since the 1970s: the banking crises of the mid-1970s led to the creation of the BCBS, and the 2007 financial crisis/eurozone sovereign debt crisis led to the creation of a eurozone banking union. Yet this should not obscure the fact that the European Commission and the EEC member states did discuss, as early as the 1960s, the possibility of harmonizing their supervisory and regulatory frameworks – but, interestingly, for entirely different reasons.

The search for financial stability – the most standard motivation for developing banking regulation/supervision – appeared relatively late, towards the mid-1970s: that is, nearly a decade after the first discussions had begun in the EEC. The introductory parts of reports or speeches on the topic started mentioning it *en passant*. This motivation was of course linked to the financial context. Among the various financial innovations/crises that spurred the debate about international regulation/supervision were the rise of the

<sup>2</sup> Archive of the Bank of England (thereafter BoE), 8A48/4, Unsigned note, Draft Directive on the Harmonisation of Supervision over Credit Institutions, 19 September 1972.

<sup>3</sup> The National Archives, UK (thereafter TNA), T 233/2525, Seamman to Unwin, EEC directive on the coordination of banking legislation, 25 June 1973.

unregulated euromarkets from the 1950s–60s onwards (Schenk, 1998), the international banking crises of 1974–5 (Schenk, 2014) and especially the collapse of Bankhaus Herstatt (Mourlon-Druol, 2015). Events in the banking sector, especially in the foreign exchange and eurocurrency markets, called for measures to be taken in the co-ordination of banking legislations. EEC finance ministers stressed this during a meeting on 18 November 1974, and the European Commission highlighted this as well when it proposed the further strengthening of co-ordination among European supervisory authorities: ‘A meaningful step should be taken without delay [...] The proposed decision should make it possible to compare without delay the practices of the various authorities and to begin discussion between these authorities and the Commission with a view to developing urgently appropriate measures to improve the financial security of credit institutions (liquidity, solvency), and in particular of those active on the euro-markets’ (Commission, 1974). All these crises, sometimes explicitly mentioned in the discussions and sometimes not, created a sense that international co-operation on these matters ought to be improved. This also raised the ambiguity, limits and pitfalls of an exclusively EEC-centred approach confronted with issues that were global in nature, as I will come back to in more detail below.

Yet the two most important reasons why the Commission put this issue on the agenda in the 1960s were related to the creation of a common market in banking and the link with potential monetary integration. Unlike in other EEC policy areas, such as, most famously, agriculture and currency relations (Knudsen, 2009; Dyson, 1994), the co-ordination of banking legislations had some detailed grounding in the Treaties of Rome, although there was no standalone chapter entitled ‘financial integration’ (Maes, 2007). If this certainly could not predict its eventual realization, it however explains why the European Commission seized the topic so quickly. Attempts at co-ordinating banking legislation were based on provisions related to the right of establishment and the free movements of services and capital – especially Articles 54 (freedom of establishment), 57 and 61 (liberalization of banking activities) of the Treaty. In that sense, debates about the supervision and regulation of banks at EEC level have to be seen in the perspective of the creation of a common market for banking, and even more generally of European financial integration.<sup>4</sup> As the Segré Report indicated, disparities in supervision and regulation across the EEC could be considered as obstacles preventing access to the European market. Christopher Tugendhat, the British Commissioner in charge of the discussions after Haferkamp, articulated this reasoning very well: ‘Let us imagine a situation in which complete freedom of operation existed throughout the Community for loans, deposits, the issuing of securities and investment. In these circumstances there would be a clear need, in the interest of the protection of savings and for the sake of orderly market conditions, for some kind of common regulatory framework’ (Tugendhat, 1981). This explains why discussions, after the abandonment of the ‘global approach’, focused on very technical matters – that is, the elimination of restrictions to the freedom of establishment in the banking sector that was the object of the 1973 directive.

