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Banking Union and Banking Nationalism – Explaining Opt-Out Choices of Hungary, Poland and the Czech Republic

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1. Introduction

The Banking Union (BU) is possibly the greatest single step towards tighter financial integration taken by the European Union member states since the introduction of the Euro. Based on a single rule book for all 28 member states, it establishes a single supervisory (SSM) located at the European Central Bank (ECB) that has the promise of creating a level playing field for all major banks in Europe. The Banking Union project also encompasses a single resolution mechanism (SSR) that has the potential to disentangle the interdependence among banks and nation states. Once the Banking Union is fully functional - including the now postponed Single Deposit Insurance System - it is hoped that there will be a more stable and secure banking system in Europe. Joining the Banking Union is compulsory for all Eurozone member states. Non-Eurozone European Union (EU) members may decide to join the project or not. UK and Sweden opted out saying that the BU gives limited rights to non-Eurozone states.[3] However, Denmark also outside the Eurozone has indicated an interest in joining the club.[4] A few Central and Eastern European (CEE) countries with banking sectors largely dominated by Western European mother banks have taken a cautious wait-and-see approach.

There is an ongoing debate on the magnitude of the change brought about by Banking Union for European banking. Some contend that the creation of common supervisory mechanism amounts to a huge loss of national control over banks (Esptein and Rhodes 2014; Howarth and Quaglia 2014); others however, question the magnitude of change. They argue that major change was compromised and national regulators are still in control (Donelly 2014; McPhilemy 2014). We agree with De Rynck (2016) who argues that “centralizing supervision and harmonizing standards are a rupture with the past and introduce a new policy model” (p. 120). Because of the importance of change, we believe the Banking Union raises a number of intriguing political and economic questions: Why did the largest potential beneficiaries opted out? Why the Eurozone countries agreed upon this particular form and content? Why now? Or, even more interestingly, why do some Central and East European EU member states dissent from an arrangement that promises safer and more stable banking to all participating members? In this paper, we attempt to answer this last question.

Central and Eastern European non-Eurozone countries’ mixed position on the BU is puzzling for at least two reasons. First, their banking sectors share a number of similar structural characteristics, yet their positions vis-à-vis the Banking Union differ sharply. While Poland, The Czech Republic, Hungary and Croatia have taken a wait and see approach in 2014, Bulgaria and Romania declared intentions to join the club as soon as possible. Second, because these countries’ banking sectors are extremely open to foreign investors, two influential Bruegel studies, one in 2013 (Darvas and Wolff

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[3] http://www.ft.com/intl/cms/s/0/f5af041e-43ac-11e2-844c-00144feabdc0.html#axzz3x6r1oS3Y
[4] http://uk.reuters.com/article/uk-eu-banks-denmark-idUKKBN0NL1TR20150430

2013) and one in 2016 (Hüttle and Schoenmaker 2016), argued that joining the BU would be beneficial for them because it could improve the credibility of national prudential arrangements, overseen by the ECB. Yet, the above mentioned CEE countries prefer local control over their banking sectors to ECB-provided stability.

CEE policy makers' own account for the dissent was presented and analyzed by the International Monetary Fund (IMF) in 2015. The IMF organized a policy forum in 2014 where representatives of six CEE governments and central banks together with the ECB evaluated the possible impact of the Banking Union on their national banking sectors. The forum's conclusion was that the CEE decision makers are more concerned about potential downsides of early opt-in to the BU than benefits of potential upsides. Among the downsides of joining the BU they emphasized those features of the BU which weakens the supervisory power of the state such as the loss of control over intra-group flows, loss of control over bank resolution. Additionally, under SSM, bank supervision may not be strict enough or may be too strict for country circumstances. They extensively criticized the current set up of the SSM for being overly complicated, for not granting the same fiscal safeguards to non-Eurozone member states and for being too expensive for what it provides (IMF 2015 p. 38). In other words, Hungary, the Czech Republic, Poland and Croatia communicated that their reason for opting out is that they believe they can provide for the same level of stability of their banking sector as the ECB, but for less. However, arguments regarding the soundness of banking in these countries are backward-looking and implicitly contain the unjustified assumption that the future probability of banking crises and the related resolution costs will be also lower in these countries than in the Eurozone countries.

We argue that these CEE countries opt out mainly because governments in these countries want to stay in control of their own banking sectors and believe that their supervisory practice is equal or superior to that of provided by the ECB. We show how banking nationalism dominates policy making in CEE, and that this policy choice explains their distance from the BU. We argue that Bulgaria and Romania opt-in BU because their banking systems are highly fragile and these fragilities are coupled with a low level of state capacity to maintain financial stability. In addition, these two countries are among the most Europhile countries of the EU. In this study, we only consider opt out positions taken by the Hungarian, The Czech and Polish governments and exclude Croatia from the investigation. Even though Croatia took a similar wait-and-see approach, because this country was not a member of the European Union during the financial crisis, we cannot exclude that it made the same decision for different reasons than the other three countries. Out of these three countries we look at Hungary where banking nationalism is probably the most prominent and best documented. We argue that banking nationalism is the underlying policy preference that ultimately defines CEE governments' position vis-à-vis the Banking Union.

In the course of the research for this article we conducted semi-structured interviews with officials from the Hungarian central bank, experts from Hungary and Poland and bankers from Hungary, Poland and the Czech Republic. The interviews were conducted in 2015.

The paper is organized as follows. First, we overview alternative explanations to the dissent of CEE countries. Most of these explanations take distinct structural characteristics of banking sectors and derive the opting in and opting out choices from these characteristics. We show that these attempts not only fail to logically link different structural attributes to the chosen policy lines, but that there are no underlying structural similarities in the opt-in countries that would set them apart from the opt-out countries in CEE. As potential alternative explanations we analyze the state capacity and the EU's perception of CEE5. It is followed by an outline of banking nationalism that legitimates controversial policies that could not be pursued inside the Banking Union. Next, we present a detailed case study of Hungary and reveal banking nationalism. Finally, we show examples of banking nationalism from Poland and the Czech Republic. The last part concludes.

2. A failed attempt: Structuralist frameworks

Explaining positions taken by various countries towards international rule harmonization based on differences in their domestic structural characteristics has a long established tradition within IPE (Frieden 1991, Frieden and Rogowski 1996, Frieden 2002, Garett 1992). One of the attempts which is based on this literature and set out to explain opt-out positions of CEE member states from the Banking Union was published by Spendzharova in 2014. Spendzharova (2014) argued that countries where foreign ownership in the banking sector is high and domestic bank internationalization is low would prefer to preserve some national regulatory autonomy. "The causal mechanism here is that banking supervisions in host countries are wary of giving up regulatory tools that allow them to steer credit flows in a direction that is most compatible with their national mandate and policy priorities." (p. 960). In her analysis, all CEE countries have fallen into this category.

There are a number of problems with this argument, however. First, as of 2016 we know that both Romania and Bulgaria opted in the Banking Union, while Poland, the Czech Republic and Hungary registered a wait and see approach. In the two structural categories selected by Spendzarova (high foreign ownership and low internationalization of domestic banks) Romania and Bulgaria are in the same category as Poland and the Czech Republic so they should have the same preferences vis-à-vis the Banking Union, but they do not. If there is one outlier among the CEE5 cases under these structural conditions, it is certainly Hungary, where OTP bank (a bank under domestic control) has developed a marked presence in neighboring countries' markets. Yet, Hungary's position is still the same as that of its Czech and Polish counterparts. This fact in itself disproves her argument which presupposes similar policy formation under similar structural constraints. Second, selecting only two structural categories may not be enough to clearly see how banking sector conditions influence governments' policy formation. It seems to us that a more complex picture may reveal other interests. Taking into consideration financial depth, banking sector concentration, profitability of largest banks, and other factors should provide additional resources to a structure-based argument. Finally, as in the case of many

other structure-based analysis, it is unclear that given the particular structural conditions selected by Spendzarova are prior to and explanatory of the regulator's choice of the predicted behavior (control) rather than some other. A preference for the autonomy in financial regulatory matters is assumed rather than accounted for causally.

