

Differentiated Integration: The case of the European Banking Union

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Abstract

The European Banking Union (EBU), a system of unified financial supervision, regulation and resolution, arguably represents the biggest transfer of national sovereignty in Europe since the launch of the euro. Participation in the EBU is mandatory for the Eurozone states and voluntary for the non-Eurozone states, which makes it an example of differentiated integration (DI). This article analyses the implications of DI in the context of the EBU. The central question is whether the current EBU arrangements are going to result in uniform integration or continued differentiation. After outlining the main pillars of EBU, the article discusses whether we can envision more non-Eurozone states following the examples of Bulgaria and Croatia by opting into EBU before adoption of the euro, or whether there is a risk of more division between the EBU members and non-members. The focus is on the main economic and political considerations that affect the EBU in the medium term. The article shows that only the non-Eurozone states willing to relinquish their national sovereignty in financial supervision seek to join the EBU and that in the post-Brexit EU the differentiated EBU can potentially move towards more integration.

Keywords: differentiated Integration, European Banking Union, European Union, non-Eurozone

Introduction

The European Banking Union (EBU) is a system of unified financial supervision, regulation and resolution, aiming to encompass deposit insurance. Its objective is to make the European banking market more transparent and safer, and to ensure that bank resolution takes place without recourse to taxpayers' money (European Commission 2015). The EBU plays a crucial role in the European integration process for three reasons.

First, the EBU is a very ambitious project – by moving bank supervision and resolution to the supranational level, the EBU represents the greatest transfer of national sovereignty in the EU since the launch of the euro in 1999 (Schäuble 2013).

Second, despite the complexity of EU legislation, the EBU advanced with remarkable speed in response to the Eurozone sovereign debt crisis. The EBU was endorsed at the European Council Summit in June 2012 in order to restore financial stability. In this regard, it should be noted that the European Commission had advocated a banking union as early as in the 1960s, though the initial proposal at the time was much less ambitious and not crisis-driven (Mourlon-Druol 2016).

Third, the EBU represents a key component in the EU's comprehensive framework of post-crisis reforms aiming for 'a deep, genuine and fair Economic and Monetary Union (EMU)' (Juncker et al. 2015).

The EBU-related research has, however, remained remarkably sparse, compared to the extensive literature on the monetary policy in the Eurozone. It is also noteworthy that while most of the EBU-related research has focused on unified financial supervision, EBU legislation and the links between the EBU and Fiscal Union, there has been comparatively less research on so-called Differentiated Integration (DI) in the context of EBU. This article addresses this less studied phenomenon by taking into account the perspectives of non-Eurozone states towards the EBU with the aim of examining whether the differentiated EBU will ultimately converge in uniform integration or result in further division.

The article first outlines the EBU structure in Section 1. Section 2 then positions the EBU as a case of DI. Section 3 examines the stances of non-Eurozone states on joining the EBU, while Section 4 highlights the changes since 2016 and the implications for the differentiated EBU. Section 5 concludes.

1 Towards a fully-fledged EBU

The EBU consists of three pillars: Single Supervisory Mechanism (SSM), Single Resolution Mechanism (SRM) and the common European Deposit Insurance Scheme (EDIS), all of which apply to the Eurozone members and to those non-Eurozone members that choose to join the EBU. The three pillars are supported by the Single Rulebook, which is a set of harmonised legislation applied to all financial institutions across the whole EU (European Commission 2015). As explained below, the current EBU is not yet fully-fledged.

SSM refers to unified and harmonised bank supervision. In June 2012 the Heads of State or Government of the Eurozone agreed to assign the supervisory tasks within SSM to the European Central Bank (ECB), and in November 2014 the ECB assumed its role as the principal supranational supervisor of banks. As of 1 July 2021, the ECB directly supervises 114 'significant banks' in the Eurozone, while the 'less significant' banks in Eurozone continue to be supervised by national supervisory authorities (European Central Bank [ECB] 2021)¹. The ECB has the authority to revise a bank's status from 'less significant' to 'significant', in cases of potential systemic risk for the banking sector. The transfer of national sovereignty in bank supervision to a supranational institution like the ECB represents an exceptional step from the fragmented supervisory framework in the pre-crisis EU. Overall, SSM enables both early crisis prevention and minimises the possibility of bank failures, as the consistent application of high quality standards within SSM ensures that banks keep a sufficiently robust capital base, and unified supervision ensures effective risk monitoring of banks.