### III. Linking EU Monetary Integration and Banking Regulation and Supervision

The EU’s quest for monetary integration provided a second important motivation for harmonizing banking regulation and supervision in the EEC. The theoretical link between

<sup>4</sup> Historical Archives of the European Commission (thereafter HAEC), BAC 244/1996 No.278, *Compte-rendu de la première réunion du groupe de travail ‘coordination des législations bancaires’*, 23-24 June 1969.

monetary integration and the harmonization of banking regulation and supervision comes from the fact that for monetary integration to happen, the free circulation of capital and the integration of financial markets would have to be achieved. A single financial market and a single monetary policy would have to imply, sooner rather than later, a common financial regulatory and supervisory framework. British Treasury official Brian Unwin thus acknowledged in 1972, shortly prior to UK entry, that ‘some coordination of banking law is at least a logical concomitant of monetary union’.<sup>5</sup>

The disconnect observable in the 1990s and 2000s between the development of European monetary integration (that eventually led to the creation of the euro) and that of banking regulation/supervision (that only really took off from 2012) was not manifest in the EEC of the 1960s–70s. At the time of the introduction of the euro, Padoa-Schioppa underlined the ‘novelty [represented by] the abandonment of the coincidence between the area of jurisdiction of monetary policy and the area of jurisdiction of banking supervision’ (Padoa-Schioppa, 1999). Back in the late 1970s and early 1980s, some European policy-makers had however very clearly articulated the process of monetary integration with what was then called ‘the harmonization of banking legislations’.

The very first discussions about European monetary co-operation and integration in the 1950s and 1960s did not really tackle the issue, however (Warlouzet, 2011). The various proposals set out by European Commissioner Robert Marjolin in the first half of the 1960s did not tackle the issue of banking regulation and supervision, but dealt instead with monetary co-operation and macroeconomic policy co-ordination. The Barre memoranda of February 1968 and then February 1969, which partly tried to revive the debate initiated by Marjolin, followed the same template. Barre’s thinking unfolded in three steps, which did not cover banking regulation and supervision: convergence of mid-term national economic orientations first, then concertation of short-term economic policies, and finally the creation of a mechanism for monetary co-operation. This situation may have simply reflected the fact that, at the time, capital movements were still restricted, and the principal motivation behind the harmonization of banking regulation and supervision was the creation of a common market in banking, not cross-border financial stability and the creation of a single currency.

The next important moment in the discussions about monetary integration in Europe, the 1970 Werner Report that set out a plan for the realization of economic and monetary union, gave a first hint at the link between banking regulatory/supervisory issues and monetary integration. While it did not feature prominently, the Werner Report however included a remark explaining that ‘As regards the structural aspect [of the coordination of policies in relation to financial markets], it is necessary to carry out measures of “technical” harmonization in a series of fields, as for example regulations governing the activities of credit institutions and institutional investors, the notification and protection of holders of securities, conditions for the operation of stock exchanges, the encouragement of saving and certain forms of investment, and the legal instruments of financial transactions’ (Werner, 1970, pp. 20–1). Still in 1970, a meeting between Commission officials and representatives of the EBF (European Banking Federation) also highlighted this link. A number of EBF representatives noted that the absence of harmonization of legislation

<sup>5</sup> TNA, T 233/2522, Unwin to Downey, EEC directive on the coordination of the law on credit institutions, 19 September 1972.

had, so far, not created problems, and thus wondered whether co-ordination was at all necessary. Ivo Schwartz, head of the directorate of banking and insurance in the Commission's DG XIV, replied that co-ordination may not seem necessary immediately, but was in the long term. Schwartz identified two reasons: the need to eliminate discrimination (hence related to the idea of a common market in banking), and the creation of 'the conditions of a monetary union taking into account the banking dimension'.<sup>6</sup>

The context changed more radically in the course of the 1970s. The creation of the European Monetary System (EMS) in 1979 provided weight to the theoretical argument that monetary co-operation and banking harmonization should move at similar pace (Mourlon-Druol, 2012). In a meeting with senior officials of the member states' regulatory and supervisory bodies in Brussels, Tugendhat used the EMS as a further reason for moving forward: 'There is the close relation between this field [banking harmonization] and the wider issue of the EMS. It would be easier to implement a common monetary policy if we had banking systems supervised according to equivalent common standards, and eventually of similar structures. Moreover, to the extent to which EMS gives rise to more capital liberalisation, we have to make sure to be able to monitor the actors in this forthcoming common capital market, i.e. the European credit institutions, on the basis of equivalent rules'.<sup>7</sup> Similarly, an internal note of the Commission explained: 'It will be important to bear in mind the relationship between banking integration and progress towards economic and monetary union. EMU will involve not only convergence in the field of monetary policy but also movement towards the integration of structures and the institutional arrangements of the banking sector. We must guard against a situation in which the momentum towards EMU is held up because the necessary underlying work on the institutional side has not been accomplished'.<sup>8</sup> The governor of the Bank of Italy, Paolo Baffi, made a comparable reflection to that of Paulo Clarotti, head of division in the European Commission, when the two talked about this subject in September 1978 in Rome.<sup>9</sup> A Commission report published in 1982 is even more fascinating to read today, as it describes what did not happen – or, at least, what took much longer than expected to happen: 'The overall priority to be given to future work in the field of banking coordination will undoubtedly depend on progress towards monetary integration in the Community. [...] Assuming that the system [EMS] is maintained and even strengthened, it seems fair to expect that it will lead to a situation where a gradual abolition of remaining obstacles to capital movements can be set in motion. It goes without saying that such a situation, in which cross-frontier banking services will come to play a much bigger role than now, will call for an accompanying increase in the intensity of cooperation between supervisory authorities of Member States, and will exert a strong pressure for coordination of supervisory procedures and instruments in the Community'.<sup>10</sup>