Howarth and Quaglia (2014) set out the task of explaining EU member states' position towards the BU using a much larger set of structural variables. They looked at the degree of banking system concentration; the degree of internationalization/Europeanisation; the degree of foreign bank penetration; and the funding of different banking systems (and specifically the extent of short-term (less than one year) funding) on wholesale markets (largely inter-bank and cross-border). The major claim of their paper is that banking sector structures strongly influence member states' positions vis-à-vis the BU. However, when turning to explain the opt-out positions of CEE countries they write: "Central and Eastern European countries with banking systems dominated by foreign (mostly Euro area) banks had an incentive to join BU because they were not in a position to safeguard financial stability domestically. However, they came out against participation." Therefore, they conclude "these stand as counter-examples to the importance of banking system structure to policy preference" (p12.) Unfortunately, they stop their explanation with regards to CEE positions right there, leaving the reader to wonder why banking sector structures are good proxies in Eurozone member states but are unimportant in non-Eurozone countries.

Epstein and Rhodes (2014), in a partly structure-based analysis, also examine the reasons why European countries decided to move financial supervision to supranational level (the opt-in position). First, they point out that global liberalization made banking sector protectionism more costly and conflictual for states. In particular, they argued that because of increased integration of capital (including bond) markets the danger in the process that banks provided credit to "their sovereigns" in the form of buying excessively state bonds became more costly and risky. As government bond yields increased not only did states face higher borrowing costs, but also, at the same time, their banks got into trouble. Therefore, they claim, one of the major reasons why states in Europe became inclined to give up banking sector protectionism was the increased financial vulnerability of both banks and states. Second, they argue that the introduction of the common currency, together with fragmented banking systems, created structural conditions in which recession hit banking systems faced limited adjustment tools. Moreover, the same structural contradiction led to another problem in the Eurozone, namely the ineffective transmission mechanism of the monetary policy by ECB. The common currency also created new channels through which states' vulnerabilities could travel: troubles in one Eurozone countries' finances easily affect other member states borrowing costs. This is the case as the common currency thus far was not backed by a common pool of resources to help troubled banking systems. Third, Epstein and Rhodes pointed out a change in the interest of international banks away from that of their home authorities. They claim that internationally active banks became increasingly wary of the conflicts they faced with home and host regulators and demanded a common framework of supervision in Europe. Finally, they pointed

out the importance of ECB and the Commission in actively persuading member states (most importantly the reluctant Germany) to follow suit and opt into the BU initiative.

While Epstein and Rhodes (2014) only endeavored to explain the opt-in position, we may try to relate these structural and institutional factors and examine how they affect CEE5 choices to opt-out. It seems to us that based on these changes in European banking we cannot discern definitely any shared, preferred position of CEE countries. First, during the financial and sovereign debt crisis, the sort of sovereign-and-banks intimacy which affected some Eurozone countries never developed in CEE, due to the very high internationalization of their banking sectors. Second, CEE5 countries have not introduced the Euro yet, so those structural changes in banking that make the preservation of fragmented banking systems in Europe costly under one single currency do not affect them. These two structural factors thus do not push them towards an opt-in position. Puzzlingly though, two out of the CEE5 non-Euro area countries decided to join in. Third, the second structural reason (a change in the interest in the internationally active banks if applied to the CEE cases) would certainly push all of them towards opting-in. Their banking sectors are dominated by large, international banks, whose interest is certainly with the delegation of bank supervision from state level to the ECB. Yet, three countries out of the CEE5 countries chose the opt-out position.

In sum, it seems that the above discussed structural factors are not helpful in understanding the opt-out positions of Hungary, the Czech Republic and Poland. However, other factors might. This is why we decided to take a survey of a number of additional structural factors. Our main question in the following is thus: Does the structure of CEE5 banking sectors explain opt-in and opt-out policies?

3. Survey of CEE5 banking sectors' structural characteristics

While all Euro-area countries belong to the high income countries, only two out of the five CEE5 countries belong to that group (the Czech Republic and Poland) and the other three to the upper middle income countries. At the same time, all CEE5 countries have much shallower banking systems than their West European peers. The largest deviation from West European trends is shown in the case of Romania, where both total assets to GDP and domestic credit to GDP is the lowest in the region. Poland has the second lowest level of banking intermediation. The level of total asset to GDP is very similar in Bulgaria, the Czech Republic and Hungary, while Bulgaria is the only country where bank lending to the domestic private sector is close to the level of the upper middle income countries. The difference between domestic credit to private sector to GDP and total asset to GDP is the smallest in Poland and Bulgaria. This fact is also evident in these two countries' banking systems' higher domestic lending orientation (Table 1).

Table 1. Financial depth in CEE5 in 2011

Country	Bulgaria	Czech Republic	Hungary	Poland	Romania	Upper middle income countries	High Income countries	EU 27
banks' total assets to GDP (%)	114,19	116,02	116,18	83,54	69,79	n.a.	n.a.	365,83
domestic credit to private sector to GDP	71	57	57	54	38	88	94	n.a.

Source: World Bank, ECB, Eurostat

All five countries' banking systems are dominantly foreign owned, mostly by EU banks. The largest market participants are subsidiaries; however some branches are also operating on CEE5 markets. The market share of subsidiaries and branches of non-EU banks is negligible. The proportion of foreign banks' total assets to total assets of banking sector is 25% in EU 27. It ranges in CEE5 between 60 (Hungary) and 92 (Czech Republic) percent. In addition, the five countries' banking systems are similarly concentrated. According to their Herfindahl indices, they have relatively competitive markets. The share of the three largest banks' total assets is between 24 and 51 percent which is in the lower half of EU national banking markets (ECB 2014).

Since the banks of CEE5 are relatively small only the three largest banks would be directly supervised by the SSM in case of opt-in to the BU (Table 2). Presently, there is no large enough fourth bank in CEE5 which is close to the 30 billion EUR total assets in size or to the 20 percent of domestic GDP that would render it under ECB supervision. The owners of the top three CEE5 banks are predominantly banks from the European Monetary Union (10 cases out of 15). There is only one large state owned bank (the Polish PKO BP). Out of the two domestically controlled banks, Bulgarian First Investment Bank (the third largest Bulgarian bank), is 85 percent owned by two Bulgarian private persons and the remaining part is public; the Hungarian national champion, OTP is a public company with dispersed holding but controlled by the Hungarian management. OTP is also the owner of the second largest Bulgarian Bank, DSK.