SRM refers to a mechanism by which the EBU ensures the efficient resolution of failing banks with minimal costs for taxpayers and the real economy. The Eurozone financial crisis pushed the EU to adopt a consistent framework for efficient resolution of cross-border banks in order to avoid the complicated and very costly bank resolutions. SRM consists of the Single Resolution Board (SRB), the administrative body established in

¹ Banks qualify as 'significant' if they meet at least one of the four specified criteria (asset size, economic importance, cross-border activities and direct public assistance).

January 2015 with the aim to ensure swift decision-making procedures, and the Single Resolution Fund (SRF) established in January 2016 in order to enable payment for resolution measures (European Parliament 2021). It is important to note that SRF, which is composed of contributions from banks and certain investment firms in the Eurozone, started with ‘national compartments’ that have been built up and mutualised over an eight-year period (2016–24) to reach the target level of at least one per cent of the amount of covered deposits of all banks within the EBU by 2024 (Single Resolution Board 2021). Through the completed SRF, the EBU expects to be in a position to achieve one of its primary aims: breaking the negative link between banks and sovereigns². In November 2020, progress toward SRF gathered further momentum, as the Eurozone finance ministers agreed on the early introduction of a financial backstop to the SRF in 2022, rather than in 2024, in the form of the European Stability Mechanism (ESM) (European Parliament 2021)³.

EDIS remains to be the least advanced EBU pillar. Deposit Guarantee Schemes (DGS)⁴ used to vary greatly among EU Members but following the DGS Directive of March 2009 the minimum protection level across the EU was harmonised to 100,000 euro (per depositor, per bank) by the end of 2010. In 2014, the DGS Directive further ensured that national DGSs would have a significant level of ex-ante funding. Despite the European Commission’s legislative proposals for EDIS in 2015 and 2017, there was little progress with EDIS due to the opposition from several EU Members, notably Germany⁵. However, in November 2019 constructive suggestions on EDIS from the German Finance Minister, Mr Olaf Scholz, ended the impasse and in December 2020 the three EU institutions confirmed the establishment of EDIS to be a legislative priority for 2021 (European Parliament, 2021).⁶

Overall, the current EBU is expected to advance towards its fully-fledged form, and recent developments imply that this progress has gathered some fresh momentum. Centralised financial supervision and regulation together with a unified resolution framework under the current EBU already strengthen the crisis prevention and resolution capabilities of the Eurozone. The following sections examine how these benefits provided by the EBU are seen by the prospective EBU members.

2 Differentiated Integration and the case of the EBU

Differentiated Integration (DI) refers to the case when the territorial extension of EU membership and EU rule validity are incongruent (Holzinger & Schimmelfennig, 2012). Earlier theoretical work on DI explains the demand-side and supply-side-factors: EU enlargements led to an increasingly diverse membership with heterogeneous integration preferences and capabilities (demand-side), while on the supply side the expansion of the EU’s policy scope led to more demanding and conflicting rules (Winzen & Schimmelfennig, 2015). DI provides a solution to

² With bank resolution financed from the resolution fund, bank failures will no longer negatively affect the country’s fiscal position, which will in turn prevent higher sovereign bond yields.

³ This means that in case of need a credit line from the ESM may provide extra funds for bank rescues.

⁴ Safety nets for bank account holders in case of bank failures.

⁵ Germany, apprehensive that its taxpayers would have to bear the cost of bank bailouts in other Eurozone states under EDIS, had for long opposed the scheme.

⁶ The three EU institutions denote the Council of the EU, the European Parliament and the European Commission.

deadlocked negotiations by allowing the Member States to cooperate at different levels of integration.

Winzen & Schimmelfennig (2015) use Member States' strength of national identity and Member States' wealth as the main explanatory factors of heterogeneous integration preferences.

The EBU itself is an example of DI: not all EU Members participate in the EBU, as the participation is mandatory for Eurozone states but voluntary for non-Eurozone states. Why has the EBU been differentiated from the start? Firstly, it was not feasible for the EU to include all of its Member States in the EBU due to the lack of political consensus. The UK, a long-standing opponent of closer integration, did not seek to join the EBU (Quaglia 2017). Secondly, there was a consensus that all Eurozone members should be included in the EBU (Elliott 2012)⁷. Eventually, the European Commission's proposal to include Eurozone plus voluntary non-Eurozone participants was adopted, as it was the most feasible option for the short and medium term (Elliott 2014). The question remains, however, whether in the long run the differentiated EBU converges into uniform integration or, on the contrary, leads to further differentiation.