<sup>6</sup> HAEC, BAC 244/1996 n°278, *Compte-rendu de la réunion d'information avec la fédération bancaire de la CEE*, 5 March 1970.

<sup>7</sup> HAEC, 223/1997 No.3, *Record of the meeting of senior officials of the Member States in the field of banking legislation and bank supervision held in Brussels on 7 December 1978*.

<sup>8</sup> HAEC, 223/1997 No.3, *Commission, The common market in the banking sector: policies and work programme*, XV/141/78.

<sup>9</sup> HAEC, 223/1997 No.3, *Compte-rendu de mission de P. Clarotti, Entretien avec le gouverneur de la Banque d'Italie à Rome*, 7 September 1978.

<sup>10</sup> HAEC, 223/1997 No.13, *Commission, A Community work programme for the banking sector: situation and prospects*, XV/59/82 Rev.1.

Interestingly, the link between monetary integration and ‘banking union’ was drawn within the Commission’s circles or in the various committee structures discussing banking regulation and supervision, but not during debates about monetary co-operation and integration themselves (James, 2012a; Murlon-Druol, 2012).

The Commission’s project of the 1960s–70s was, however, difficult to realize. Cross-border banking in the EEC was not sufficiently developed to necessitate the harmonization of banking legislations. The high diversity of European financial systems, in turn, made such harmonization very difficult. The very first topic of discussion tackled by the Committee on the co-ordination of banking legislation in 1969 was as basic as the definition of what actually constituted a bank.<sup>11</sup> In a meeting of the Banking Advisory Committee in 1978, the Danish delegation noted that ‘the banking structure of each country was heavily dependent on the country’s overall economic structure and could therefore be changed only slowly and gradually’.<sup>12</sup> In some member states, banking supervision and prudential instruments were much used in monetary policy-making (Monnet, 2014). The need for the European Commission to call for the assistance of multiple expert groups was a direct consequence of the high diversity of systems in the EEC (Clarotti, 1988, p. 154). Experts were there to assist the Commission in its endeavours, if not EEC member states individually, since each of them knew actually very little about each other’s regulatory and supervisory framework. In the same 1978 meeting, the Danish delegation thus further added that ‘it would welcome documentation on banking legislation and the operation of the banking system in each country’(!)<sup>13</sup> In addition, and contrary to the Commission’s thinking, the banks themselves did not seem to be taking differences in banking legislation as a significant obstacle to cross-border operations. As mentioned above, as early as 1970 the EBF expressed doubts about the need to co-ordinate banking legislation in the EEC. Similarly, at the same meeting of the Banking Advisory Committee in 1978, the German delegation reported that ‘from the viewpoint of the banking industry there were no major legal obstacles to transnational activities’.<sup>14</sup>

The disconnect between monetary integration and banking regulation and supervision which was evident from the euro’s creation until the creation of the banking union in 2012 should therefore not be retrospectively taken for granted, as is commonly the case in the literature and contemporary debates. This disconnect first emerged at the time of the creation of the EMS, when it became clear that the evolution of both fields were not going hand in hand: the Commission’s plans for a ‘banking union’ had failed, or at least their ambition had been considerably reduced, while currency relations were back at the top of the agenda with the return of France, Italy and Ireland to the EEC common exchange rate system.