The CEE5 banks focus on domestic banking. Out of the 15 largest banks only the Hungarian OTP has significant foreign activity. It has subsidiaries in the Euro area (Slovakia), in the EU outside the Euro area (Bulgaria, Romania, Croatia) and outside the EU (Montenegro, Serbia, Ukraine, Russia). The total foreign assets of OTP are equal to about 40 % of its domestic assets. The Bulgarian Fibank has much more limited foreign activity: it has a subsidiary in Albania and a branch in Cyprus. Apart from these, only the Polish PKO BP and the Romanian Banca Transilvania have some foreign activity. PKO has a small Ukrainian subsidiary with its headquarters near to the Polish border in Lvov. It also used to have a branch in London serving mainly Polish people working in UK, which was closed in

2012. Banca Transilvania used to have a branch in Cyprus, which was closed in 2013 and opened a branch in Italy in 2014.

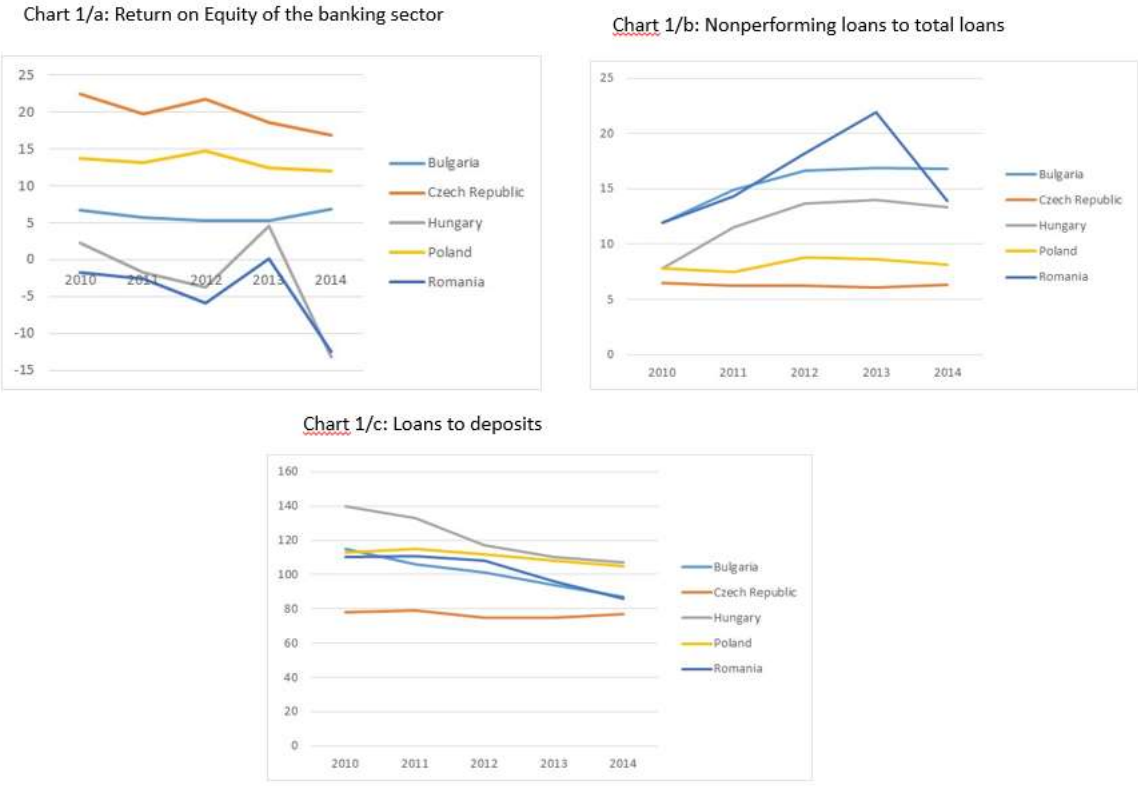
Table 2: The three largest banks in CEE5 (2014)

top 3 banks 2014 in CEE5		total assets (billion EUR)	total assets to domestic GDP (%)	market share on domestic market	ultimate owner
Bulgaria	Unicredit	7,18	18	17,4	Unicredit
	DSK	4,70	12	11,7	OTP
	First Investment Bank	4,66	12	10,2	two private persons plus dispersed holding (publicly listed)
Czech Republic	CSOB	39,16	26	18,4	KBC
	Ceska Sporitelna	36,66	25	15,9	Erste
	Komercni Banka	32,70	22	15,7	Societe Generale
Hungary	OTP	36,24	36	22,2	dispersed holding (publicly listed)
	K&H	8,95	9	7,6	KBC
	Erste	7,91	8	5.9	Erste
Poland	PKO BP	49,80	13	15,9	Polish state owned
	Bank Pekao	39,63	10	10,9	Unicredit
	Bank Zachodni WBK	26,52	7	7,9	Santander
Romania	BCR	15,43	11	16,2	Erste
	BRD	11,10	8	12,4	Societe Generale
	Banca Transilvania	7,46	5	9,8	EBRD and dispersed holding (foreign and domestic)

Source: IMF (2015- Country report 15/98),Raiffeisen Research (2015), homepages of banks,

The profitability of the banks in CEE5 has a high standard deviation. On average the Hungarian and the Romanian banking sectors were predominantly loss-making between 2010 and 2014, while the other three countries' were profitable. The profitability of the Czech banking sector remained outstandingly high after the crisis, the Polish banks also realized high returns, and the Bulgarian banking sector had positive but modest RoEs (chart 1/a). As regards the portfolio quality of the CEE5 banks, the Czech and the Polish banking sectors have a significantly lower, the Romanian and the Bulgarian have a higher proportion of nonperforming loans. Hungary is in between. In 2010 the Hungarian nonperforming loan ratio was on the Polish level, but later on, as it significantly increased, the portfolio quality came closer to the Bulgarian and Romanian levels (chart 1/b). On aggregate level only the Czech banking system is financed from domestic deposits. By 2013 the Bulgarian and the Romanian banking systems also became domestically financed. In the meantime, the Polish and the Hungarian banking systems are still exposed to foreign funds although to a steadily decreasing extent (chart 1/c).

Chart 1: Selected characteristics of CEE5 banking sectors



Source: Raiffeisen Research (2015)

As it is shown above, despite the common roots and several similarities the structure of the CEE5's banking systems are different in several respects. Table 3 gives an overview of the most important similarities and differences in the CEE5's banking structures. The last column of Table 3 determines the dividing line among the CEE5 countries in relation to all relevant structural attributes. Based on the overview of the differences we can clearly conclude that there is no structural dividing line between the two opt-in countries' banking sectors and the three opt-out countries' ones. In case of seven out of eight structural characteristics we could identify structural differences among the CEE5. However only the level of nonperforming loans forms a division between Bulgaria and Romania, on the one hand, and the Czech Republic and Poland, on the other hand. Even in this case Hungary has an in-between position. The other characteristics have different dividing lines. This implies that the opt-in/opt-out choices cannot be explained by the structural characteristics of the CEE5 banking sectors.