3 More Union or division?

The EBU includes all Eurozone countries, therefore any EU Member State that adopts the euro in the future will automatically become an EBU member. At the same time, any non-Eurozone State can join the EBU through a close cooperation agreement with the ECB under the SSM supranational framework of supervision and with the SRB under the supranational framework of resolution (ECB, 2014). The option of joining the EBU prior to euro adoption has sometimes been referred to as 'opting in' (International Monetary Fund [IMF] 2015).

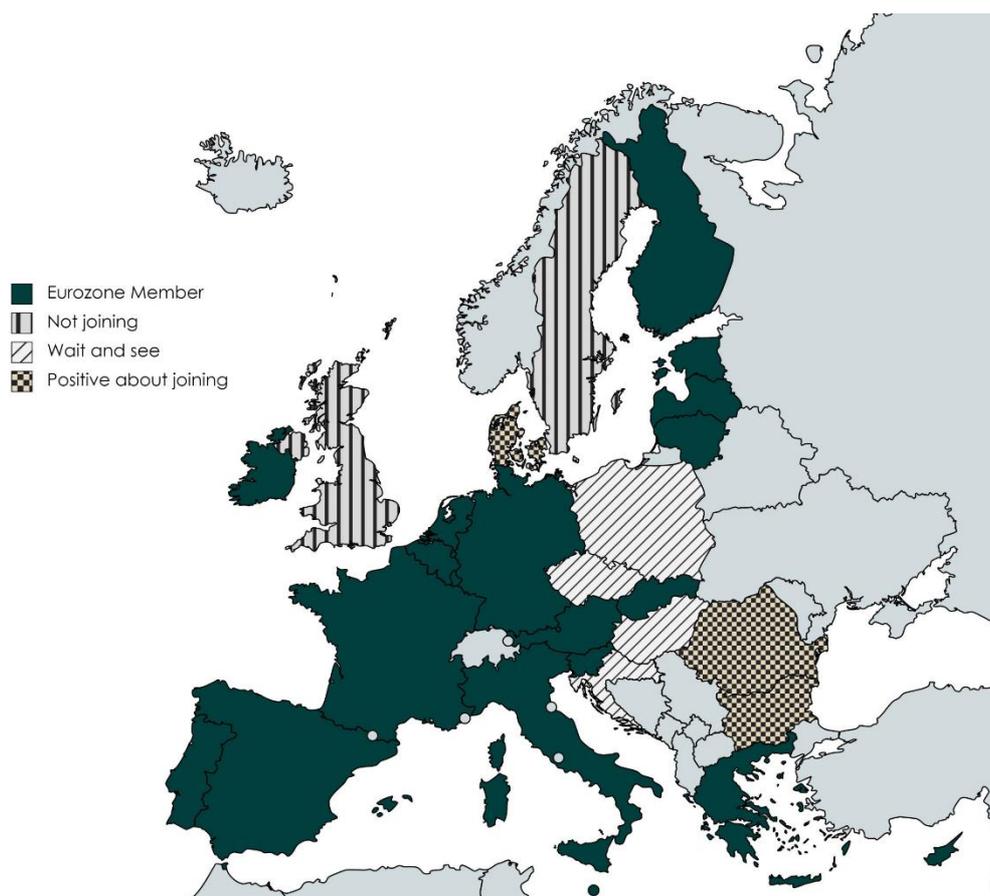
Figure 1 shows that in May 2016 only three non-Eurozone states were positive about opting into the EBU, while four adopted the 'wait and see' approach and two opposed opting in⁸. What kind of economic and political considerations do such diverging stances towards the EBU reflect? These diverse stances represent different integration preferences of these countries and thus can be viewed as the aforementioned demand-side of DI. Belke et al. (2016) assume that the countries with following characteristics are more likely to opt into the EBU: high share of foreign ownership in the domestic banking, weaker banking system and lower supervisory standards, insufficient national resolution funds, and perspective of the euro adoption in near future.

Have there been any pronounced changes in these diverse preferences of non-Eurozone states since 2016? What can be implied for the differentiated EBU in longer term? This section addresses these questions.