#### **IV. The Historical Innovation of Introducing a European Supranational Supervisor**

However ambitious they were, the plans of the European Commission set out in the 1960s–70s did not envisage the move of the supervisory framework to the supranational

<sup>11</sup> HAEC, BAC 244/1996 No.278, *Compte-rendu de la première réunion du groupe de travail “coordination des législations bancaires” tenue les 23 et 24 juin 1969.*

<sup>12</sup> HAEC, 223/1997 No.2, *Record of the meeting of senior officials of the Member States in the field of banking legislation and bank supervision held in Brussels on 7 December 1978.*

<sup>13</sup> *Ibid.*

<sup>14</sup> *Ibid.*

level. In that sense, the creation of the SSM in 2014 represents a major historical novelty. The introduction of an EEC supranational supervisory system whereby member states' governments would have delegated their supervisory powers to an EEC-wide authority seemed unthinkable in the 1960s and 1970s. An internal note of the European Commission reads: 'The most far-reaching solution in EC banking supervision would consist in planning for a European control authority; this, however, has for political reasons never been proposed. The coordination plans have at all times (even in the comprehensive 1972 Draft Directive) aimed for cooperation of the supervisory bodies but, of course, with a view to giving them authority to deal with individual cases of day-to-day banking control'.<sup>15</sup> About ten years later, in 1983, Tugendhat noted: '[The Commission] has no intention of introducing a Community supervisory authority and with it another tier of bureaucracy' (Tugendhat, 1983). As explained above, the supervisory/regulatory agenda of these years was not as crisis-driven as it would later become, which may explain the reluctance of the European Commission, any other political considerations aside, to suggest the setting-up of a full-fledged supranational supervisory framework.

The Commission never dared to propose the creation of a single, EEC-wide entity for supervision that is central to today's situation; it suggested instead to improve the co-ordination among EEC supervisory authorities. This was a key purpose of the second banking directive that created the BAC (Banking Advisory Committee). The BAC was composed of high-ranking officials from the banking control authorities of the EEC member states and the Commission. In presenting the draft directive, vice-president of the European Commission Henri Simonet explained that 'the question is not only to harmonise texts, but also and above all to harmonise mentalities. The existence of a Committee will allow these authorities to periodically confront their ideas and their conceptions concerning problems of common interest and should facilitate this rapprochement of mentalities, necessary preliminary to the rapprochement of legislations and practices that the Commission should pursue'.<sup>16</sup> A few years later, a Commission official further explained that 'the Community still lack[ed] machinery for strategic and long term thinking and advice, and it is this role which the advisory committee must perform'.<sup>17</sup>

Tugendhat, however, seemed to be aware that the situation could require a more ambitious move in the future. When talking about the mutual recognition of winding-up procedures, Tugendhat explained that 'such arrangements had their use in that, with closer integration of banking systems, for example where a bank had branches in several Member States, crisis management at European level was necessary and could contribute towards the stability of a common market in banking. However, this question did not rank very high in the order of priorities'.<sup>18</sup> In the same 1983 speech quoted earlier, and after having explained that the Commission did not want to introduce an EEC supervisory authority, Tugendhat added: 'But it is important to bear in mind that the swift changes we can expect in European

<sup>15</sup> HAEC, BAC 223/1997 No.3, Note, Position and role of the advisory committee (Art. 11 of the first coordination directive), unsigned, undated, presumably early 1973-4.

<sup>16</sup> BAC 94/1985, n°99, Communication de M. Simonet, Proposition d'une directive du Conseil visant à la coordination des dispositions législatives, réglementaires et administratives concernant l'accès à l'activité des établissements de crédit et son exercice, 28 November 1974.

<sup>17</sup> HAEC, 223/1997 No.3, Note unsigned, The committee structure in the banking field – role and procedures of the advisory committee, XV/323/78-EN.

<sup>18</sup> HAEC, BAC 223/1997 n°2, Record of the meeting of senior officials of the Member States in the field of banking legislation and bank supervision held in Brussels on 7 December 1978.

banking markets in the years to come do require similarly rapid adjustments on the part of the prudential authorities if the same quality of supervision is to be maintained with a bigger element of international business, and these rearrangements can only be realized at Community level' (Tugendhat, 1983). The British Commissioner therefore clearly linked the evolution of the EEC's supervisory institutional framework to the degree of integration of Europe's financial markets. Tommaso Padoa-Schioppa, then Director-General of the Economic and Financial Affairs Division at the European Commission, had reasoned similarly in 1982, when he said: 'To the extent to which there therefore is a need for control and supervision, the question arises of determining the appropriate level at which they should be exercised, and in this regard there is a solid case for operating them at a Community level: the EEC could in this regard be seen as constituting an *optimum regulation area*' (Padoa-Schioppa, 1982).