Table 3: Main structural similarities and differences of CEE5 banking system

Structural Characteristics	Similarities	Differences	Dividing Line
Depth of banking intermediation measured by total asset to GDP	Low level in international comparison	Romania and Poland are more far from their peer	Romania and Poland vs. Bulgaria, Czech Republic and Hungary
Depth of banking intermediation measured by domestic credit to GDP	Low level in international comparison	Bulgaria is relatively close while Romania is the most distant from their peer	Bulgaria vs. Romania in between: Czech Republic, Hungary and Poland
Role of foreign ownership	Dominantly foreign owned banking systems	In the Czech Republic all top 3 banks are foreign owned; in Poland the largest bank is state owned; in Hungary the largest bank is domestically controlled; in Romania the third largest is owned by EBRD and dispersed owners; in Bulgaria the third largest bank owned by two private persons.	Czech Republic vs. Hungary and Poland in between: Bulgaria and Romania
Concentration of banks	Relatively competitive banking market		no
Exposure To Foreign Funds		The largest Czech and Polish banks are domestically funded while the largest Bulgarian, Hungarian and Romanian banks are financed from abroad. On systemic level the Czech and since 2012 the Bulgarian and Romanian banks are domestically funded.	Czech Republic vs. Hungary and Poland in between: Bulgaria and Romania
Foreign Activity	Dominantly no foreign activity, foreign owners target the domestic market	Only OTP has significant foreign operation throughout Central and Eastern Europe.	Hungary vs. Czech Republic in between: Bulgaria Poland, Romania
Profitability		There are profitable and unprofitable banking sectors and large differences in individual banks' profitability.	Hungary and Romania vs. Bulgaria, Czech Republic and Poland
Nonperforming Loans To Total Loans Ratio		Three countries have significantly higher NPL ratio than the other two.	Romania, Bulgaria vs. Czech Republic and Poland in between: Hungary

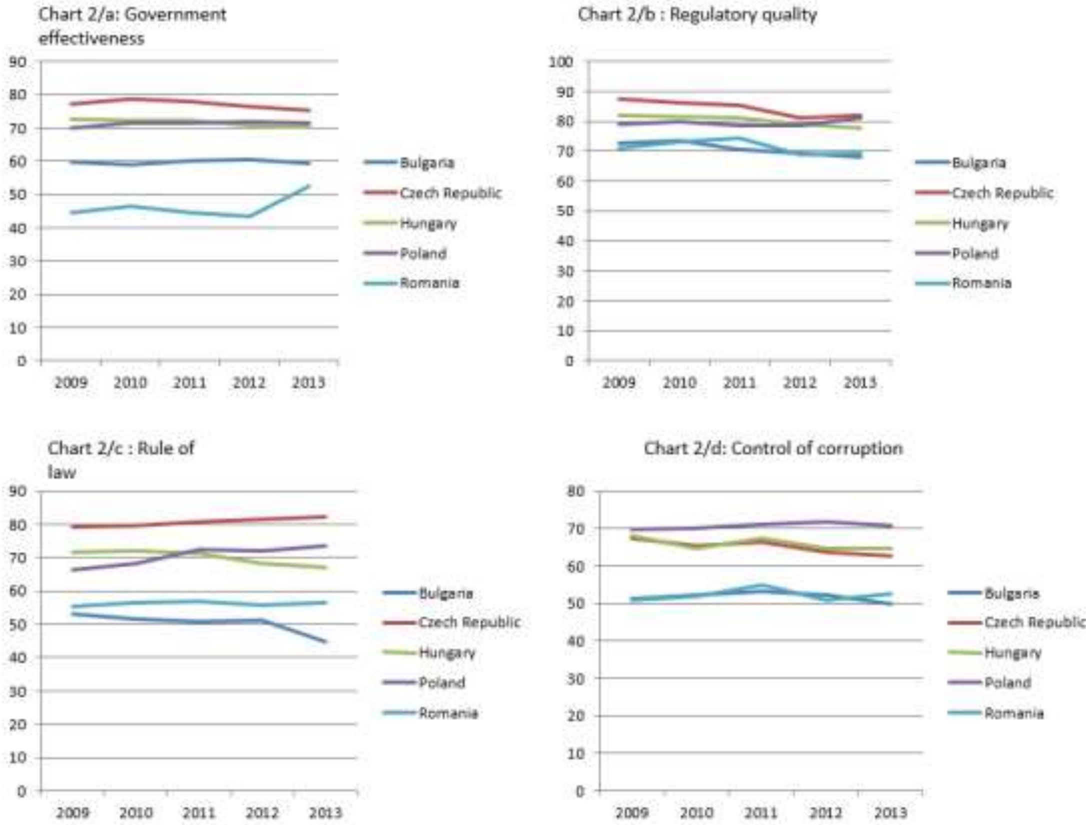
4. State capacity and EU's perception – alternative explanations

It is clear from the above discussion that Banking Union's attractiveness is not defined by structural characteristics of member states. Instead, we argue that when answering the question of why there is a difference in the attitude towards the BU we must investigate the role of *domestic politics* as well. As a

first step we propose looking at state capacity and attitudes towards the EU in CEE5. We argue that these two sets of indicators can explain the opt-in, but not the opt-out choices.

In order to define the level of state capacity in our sample, we looked the Worldwide Governance Indicators (WGI) data set and focused on the post-crisis period (2009-2013). It seems clear that the values for all of these countries are generally lower than the most developed countries' values. Germany's and France's values, for example, fluctuate around or above 90 percentile in all four indicators. Moreover, after the GFC there is a strong dividing line between Hungary, the Czech Republic and Poland on the one hand and Romania and Bulgaria on the other with regards to governments' autonomy. Looking at government effectiveness, regulatory quality, rule of law and control of corruption Romania and Bulgaria show significantly lower values from Hungary, Czech Republic and Poland (see charts 2a-d). The greatest divide can be seen in the effectiveness of controlling corruption. While Hungary, Czech Republic and Poland cluster between 62 and 71 percentile, Romania and Bulgaria can be found between 55 and 49 percentile. With regards to government effectiveness Hungary, the Czech Republic and Poland are between 70 and 80 percent for most of the period, while Romania and Bulgaria score no higher than 60 percent. If we look at more qualitative indicators the dividing line still prevails in the case of rule of law we see that Hungary, the Czech Republic and Poland vary between 67 and 82 percent, while Romania and Bulgaria stay between 45 and 55 percent. With regards to regulatory quality we see them closest; nevertheless the two clusters of countries take on significantly different values. Looking Based on these findings, we argue that the low level of government autonomy in the cases of Bulgaria and Romania motivated these countries' governments to join the BU. This is because, by delegating banking regulation to EU level, these governments could safeguard banking stability even in case of low level of state capacity.

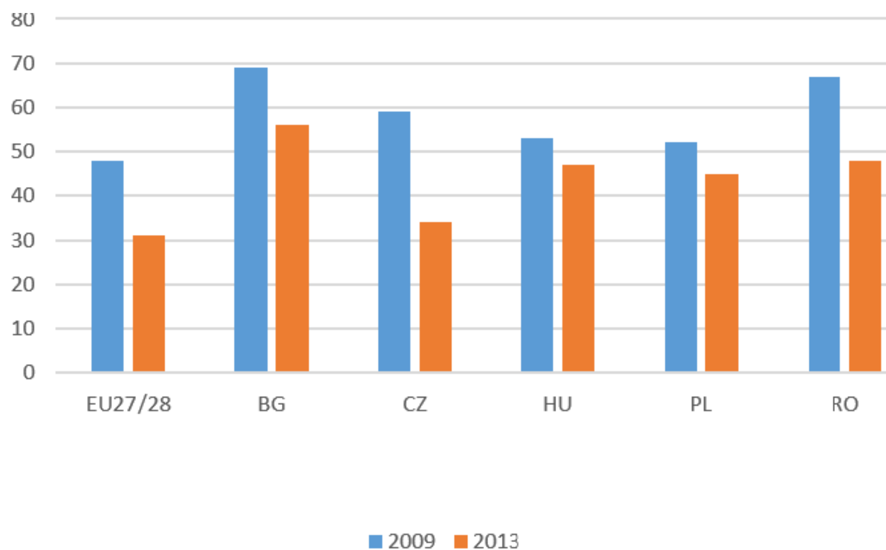
Chart 2: Indicators for state capacity in CEE5



Source: WGI dataset

Attitudes towards the EU are very different across CEE. According to Eurobarometer survey results in 2009 Bulgaria and Romania were the most Europhile countries. The other three countries trusted in EU to a lesser extent, but more than the EU average. By 2013 Euroscepticism became more characteristic throughout the EU, the proportion of those who tend to trust in EU decreased significantly. Bulgaria remained a highly Europhile country, with a low decrease in trust in EU. The proportion of those who trust in the EU decreased most significantly in the Czech Republic and in Romania. As a result Romania became less Europhile than earlier while the Czech Republic became the least supportive for EU. The most moderate decrease in EU supporters have taken place in Hungary and Poland. However the proportion of those who tend to trust in EU is generally higher in CEE than in the EU on average. All-in-all, the Bulgarian opt-in position and to the lesser extent the Romanian also can be supported by the positive attitude towards the EU, while in case of other countries it seems it does not to have explanatory power. (Chart 3)

Chart 3: Trust in EU (percent of those who tend to trust in EU) 2009-2013



Source: Eurobarometer 72. and 80.