⁷ Elliott (2012) notes that if a smaller Eurozone member was omitted from the EBU, the country would most likely encounter capital outflows, as a result of risk assessment by markets. On the other hand, if for example Germany was not part of the EBU, markets would lose confidence in the EBU.

⁸ The non-Eurozone members' stances on the EBU crystallised during the first four years (the period when the EBU regulation came into force and the ECB became the supranational supervisor) since the endorsement of the EBU. 2016 is therefore chosen as the benchmark year.

Figure 1 Stance of each EU Member on the EBU (as of May 2016)



Source: Press releases by National Central Banks of EU Members

3.1 Why are some non-Eurozone Member States reluctant to opt in?

Let us first examine the stances of the six non-Eurozone members reluctant to opt into the EBU in 2016. For the UK, a staunch opponent of closer integration, opting into the EBU was politically unacceptable, as it would involve supranational banking supervision and resolution (Quaglia 2017). However, the UK is no longer an EU member: the country withdrew from the EU on 31 January 2020 (in the so-called ‘Brexit’ process).

For Sweden, one of the most Eurosceptic EU Members, the loss of national sovereignty had traditionally been a contested issue and the country has remained outside the Eurozone following the 2003 referendum, in which 56% of Swedes voted against the euro adoption (Schimmelfennig et al. 2015). Consequently, preference for retaining national regulatory autonomy in crisis management of banks was one reason for not joining the EBU. Sweden was also concerned that debt mutualisation under the SRM may result in cases where Sweden (should the country join the EBU) pays for the resolution of failed non-Swedish banks (Spendzharova & Bayram 2016).

The rationale behind the “wait and see” approach displayed by the Czech Republic, Croatia, Hungary and Poland can be summarised as follows. First, these countries do not have an imminent need for opting into the EBU, as their capabilities in national bank supervision proved sufficiently strong and credible during the European financial crisis (Profant & Toporowski 2014). Therefore, the transfer of national authority in

supervision and resolution to the supranational level has not become a prominent issue in the economic and political discourse (Profant & Toporowski, 2014; Kisgergely & Szombati, 2014). Second, as the EBU is not yet fully-fledged, and several policies and mechanisms of SRM have remained largely untested, these four non-Eurozone countries deemed it risky to participate in relatively new EBU mechanisms (Kisgergely & Szombati 2014; Belke et al. 2016). Third, these countries were concerned about the imbalance between non-Eurozone and Eurozone members within the differentiated EBU (Profant & Toporowski 2014). To be precise, these countries advocated for equal participation in the decision-making process of SSM, as under the current arrangements, only Eurozone states can have a seat in the ECB Governing Council, the highest decision-making body in SSM. Furthermore, should non-Eurozone states opt into the EBU, they would not gain access to fiscal backstops and liquidity support, as under the current SRM arrangements such access is available only to Eurozone states.

It should be added that in the light of Hungary's as well as Poland's strained political relations with the EU in the last few years, these two countries are not expected to opt into the EBU. Some studies identify Hungarian and Polish policies that promote national interests in banking as 'banking nationalism' and indicate that such policies are incompatible with the EBU (Mero & Piroska 2016)⁹.

Let us now examine how the EU addressed the imbalance between non-Eurozone and Eurozone EBU members. Regarding the decision-making process of SSM in the differentiated EBU, due to treaty constraints there is no change to the stipulation that only Eurozone states have a seat in the ECB Governing Council. However, non-Eurozone states that opted into the EBU are able to participate in the ECB Supervisory Board, which prepares final decisions related to banking supervision (Belke et al., 2016). Furthermore, to prevent Eurozone members from imposing rules on non-Eurozone members, the European Banking Authority (EBA) voting reform introduced a double-majority voting system, whereby a dual majority from EU Member States inside and outside the EBU is required for implementing EBA decisions (Quaglia 2017)¹⁰. Despite this compromise in voting modalities, some non-Eurozone members remain concerned about full participation in the EBU decision-making, which then impacts their decision of not opting into the EBU (Spendzharova & Bayram, 2016)¹¹.

Regarding access to fiscal backstops and liquidity support at times of crisis, non-Eurozone EBU members are unable to access funds for direct bank recapitalisation from the ESM, as the ESM Treaty is open only to Eurozone members, and political constraints hinder any future change in the Treaty (IMF 2015; Belke et al. 2016). Consequently, should banks in a non-Eurozone EBU member face a liquidity crisis, liquidity could be granted only via repo or swap lines (IMF 2015)¹².