Yet in the 1970s the EEC did not represent such an optimum regulation area. The banking crises of the mid-1970s involved an international dimension, but one that went beyond the EEC's borders. The failure of Bankhaus Herstatt highlighted the need for co-ordination across the Atlantic, the Israel–British Bank involved transactions between a London subsidiary and the head office in Tel Aviv, and the Lloyds Lugano banking scandal happened in the Swiss branch of the British bank (Mourlon-Druol, 2015; Schenk, 2014). In all three of these cases, intergovernmental co-operation was more necessary at the BCBS/BIS level than at the EEC level. The mere creation of the BAC in the second half of the 1970s proved to be difficult because of the possible overlap in the various committee structures that had emerged in the 1970s. In commenting on the EEC Council of ministers' lack of enthusiasm at the emergence of the BAC, a Commission official explained that 'this was almost certainly partly due to the fact that at that moment another Committee had been created in Basel within the framework of the Group of Ten'.<sup>19</sup> More generally, the further expansion of committees and their accompanying bureaucracy raised little enthusiasm. With the benefit of hindsight, it is interesting to read the then head of the French Treasury, Jacques de Larosière, commenting: 'Such a bureaucracy [the Banking Advisory Committee] seems useless to us and even harmful due to the temptations to hegemony that they would not miss to develop. In addition, it would duplicate the cooperation that already exists between the central bank governors'.<sup>20</sup> Incidentally, the institutional context of the time made a treaty change necessary for a new EEC supervisor to be a supranational body. Today, by contrast, the Treaty on the Functioning of the EU provides the legal basis of the banking union with Articles 114 and 127(6) (Véron, 2015).

## Conclusions

The European Commission's plans in the 1960s represent an interesting if unsuccessful attempt at setting a regulatory/supervisory framework *ex ante*, rather than *ex post*. The fact that such plans were thought of as early as in the 1960s contradicts the widely held belief that European policy-makers never thought about regulation and supervision when devising plans for monetary integration. The Commission's thinking in the 1960s shows that some

<sup>19</sup> HAEC, 223/1997 No.3, Note unsigned, The committee structure in the banking field – role and procedures of the advisory committee, XV/323/78-EN.

<sup>20</sup> Archives historiques de la Banque de France, 1357200901/98, de Larosière to Barre/Boulin, Visite de M. Tugendhat, 10 June 1977. My translation.

European policy-makers clearly articulated financial integration, banking regulation/supervision and monetary integration all together – albeit that the proposals did not go through. The strategy, of course, radically changed in the late 1980s, when the European Commission decided to prioritize capital liberalization over the harmonization of prudential regulations. The 1980s witnessed a progressive change of orthodoxy regarding the supervision of banks and financial markets, with the emergence of neoliberalism (Abdelal, 2007; Jabko, 2006).

The failure of the Commission's proposals shows that if there is, in theory, a logic that necessitates financial regulatory/supervisory union to go along with monetary union, the situation is much different in practice. The Commission's project indeed seemed doomed to failure in the 1960s. Limited cross-border capital movements, fragmented banking systems and structural differences in national political economies made a 'banking union' as a political construct difficult to implement, in spite of its theoretical soundness from an EMU perspective. The context radically changed in the 2000s, when the introduction of the single currency unleashed new material and political forces that rendered banking union necessary. The creation of a regulatory/supervisory framework proved impossible *ex ante*, but necessary *ex post*.

While the various elements outlined above underscore the continuities of the difficulties encountered in the evolution of European financial integration in the past 50 to 60 years, they also highlight two discontinuities. They first contribute to stressing how much of a radical change the inception of the SSM has been; it is European economic integration's biggest step since the creation of the euro. Indeed, however ambitious, the Commission's early proposals about a European 'banking union' never set out to create a supranational supervisory framework in the EEC. Second, the context of the 1960s and 1970s – namely, limitations though rising movements of capital, multiple currencies, no or limited public deficit and debt levels – meant that the disagreements between EEC countries mattered less than they do today. They mattered to the extent that they prevented the European Commission from completing its plans, and thus creating some sort of banking union prior to the creation of a single currency; but today such disagreements are so serious as to put at risk the financial stability of the eurozone.

Finally, it is worth noting that the question of the general public's understanding of these often extremely technical issues was present about 40 years ago, as it is today. The European Commission explicitly raised this problem as early as in 1981, when Tugendhat explained: 'Our plans may be technically all right. They may fit into the present economic context. But our chances of realising them will be slim if we seem to be approaching the problem merely in a technocratic way or as a routine matter. Our ideas will only "sell", to use a marketing expression, if we can prove their political and social utility. We should, therefore, think of the broader context of what we are trying to achieve' (Tugendhat, 1981). This challenge has undoubtedly remained central to European policy-making up to the present day.

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