While the analysis above clearly shows how these factors conditioned Romania and Bulgaria to join the Banking Union, in the cases of the opt-out countries the higher level of state capacity and Euroscepticism provide the condition for opting-out, but does not explain it.

5. Reasons for opt-out: banking nationalism

In order to explain the opt-out positions of Hungary, the Czech Republic and Poland we propose to look at the effect of banking nationalism. In the case of Hungary, financial nationalism was recently exposed by Johnson and Barnes (2015). They defined it as: "An economic strategy that employs financial levers – including monetary policy, currency interventions, and other methods… to promote the nation's unity, autonomy and identity." (p. 536.) The authors indicated that while financial nationalism, just like economic nationalism, may be constructed in a number of ways, i.e., in different countries the term may describe different policy choices, in general, however, financial nationalism manifest itself in five interrelated policy choices. These policy choices are autonomous monetary policy, dirty floating currency regime, undermined independence of the central bank, banking nationalism and animosity towards foreign international institutions. Johnson and Barns (2015) convincingly argue that in Hungary Orban's government follows financial nationalism, but they did not look at the CEE region at large. We argue that although financial nationalism may not be detected in the Czech Republic and Poland, but a narrower version of it, namely banking nationalism is clearly present.

Banking nationalism is a government policy which promotes national interest in banking. Banking nationalism is usually defined in the literature as "preference for national financial institutions

over foreign ones, with national (insider) banks typically defined by ownership rather than physical location" (Johnson and Barnes (2015 p. 539), but also (Epstein, 2013; Epstein and Rohdes 2014)).

We argue that governments in Central and Eastern Europe that follow banking nationalism use all state functions in banking to promote the national interest. It is most visible in the three most important government functions that any state performs in relation to banking, namely bank regulation, bank ownership and bank supervision (Piroska 2006). To detect banking nationalism in CEE it is necessary to look at all of these functions. In the majority of CEE countries banks are dominantly owned by foreign mother banks. If we narrowed down banking nationalism to government ownership of banks, we might miss detecting it in CEE at all.

Johnson and Barnes (2015), in operationalizing the concept, emphasize the usefulness of national banks to governments over foreign banks, and argued that governments may perceive domestic banks to be "easier for the government to influence, will not cut and run in crisis, will be more likely to further national prosperity and autonomy through their lending and reinvestment policies, and may even serve as national champions promoting the nation's image and interests on the international scene." (p. 539) They also pointed out the political instrumentality of the concept in defining national insiders in contrast with outsiders.

We argue that in Central and Eastern Europe advancing banking policies in the name of national interest serves the primary purpose to legitimize controversial government actions (see Smith 2010 on why the notion of legitimacy is essential to the study of nationalism). Government actions advanced in the name of national interest in the banking sector might be controversial for a number of reasons. They for instance may not primarily promote stability of banking, but rather put foreign banks in a worse off market position. They also are helpful in inserting the ruling party-related individuals into important decision-making positions. They may create regulatory environment more beneficial for local banks. In other words, banking nationalism as a policy by justifying actions through a claim to national interest, it increases governments' room for maneuvering within the banking sector. Although national interest as a concept could be filled with other content in Hungary, the Czech Republic and Poland, it increasingly justifies a banking policy that is hostile to foreign banks and international organizations. We argue that banking nationalism advanced by Central and Eastern European governments clashes with the Banking Union initiative of the EU. This is why these governments opted out.

Banking nationalism manifests itself differently in the three above mentioned state functions in Central and Eastern Europe. Within the European Union the scope for banking nationalism in the field of *bank regulation* has been significantly reduced since the introduction of the single rule book, one of the pillars of Banking Union. With the entering into power of the single rule book, the EU moved from regulating banks by directives to regulating by compulsory regulations. The new Capital Requirement Regulation (CRR) and the technical standards worked out by the European Banking Authority (EBA) are issued as regulations and thus are compulsory for all member states. They decrease the room for maneuvering for member states' governments: Central and Eastern European non-Euro zone countries

are no exceptions. However, the CRR/CRD framework delegates some important regulatory power to competent supervisory authorities (which is the ECB for BU members and the national supervisory authorities for non-BU members), mainly in the field of macroprudential regulation and transitional arrangements for the period between 2014 and 2019. Both trends encourage CEE governments to retain their existing regulatory power and stay outside the BU.

Bank ownership by states has been more important in Western Europe than in Central Eastern Europe since the mid-1990s (Esptein 2013, Kudrna and Gabor 2013, Johnson 2016). As mentioned above, banking nationalism in the form of bank ownership has been exposed as one of the main causes of the 2010 Euro crisis in Western Europe (Epstein and Rhodes 2014). The Banking Union was created precisely to loosen the ties between national banks and government, without changing the ownership structure. In Central and Eastern Europe, however, where national bank ownership was lower, since the financial crisis, there seems to be an urge to increase national ownership and politicians stress the importance of national ownership of banks. In some countries, actual steps have been made to increase the domestic and state ownership of banks (the Hungarian government purchased two banks and in several ways promoted the increase of domestic ownership, while the Polish government and central bank made political declaration on the need for "domesticating" the banking system[5]; see more in the case studies). In other words, Central and Eastern European governments would increase national ownership of banks at a time when the Banking Union would loosen ties between national banks and governments.

Finally, it is in the field of *bank supervision* that the EU initiated Banking Union clashes most with banking nationalism of the Hungarian, Czech and Polish governments. Bank supervision both at the micro (individual bank) and macro (banking sector) level gives the opportunity for politicians to exercise *control* over national and foreign banks. Delegating supervisory power – even directly only of the three largest banks – could deprive these governments from pursuing national (private) interest in banking. We argue this is the most important reason why banking nationalist CEE governments are reluctant to join the Banking Union. Giving up control to ECB in the area of bank supervision is especially problematic for CEE policy makers. There is a strong feeling among the policy makers of the three opting-out states that quality of bank supervision in their own country is equal or superior to that of provided by the ECB (IMF Report 2015). Retaining bank supervisory powers in national institutions makes it easier for CEE policy makers to pursue such a bank policy that does not need to be brought in harmony with ECB's considerations. Transferring the right of authorization is an especially dear power that CEE politicians would not want to give up. The freedom of authorization can be very important in reshaping the ownership structure of the banks. Moreover, giving up further scope of supervisory autonomy is against the banking nationalist ideals of the CEE governments in power. We argue through the case study of Hungary that at the essence of these concerns is a commitment to banking nationalism,

[5] http://wbj.pl/belka-im-in-favor-of-domesticating-banks/

which gives priority to governments over markets, local decision makers over the ECB, and local stability concerns over Europe wide financial stability.