⁹ The quoted study mentions reshaping banks' ownership structures in Hungary and (to a lesser extent) in Poland as some examples of banking nationalism.

¹⁰ This safeguard will end once there are less than four non-EBU members (Quaglia 2017).

¹¹ Unlike Sweden and Poland, Denmark views the SSM arrangements positively: "It is assessed that the difference in access to the Governing Council will not in practice constitute a significant challenge for non-euro area Member States participating in the Banking Union....it is the assessment that the structure of the Banking Union secures equivalent terms of participation of non-euro area Member States." (Danish Ministry of Industry, Business and Financial Affairs 2019, pp.9-10).

¹² Liquidity provisions by ECB to non-Eurozone members via repo or swap lines are evaluated on a country-by-country basis and subjected to monetary policy considerations.

Through the above-mentioned measures the EU found a balanced solution that at least partially reduced the imbalance between non-Eurozone and Eurozone members of the EBU. There is also a safeguard in the form of an exit clause enabling non-Eurozone states (but not Eurozone members) to withdraw from the EBU (IMF 2015).

3.2 Motivations for opting into the EBU

In 2016 Denmark, Romania and Bulgaria were all positive about opting into the EBU. Before explaining each country's stance, it should be pointed out that Denmark has secured an opt-out from adopting the euro.

The Danish Central Bank identified several reasons why joining the EBU would be in the country's interest (Danmarks Nationalbank [DNB] 2015). First, the SSM would strengthen financial supervision in Denmark and the country would be able to influence the development of supervisory standards. Denmark in particular stressed the importance of taking national specifics into account in the EU regulations due to having a large mortgage credit sector with a specific business model. Second, SRM would provide a more efficient and credible framework for crisis management¹³. Moreover, according to Denmark's assessment, the EBU has measures for limiting the risks that resolution costs of failed banks in an EBU member would transfer to other members. Third, uniform supervisory standards ensure a more level playing field and reduce regulatory costs, which is mainly relevant to banks with cross-border activities. Finally, the Report by DNB gives some caveats about expected costs of non-participation in the EBU, notably a possible negative impact on Danish banks' funding. Market participants are expected to view the EBU participating and non-participating countries separately. Should the Danish banks remain positioned outside the scope of the SSM and its unified supervisory standards, it is expected that international investors will compare Danish banks with banks in other Western and Nordic non-Eurozone states (UK, Sweden and Norway), while at the same time there would be an extra cost for the investors to follow Denmark-specific rules in supervision¹⁴.

From Romania's perspective, there are many drawbacks to staying outside the EBU. Should a bank crisis occur while Romania is outside the SRM, the country is likely to be vulnerable to financial contagion and its national resources for crisis resolution insufficient (Linhardt, 2014a). Romania also seeks to join the EBU in order to have some influence on decision-making related to banking regulation (Georgescu 2013). Market experts have stressed that Romania needs independent and transparent banking supervision (Goranitis 2020). Moreover, similarly to other Central and East European Countries (CEECs), Romania's banking sector is dominated by foreign-owned banks (predominantly banks from the Eurozone), which makes joining the EBU a natural choice. In this regard, joining the EBU is expected to mitigate or even eliminate the host/home coordination issues in bank supervision¹⁵. For all these reasons, opting into the EBU is considered to match the country's national interest.

¹³ In this regard, the Report also notes that the fully mutualised SRF, which was estimated to reach 55 billion euro in the original plan for 2024, would be about 45 times the size of the Danish national fund (DNB 2015, p.45).

¹⁴ Compared to Denmark, the mentioned countries tend to have stricter capital requirements for banks and tighter rules for measuring credit risks on mortgage credit (DNB 2015, p.48).

¹⁵ Subsidiaries of foreign-owned banks tend to be systemically important in host countries (e.g. Romania), while not systemically important in the foreign bank's home country (e.g. Italy). This had frequently led to the so-called 'home/host coordination problem'. However, in terms of size most foreign-owned subsidiaries in CEECs usually

Bulgaria officially announced its willingness to join the EBU in July 2014 and the perceived benefits of SSM, such as centralised high-level supervision enabling efficient crisis prevention, seem to have influenced this decision. This followed the banking crisis in the country: in June 2014, the Corporate Commercial Bank (CCB), the fourth largest Bulgarian bank in terms of assets, experienced a sudden run on deposits after some political instability. Then, the First Investment Bank, the third largest bank in terms of assets, also experienced a run on deposits due to a deliberate and systemic criminal attempt to disrupt the banking system (Cristova-Balkanska 2014). Depositors removed deposits from these two banks to some foreign-owned banks in Bulgaria, which they perceived to be safer (Linhardt, 2014b). Moreover, the Bulgarian National Bank's Deposit Insurance Fund had insufficient funds to cover depositors from CCB, which prompted intervention by the European Commission. Following these developments, Bulgaria strongly needed a credible external assessment of its banks, which would be provided by the ECB's Comprehensive Assessment (CA) once the country joins the EBU, as well as implementing an effective bank resolution system, which would be provided within the SRM (Linhardt 2014b).

4 Dynamic aspects and implications for the future of a differentiated EBU

As shown above, economic considerations linked with political dimensions define countries' positions vis-à-vis the EBU. However, just as the EBU evolves, these positions are bound to change over time, which in turn may lead either to a more integrated or more divided EBU. The following four main dynamic aspects are expected to shape the EBU in the course of time.

4.1 Brexit

Brexit inevitably creates new power dynamics in the EU, and by stimulating the non-Eurozone states to revisit their stances on the EBU may potentially even affect the propensity of at least some of these states to opt into the EBU. Since the Eurozone has much greater weight in the post-Brexit EU, non-Eurozone states may, for instance, find themselves in a weaker negotiating position inside the EBA (Tokarski & Funk 2019). Both Denmark and Sweden have each conducted detailed analyses assessing the costs and benefits of the EBU membership for their respective economies. In both countries, opting into the EBU is starting to be viewed as a way to offset the trends towards their post-Brexit marginalisation (Danish Ministry of Industry, Business and Financial Affairs 2019; Riksbank 2020). The latest review of Denmark's possible participation in the EBU concludes that Denmark could retain its mortgage credit model within the EBU and, overall, the review reiterates that Denmark would benefit from opting into the EBU (Danish Ministry of Industry, Business and Financial Affairs 2019). However, Denmark postponed a definite decision on joining, as the EBU continues to work on additional elements (e.g. EDIS) and Denmark requires more clarification on its alliances in the economic area as a non-euro state.¹⁶

The Swedish Central Bank (Riksbank) assesses that the EBU's supranational framework for supervision and resolution would benefit Swedish banks with cross-

qualify as significant banks, and thus, similarly to the parent banks in their home country, will qualify for the ECB's centralised supervision, which should resolve the home/host coordination issues.

¹⁶ From the recent review, it is evident that Denmark closely watches Sweden's position vis-à-vis EBU (Danish Ministry of Industry, Business and Financial Affairs 2019, p.18).

border activities more than the equivalent national mechanisms and evaluates the safeguard mechanisms for non-Eurozone members as ‘not insignificant’ (Riksbank 2020). Overall, Riksbank concludes that Sweden would benefit from the EBU membership, however, the final decision on participation should be made by politicians.

It is evident that owing to Brexit, the remaining non-Eurozone members have become increasingly aware of other countries’ stances towards the EBU, and that there are also indirect market pressures on banks to seek inclusion in the EBU¹⁷.

4.2 Tangible Results

Over the past six years the EBU has achieved numerous tangible results, which may make non-Eurozone states more inclined to consider opting in. First, supervision under the SSM has proved to be strong and consistent and helped to reduce risks in the banking sector (European Commission 2019).¹⁸ It is not only the ex-socialist non-Eurozone states that stand to benefit from the significant resources and extensive supervision experience accumulated by the SSM.¹⁹ Following the recent money laundering scandals in Scandinavia and amidst the heightened cyber threats on banks, the advantages of EU-level supervision have been highlighted.²⁰ Second, financial markets reacted positively to the SRB’s June 2017 resolution decision on Banco Popular, a failed Spanish bank. Efficient resolution of cross-border banks under SRM is relevant especially to Sweden and Denmark, both home countries of cross-border banks.²¹ Third, the ECB’s Governing Council has so far not objected to any decisions of the Supervisory Board, which implies that, contrary to initial expectations, non-participation in the Governing Council would not in practice be problematic for the non-Eurozone EBU members (Danish Ministry of Industry, Business and Financial Affairs 2019).