6. The Hungarian case study

In 2012 Victor Orban, the prime minister of Hungary, met former central bank governors and discussed the potential impacts of a bank union in the European Union on Hungary. The result of the discussion was the nomination of Peter Gottfried (then PM's chief advisor on foreign policy) to lead a policy coordination forum. The forum consisted of the central bank, the Ministry of Foreign Affairs and Trade, the Ministry for National Economy and the Financial Supervisory Authority. It aimed at providing information to the PM to establish Hungary's position vis-à-vis the BU. Thus, at this point it seems Orban was open to form Hungary's standpoint.

In that year, the central bank was still under the leadership of Andras Simor, who was an appointee of the former Socialist government. The central bank's position was outlined in a working paper titled "What can we expect from the Banking Union?"[6] in 2012. It supported a wait-and-see approach. It pointed out that BU may have a number of potential benefits for the Hungarian banking sector, such as lowering the cost of banking and depreciating country risk. It also demanded that the developing SSM system exercise more equal treatment of Eurozone and non-Eurozone member states.

In 2013 there was a change in the management of the central bank, from March onward, Orban nominated the former Minister of Economy and close political ally as new governor: Gyorgy Matolcsy. From this moment on, the political independence of the central bank vanished as the Matolcsy-led Monetary Council established monetary policy targets in line with the government's interest. Moreover, under Matolcsy, the Financial Supervisory Authority became part of the central bank. Matters of bank supervision thus remained under indirect government control. The new central bank leadership revised the former position towards BU. The new position paper (Kisgergely and Szombati 2014) also proposed a wait-and-see approach, but with a very important difference from the former position paper. The focus of the first document is on the Hungarian banking sector, and it evaluates the pros and cons of joining the BU from this point of view (market focus). The second paper focuses on the capabilities of Hungarian state institutions and claims that they are similarly or better adapted to supervise Hungarian banks than the ECB (state focus). It emphasizes the more efficient organization of bank

[6] http://www.oba.hu/images/stories/downloads/konferencia/8_mit_varhatunk_a_bankuniotol-kiraly_julia-mnb.pdf

supervision in Hungary as compared to the BU as a reason for opting-out[7]. Thus, it is the trust in national institutions as opposed to international ones and avoidance of cumbersome policy coordination that are used as the reasons for opting out.

In the course of the next few years, Orban's initial openness disappeared, and the government's banking policy came to conflict with BU's ideals. In the following, we analyze those elements of the Hungarian government's banking policy that provide particulars on the existence of banking nationalism in all three area of banking policy: bank ownership, bank regulation and bank supervision. We look at events that occurred between 2013 and 2015 around the time when the decision on the BU was made. We show why banking nationalism cannot work properly within the BU.

After the GFC, the Fidesz-led Hungarian government declared several medium-term aims in relation to re-shaping the banking sector's ownership structure. It did so despite the stabilizing role and strong commitment of foreign mother banks towards their Hungarian subsidiaries during the crisis (Epstein 2014, Király 2015). According to Király (2015) the aims were as follows: increasing the market share of domestic banks to at least 50 percent; decreasing the number of large foreign banks on the Hungarian banking market; strengthening the role of cooperative banks; strengthening the role of domestically owned small- and medium-sized banks and establishing some new ones. The increase of public ownership in the banking sector has not been part of the declared aims *per se*, however as intermediate objective to reach the declared final aims, the Hungarian government's bank ownership became significant in sector.

The Orban government ambitiously started to implement these aims only after the merging of the Hungarian Financial Supervisory Authority (HFSA) into the Matolcsy-led central bank in 2013. The related steps are well-documented in the Hungarian press and in Kiraly (2015). Here we just highlight some of them. The Hungarian state nationalized the fourth largest bank (MKB). It purchased it from Bayerische Landesbank for 55 million euro in July 2014. In December 2014 the central bank (MNB), as the Hungarian Resolution Authority, took MKB under resolution. The resolution was an opaque process however, several market rumors talked about the cherry picking of MKB's portfolio by businessmen close to the government. During the resolution process, managed by MNB's staff, a former Deputy Governor, Adam

[7] More precisely, the paper draws attention to the fact that since 2013 micro and macro supervision is merged into one institution in Hungary. According to the paper this organization allows better transfer of information as it is possible within the BU, where microprudential supervision is delegated to the ECB, while the task of macroprudential supervision is divided between the ECB and the designated national authorities within a highly regulated framework of exchange of information and coordination.

Balog, became the bank's CEO. Several members from MNB's staff –including former supervisors- became the bank's top or middle managers. Another upper medium size bank, Budapest Bank, the commercial bank of GE Capital is now also under nationalization. These nationalizations are declared temporary. However, the lack of transparency in these steps questions the transparency of future privatization.

In 2013 and 2014 the Hungarian government increased capital in several small Hungarian banks. One of them, Széchenyi Kereskedelmi Bank was 51 percent owned by István Töröcskei, CEO of State Debt Management Company (ÁKK). Mr. Töröcskei resigned from ÁKK only after the collapse of Széchenyi Kereskedelmi Bank in December, 2014. According to a document owned by a Hungarian weekly (Máriás 2014) MNB was aware of the insolvency of Széchenyi Kereskedelmi Bank in January, but it failed to act as the competent supervisory authority until December. Another example for how the government influences who owns what the in banking sector is the case of Növekedési Hitelbank (NHB). The bank was initially foreign owned, but following some transformations, it was first bought by Hungarian businessmen and today it is owned by Governor Matolcsy's cousin.

Finally, two more examples that show the kind of relations the Hungarian government prefers to establish with banks. The FHB Kereskedelmi Bank needed a capital increase in late September 2014, since according to a law which entered into force on the 24th of September all banks were obliged to convert the still existing FX loans to HUF and compensate borrowers for the items which were declared unfair by the Hungarian High Court. The bank was loss-making during the previous years, and the loss accumulated due to the new state measures would have undermined its solvency. The bank's main owner was a company owned by Zoltán Spéder, a businessman with strong connection to Fidesz. On the 30th of September 2014 the state owned Hungarian Post obtained 49 percent ownership in the bank. The case even raised the question of forbidden state aid. As the president and CEO, Sándor Csányi announced at a conference, OTP turned to State Aid Monitoring Office to investigate the case[8].

The Hungarian Post was the protagonist of Takarékbank's (the central bank of the Hungarian cooperative banks) nationalization in 2013, as well (Várhegyi 2013). Together with the Hungarian Development Bank, the two fully state-owned companies obtained the majority of Takarékbank's shares. Parallel to nationalization a new form of integration in the cooperative banking sector was codified. According to the new regulation the integration's members lost their ownership control over Takarékbank. At the same time joining the integration became

[8] Csányi Sándor's lecture at the 53. Annual Conference of Economists, 03 September 2015. Referred by: www.privatbankar.hu

obligatory for all cooperative banks and for all those banks that were transformed to joint stock banks from cooperative banks previously. This was required even if these later banks voluntarily remained members of the predecessor of the cooperative banks' integration. All the cooperative banks had to adopt a new charter that was dictated by the new owner. The Hungarian Financial Supervisory Authority (HFSA) "blackmailed" the cooperative banks that it would withdraw their banking license if they did not accept the new charter that gave a wide range of rights to Takarékbank. With this step, not only Takarékbank itself, but more or less the whole cooperative banking sector, became nationalized (Király, 2015).