4.3 EBU Enlargement

From 1 October 2020 both Bulgaria and Croatia joined the SRM in parallel with joining the SSM (Single Resolution Board 2020).²² This unprecedented enlargement of the EBU by non-Eurozone countries is a historic milestone despite its low public and political visibility amidst the ongoing COVID-19 pandemic. Moreover, on 10 July 2020, the ECB announced that both countries were also admitted to the Exchange Rate Mechanism (ERM) II, which brought them one step closer to Eurozone membership.²³

¹⁷ The Riksbank’s consultation response explicitly says that “the increasing number of countries entering the banking union, provide, in itself, an argument for Sweden to do so too” (Riksbank 2020, p.18). It also notes how in 2018 Nordea Bank moved its headquarters to Helsinki to benefit from the advantages of being within the EBU (Riksbank 2020, p.12).

¹⁸ Similarly, Denmark points out that the SSM would mean “additional eyes” on the country’s largest banks and would strengthen supervision and enhance comparability (Danish Ministry of Industry, Business and Financial Affairs 2019, p.5).

¹⁹ Jensen and Schoenmaker (2020) describe the benefits of the SSM for Denmark and Sweden.

²⁰ Bjerregaard and Kirchmaier (2019) provide an overview of the Danske Bank money laundering scandal. According to Riksbank (2020), capabilities of the Swedish national authority in addressing the cyber risks cannot match those of ECB.

²¹ As Jensen and Schoenmaker (2020) note, both countries cannot provide a credible fiscal backstop to their large banks.

²² From the same date, five Bulgarian banks and eight Croatian banks will be subject to the ECB’s direct supervision.

²³ ERM II is a mechanism ensuring that the exchange rate fluctuation between the euro and a currency of the ERM II member (in this case, Bulgarian Lev and Croatian Kuna) remains within a standard fluctuation band in

There are four main implications for the future of EBU. First, the simultaneous joining of the EBU and ERM II, which had not been originally included in the EBU regulations, may from now be used as a precedent for others, as European leaders intend to follow a similar approach in the future (Eurogroup 2019). Second, under such an approach, the number of potential opt-ins may remain limited. Incentives for joining the EMU and those for opting into the EBU actually converge in the cases of Bulgaria and Croatia due to certain characteristics in their banking and exchange rate systems (Nieto & Singh 2021). Romania would appear as the most likely candidate to seek the concurrent inclusion into the EBU and ERM II, as the country has been adjusting its target year for euro adoption and remains interested in the EBU opt-in.²⁴ However, the simultaneous participation is an unlikely prospect for others: as mentioned previously, Denmark has a permanent opt-out from the Eurozone, while Sweden views the EBU participation separately from participation in EMU.²⁵ The economies of Poland, Hungary and the Czech Republic have moderately converged with the Eurozone (See Appendix), but none of these states currently seeks to join ERM II or EBU (Plevak 2021). It remains to be seen to what extent the post-2020 convergence facility proposed by the European Commission incentivises euro adoption (European Commission 2018). Table 1 summarises the current stances on the EBU.

Third, due to simultaneous participation in the EBU and ERM II, the argument of adverse selection in EBU becomes somewhat weaker.²⁶ Bulgaria and Croatia, both EU latecomers, had to implement wide-ranging reforms in their financial sector and public sector governance, harmonise their national regulations with ECB requirements, and their banking sectors underwent a CA in line with ECB standards (Croatian National Bank 2019b).

Last but not least, Croatia's case illustrates how a country can change its stance on the EBU in a relatively short timeframe of three years. Croatia started to see its EBU opt-in as a precondition for the euro adoption, to which Croatia has been firmly committed since its EU accession (Croatian National Bank 2019a).²⁷

Table 1 *Stance of each non-Eurozone State on EBU (as of November 2021)*

EBU member (since 2020)	Positive about joining EBU (with euro adoption plans)	Positive about joining EBU (no euro adoption plans)	Not inclined to join EBU (nor adopt euro)
Bulgaria Croatia	Romania	Denmark Sweden	Czech Rep. Hungary Poland

order to prevent disruption of the economic stability of the Single Market. In order to adopt euro, a country needs to stay within the ERM II for at least two years and meet all the Maastricht criteria of economic convergence.