All the transactions and mergers described above required authorization from MNB. The Matolcsy-led central bank issued all the necessary licenses for these transactions. In cases of Banking Union members, authorization is the sole right of ECB. We could not find any argumentation advanced by Hungarian politicians for opt-in vs. opt-out decisions that relates to authorization. However the above cases show that having the freedom to re-shape the ownership structure of the banking system also can be a strong motivation for opting out. More of our interviewees confirmed, that the authorizations by MNB are generally "quick and dirty," which means that all the necessary licenses to fulfill the government's aims are issued quickly without questioning the transactions. Perhaps ECB licensing would raise more questions or would be slower and maybe not so easily done. In all the above cases of authorization only staying outside the BU can ensure the smooth authorization of ownership changes.

Besides re-shaping the ownership structure and the related authorization processes, we found signs of banking nationalism in relation to regulation and supervision, as well. In this area, the special treatment of the Hungarian national champion, OTP Bank has to be mentioned. OTP has more than 20 percent market share in Hungary, and it has a significant East European subsidiary network. However it is a small bank in the scope of Europe generally. Accordingly the supervision of OTP is an outstandingly important task for MNB. In case of opt-in OTP would be supervised by the ECB and it would become a small individually-supervised bank with less specific, tailor made supervisory attention. OTP is definitely a too-big-to-fail, systemically important bank in Hungary, which explains the special regulatory and supervisory interest. To be nationally regulated and supervised is good for the bank, for the Government and for MNB. The very close connection of regulators, supervisors and the bank is testified by the fact that several former regulators and supervisors continue their career with OTP group after resigning from their position. These officials include the Finance Minister, the State Secretary of Ministry of Finance, the President of the HFSA, the deputy CEO of the HFSA, and several top and middle managers of HFSA.

An example of the advantages being domestically supervised is the case of Asset Quality Review (AQR). Before joining the BU all the EMU member states had to conduct an asset quality review in line with ECB's methodology. ECB's AQR was done by large audit companies under the strict supervision of competent national supervisory authorities, though paid and quality-checked by the ECB. In order to maintain a good reputation and shareholders' trust, OTP voluntarily underwent a very similar AQR. Upon receiving the AQR results, OTP issued an extraordinary announcement: "the AQR process found only minor deviations and deficiencies, which did not require any modification either in the Common Equity Tier One (CET1) capital serving as a base for stress test or other parameters" (OTP 2014). The successful AQR was good not only for OTP, but for MNB, as well, since it also could communicate that the national champion is stable and appropriately supervised.

However, despite strong similarities, one can identify several important differences between the AQRs of banks inside the Banking Union and the AQR of OTP. In both cases, the competent national authorities were responsible for AQR, and the review itself was made by selected large audit companies. In case of BU member states, AQR was paid and quality checked by ECB. In case of OTP it must have been domestically paid (in principle by OTP or by MNB; but more probably by OTP) and quality checked by MNB. Even if the audit company and MNB tried to mirror the methodology and check ECB's mechanisms, the AQR could not be identical, but only highly similar to ECB's. However, the lack of ECB's quality checking and the domestic finance of AQR, by definition, meant that the level of independence and objectiveness of AQR was not identical. Since the interest of both OTP and MNB was a successful AQR, which did not cover hidden asset quality problems, ECB's quality check would have been a very important element of the procedure.

Another advantage of staying outside the Banking Union is the possibility of conducting the Supervisory Review Process (SREP) and imposing fines domestically. In the SREP framework a dialogue takes place between the banks and the supervisors, which results in determining the Pillar II capital requirement of the given bank. In case of BU members, the decision on the SREP capital requirement is made by ECB, while in case of non–BU members by competent national supervisory authorities. The SREP capital requirement is a very sensitive question, because it can significantly increase the banks' capital requirement. For banks with good connections to supervisory authorities the SREP can be relatively lighter. Moreover, the SREP process is a useful tool for supervisors to follow their preferences or even to punish banks not in line with the supervisory (and/or governmental) preferences. According to our interviewees and market information MNB is not averse to use the SREP as a tool for the

enforcement its own (and the governments') preferences. The fine imposed by MNB on the banks increased significantly since MNB merged the HFSA. According to MNB (MNB 2015) this is a result of a deliberate policy. However, more and more banks perceive the extremely high fines as unfair and appeal against the decision at the court.

As regards bank regulation, several special bank regulatory tools were introduced since 2010. They are partly macroprudential tools (Mero and Piroska 2015), partly tools that handle those households' losses, that became indebted in FX before the crisis and partly tools that aim to increase fiscal revenues and take the form of different taxes (Várhegyi 2012). The latter would not clash with the BU. Since there is no single taxation mechanism in the EU several BU members introduced and operate different types of bank levies and taxes. However, MNB's macroprudential tools would become weaker within the BU. According to MNB's fears (Kissgergely and Szombati 2014, pg. 17) one "cannot be sure that the problems of smaller, non-euro area Member States will be taken as seriously as those of key Banking Union members with a more significant banking sector." In addition, MNB's management is also wary of the possibility of losing its ability to set extra requirements for systemically important subsidiaries of banking groups that are directly supervised by the ECB. Being able to retain the right to set independent domestic macroprudential rules that are also thought to be superior to ECB's regulation is a key element of MNB's opt-out position.

Moreover, we can identify other regulatory steps that are in line with the Hungarian government's banking nationalism and should result in clash with the BU. A prominent example is the case of 3 those 100 cooperative banks that with good connections to the government could avoid nationalization. Out of more than 100 Hungarian cooperative banks there were only five that could avoid the obligatory integration and nationalization of the cooperative banking sector, due to a special regulation. The Act on the integration of cooperative banking sector contained a special paragraph that allowed exemption for those cooperative banks that applied for authorization of transforming their corporate form from cooperative to joint stock banks. At the time the relevant law was adopted by the Parliament it seemed that its aim was to give an escape route to Duna Takarék, the cooperative bank that belonged to a close friend of the Prime Minister, István Garancsi. As a free rider, another small bank, Polgári Bank, could follow the example of Duna Takarék. However, the President of Hungary did not sign and issue the law, but sent it back to the Parliament for deliberation. This step postponed the adoption of the law. During the period of deliberation by the Parliament three additional cooperative banks applied for authorization of their transformation to joint stock banks; consequently by the time of the law entered into power they escaped the scope of

the law. All three cooperative banks together with the DRB Bank, a small joint stock bank that should have been part of the integration, belonged to the Buda Cash group, a group with very good government connections. The DRB Bank applied for authorization by MNB to exit from the integration and MNB accorded it to the bank in late 2013. The three cooperative banks also got authorization for transformation, so they could continue to work in close cooperation in the Buda Cash group framework. The four Buda Cash banks, together with their mother investment company, became bankrupt in early 2015.

Another example of amending an act just for enforcing the government's will is the amendment of the Act on MNB in July 2015. The aim of amendment was to permit the appointment the deputy governor of MNB for CEO of the MKB Bank. The amendment overstepped the conflict of interest rules, which in their original form would encumber the appointment of the deputy Governor to a commercial bank's CEO. According to the amendment, the rules shall not be applied for "membership or shareholder relationship, employment relationship or any other work-related relationship, executive officer relationship, supervisory board membership with any of the entities in which the Hungarian State or MNB holds a controlling share…".

7. Examples of banking nationalism from the Czech Republic and Poland

In this section, we would like to show a few examples as for why banking nationalism defines these countries' interest as to stay outside the Banking Union.

The Czech and the Polish banking sectors are the healthiest in CEE, since they accumulated relatively few nonperforming loans and their profitability has remained continuously high. This is the case because neither the Czech nor the Polish banking systems were seriously hit by the GFC. Both governments are convinced that it is the result of high quality of domestic banking policy and especially supervision.[9] Accordingly, both governments argued that joining the BU is not important for their countries. There is no need to increase their domestic banking systems' credibility, since they are more stable and credible than their Western European counterparts. Furthermore, contributing to the European Single Resolution Mechanism seems unnecessarily burdensome to these countries.

[9] Sylvia Maxfield and Mariana Magaldi de Sousa led an investigation into the similar claim of Latin American governments and found out that instead of the claim of superior supervisory capacity the reason behind the fact that Latin American banks were not so badly hit by the crisis was a lower level of internationalization of these banks. (Maxfield et al. 2014)

In a Financial Times interview, Marek Belka, the Governor of National Bank of Poland[10] stressed the superiority of nationally managed macroprudential policy to ECB managed one as the main reason for opting out. The fewer rights in decision-making (lack of representation in Governing Council of ECB) of non-Euro area countries are also among the most frequently emphasized arguments. When presenting the Czech position on the Banking Union, Mojmir Hampl, vice governor of Czech National Bank pointed out that during the crisis there was no need to channel public funds to the banks, and that the Czech Republic did not join the Vienna Initiative, an IMF supported agreement among CEE governments and Western mother banks to maintain liquidity in CEE host markets during the crisis (Hampl 2015). Both Hampl and Singer, the Governor of the CNB claimed that they did a better job prior and during the crisis than Western European supervisors. In Poland both Mateusz Szczurek (Minister of Finance) and Marek Belka (Governor of the National Bank of Poland) argued for opt-out, mainly because of the non-equal treatment of the euro area and non-euro area banks, since the later have no access to ECB's liquidity facility and have no representation in the Governing Council of ECB (Profant and Toporowsky 2014)[11]. Besides the high stability and good performance of Polish banking system, the low level of financial intermediation and the lack of sophisticated structured products – they argued - also serve as an argument for opting-out (Kawalecz 2015).

However, arguments regarding the soundness of banking in these countries are backward looking and implicitly contain the unjustified assumption that the future probability of banking crises and the related resolution costs will be also lower in these countries than in Eurozone countries. That is why it seems that reasons for opting out are rather based on the doubts in relation to the functioning of Single Supervisory Mechanism (SSM). As we argue giving up supervisory control is not the preferred choice of the banking nationalist Czech and Polish governments. Staying in control allows these governments space for maneuvering that they can utilize in their special position of state capture.

In the case of Poland, similarly to Hungary, restructuring bank ownership needs a smooth authorization procedure, which is much easily feasible under domestic supervision. Polish policymakers and even the Governor of the central bank declared that the banking system's "domestication" would be useful for effective and well-functioning banking[12]. One of the very first steps in domestication was the conditional authorization of acquisition of a Greek-owned Polish bank by Raiffeisen Bank in 2012. The condition was that by mid-2016 either

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[10] http://www.ft.com/cms/s/0/ba6537d2-5905-11e4-a722-00144feab7de.html#axzz3yCOBiDfQ
[11] http://www.reuters.com/article/poland-cenbank-idUSL6N0O72FS20140521
[12] see for example: http://www.nbp.pl/homen.aspx?f=/en/aktualnosci/2011/mpc_2011_11_09_rel.html , and http://wbj.pl/belka-im-in-favor-of-domesticating-banks/

Raiffeisen International lists its shares on the Warsaw Stock Exchange or 15% of its Polish subsidiaries will be listed in form of IPO. At the end of 2015 Raiffeisen announced that it intended to sell the Slovenian and Polish subsidiaries. However, the Polish Supervisory Authority insisted on conducting the IPO by Raiffeisen before authorizing the sale of the Polish operation. As a consequence Raiffeisen undertakes an IPO and a sale simultaneously, which is not the most logical and effective way to find a new owner.[13] More importantly, this kind of authorization would most probably have been different if exercised by ECB. As the new Polish government elected in 2015 strengthened its commitment towards increasing Polish ownership in banking, further authorization in favor of domestic owners are expected.

Regarding the Czech Republic there were neither similar actions nor declarations in favor of Czech ownership in banking. However the ring-fencing of foreign capital in banking is the strongest there in the whole of Central and Eastern Europe. The signs of ring-fencing are the early introduction of capital conservation buffer; the countercyclical capital buffer's elevation from zero percent to 0,5 percent; and the introduction of systemic risk buffer for the four largest banks in a range between 1 to 3 percent. These capital buffers are in line with the CRD regulatory framework. However, they are outstandingly high relative to the rest of Europe[14] and their calibration definitely aims not only to increase banks' stability, but also the ring-fencing of foreign capital invested in the Czech subsidiaries. Although ring-fencing is possible even within the Banking Union, this high level of its usage by Czech policy makers would surly raise more questions by ECB.

8. Conclusions

Banking Union is not only the European answer to the financial crisis, but it is also a significant step towards deeper integration. Yet, Banking Union is not complete, and it also is not appealing for all EU member states. Understanding why three Central and Eastern European governments opted out may help us better understand the dynamics of EU integration in other policy areas as well.

In this article, we looked for reasons why three out of five CEE countries opted out of the Banking Union. We analyzed structural explanations and characteristics of the CEE5 banking systems and found that there are no structural reasons for the in or out choices. The structures of the CEE5 banking systems are highly similar, and there is no structural dividing

[13] http://uk.reuters.com/article/uk-raiffeisen-poland-exclusive-idUKKBN0ND2BZ20150422

[14] The level of buffers applied by different European countries can be found at the ESRB homepage: http://www.esrb.europa.eu/mppa/html/index.en.html

line between the opt-in and opt-out countries. This is why we turned to the analysis of political preferences of opt-out countries using the case of Hungary.

In the case of banking, the politics-driven central bank, the competent supervisory authority (either within or outside the central bank), the Ministry responsible for banking regulation and several laws adopted by the Parliament serve the primary aim to help politicians and their well connected cronies to channel public funds to private pockets and/or to affirm the political monopoly of the ruling party. In the cases of Romania and Bulgaria, we argue that the state capacity is so low to provide stability of banking that they find the supranational options attractive. Given these two countries high Europhilia it is logical that these two countries plan to opt into the BU. In Hungary, the Czech Republic and Poland state capacity is high enough to allow market forces in banking to maintain the stability of the sector. Therefore, these three governments opted out of the BU since such an arrangement leaves greater room for maneuvering for local politicians.

In this analysis we lumped Hungary, the Czech Republic and Poland into the same category of banking nationalism. However, obviously, there are not only similarities but also differences among the appearance of the banking nationalism in the three countries. The main similarity is, that the reasoning for opt out is by definition nationalists in all the three countries. They argue that their supervisory practice and institutional arrangement is superior to that of European Central Bank and they have better ability to act as competent macroprudential authority. Moreover the power to enforce the countries' interest on European level is limited for non-Euro area member states. Hungary is certainly on the lead of banking nationalism and there politicians have probably by now the tightest grip of state institutions. At the time of deciding to join or not in 2014, Poland was still a milder case of banking nationalism, but since the elections in 2015, the new government set in a path similar to that of Orban's. Finally, in the Czech Republic we did not find evidence for banking nationalism in the policy field of bank ownership. Nevertheless, the evidence we did find in the fields of supervision and regulation (ring fencing) point to a banking nationalist policy direction similar to that of Hungary and Poland.

Do these countries' wait and see positions mean that they will not join the BU before joining the Monetary Union? On the basis of our research, we believe that their attitude might change for two reasons. First, if the state capacity further weakens, governments might lose their ability to maintain financial stability outside the BU. Second, if banking nationalism becomes significantly lower, BU may become more attractive. In the short run, neither solution seems to be highly probable.

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