²⁴ The original target year (2024) was postponed to 2027–28, as Romania currently does not meet any economic criteria for euro adoption (CDE News 2021).

²⁵ Riksbank explicitly states that the two memberships are entirely different (Riksbank 2020, p.7).

²⁶ The case when the EBU voluntary opt-ins are the states most likely to need assistance from other EBU members (Castaneda et al. 2016, p.11).

²⁷ From the government's viewpoint, the EBU opt-in is likely to strengthen the case for the euro adoption in the target year of 2023.

4.4 Completion Talks

After years of little progress, remaining parts of the EBU are gaining track in political discourse. This article pointed out the recent progress with the SRF and activated talks on EDIS, and that there is evidence that the EU remains fully committed to the completion of EBU (Eurogroup, 2021). At the same time, it is clear that continuing political talks are needed to surmount the differing stances among the Eurozone members. The progress with completing the EBU is closely watched by Sweden and Denmark, and both countries have now forged closer links with several Eurozone members in the form of the New Hanseatic League (Tokarski & Funk 2019).²⁸

5 Conclusion

This article examined DI in the context of EBU by explaining the differing stances on the EBU held by non-Eurozone states in 2016 and then by showing the most important dynamic changes of the past five years. The article also showed that the EBU opt-ins tend to be the so-called EU latecomers (Bulgaria, Croatia, with Romania being a prospective future EBU member), countries that positively evaluate the benefits of SSM and SRM and also view the EBU opt-in as a first step towards euro adoption. At this point, the EBU opt-in remains a distant prospect for Hungary, Poland and the Czech Republic, as their governments stay protective of national sovereignty in financial supervision.

The article highlighted the four factors that help set in motion a set of dynamics that in the longer term favours the move of a differentiated EBU towards more integration over the move towards more division.

The EU can in some ways incentivise opting into the EBU: this article illustrated some measures and safeguards that reduced the imbalance between the non-Eurozone and Eurozone EBU members. The article also pointed out that the future of the differentiated EBU was likely to be shaped by the EU approach: should the EU expect the prospective EBU members to follow the cases of Bulgaria and Croatia by joining simultaneously the EBU and ERM II, the number of future EBU members may remain limited, as both Sweden and Denmark (the countries that evaluate the EBU positively) would most likely seek only inclusion into the EBU without concrete plans to adopt the euro.

Future research could analyse the prospects of euro adoption by non-Eurozone states in the post-Brexit EU and the EBU's significance for the banks' competitive position.

²⁸ Formed in 2018, the New Hanseatic League (Estonia, Finland, Ireland, Latvia, Lithuania, the Netherlands, Sweden and Denmark) supports the compliance with common rules and keeping the EBU open to non-Eurozone. This alliance is a successful joint representation of Eurozone and non-Eurozone states and was formed mainly due to the impending Brexit.

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Appendix

Economic indicators of convergence for the seven non-Eurozone states

Country	HICP Inflation (average annual % change)			General government surplus (+) / deficit (-) (as % of GDP)			General government debt (as % of GDP)			Long-term interest rate (average annual rate)		
	2018	2019	2020	2018	2019	2020	2018	2019	2020	2018	2019	2020
Bulgaria	2.6	2.5	2.6	2.0	2.1	-2.8	22.3	20.4	25.5	0.9	0.4	0.3
Croatia	1.6	0.8	0.9	0.2	0.4	-7.1	74.7	73.2	88.6	2.2	1.3	0.9
Romania	4.1	3.9	3.7	-2.9	-4.3	-9.2	34.7	35.2	46.2	4.7	4.5	4.4
Czech R.	2.0	2.6	2.9	0.9	0.3	-6.7	32.6	30.8	38.7	2.0	1.5	1.5
Hungary	2.9	3.4	3.7	-2.1	-2.0	-5.2	70.2	66.3	75.0	3.1	2.5	2.3
Poland	1.2	2.1	2.8	-0.2	-0.7	-9.5	48.8	46.0	58.5	3.2	2.3	2.2
Sweden	2.0	1.7	1.6	0.8	0.5	-5.6	38.8	35.1	42.6	0.7	0.0	-0.1
Reference value	1.8			-3.0			60.0			2.9		

Note: Indicators exceeding the reference value for 2020 are marked in bold. Besides these nominal convergence criteria, exchange rate developments are monitored and national legislation must fulfill required criteria. Source: ECB 2020, p.44.