Guest Editorial

Dilemmas in post-crisis bank regulation: Supranationalization versus retrenchment

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ABSTRACT The US financial crisis that started in 2007 ultimately had global reach, but those countries most severely affected were the advanced industrialized states. In the United States and Europe, banks, many of which had regional or global profiles, were the source of nearly unprecedented economic instability. This special issue therefore examines the politics behind the re-regulation of banks after the crisis, focusing on the Transatlantic community. The volume finds competing impulses for enhanced international regulatory coordination on the one hand versus national retrenchment on the other. From these two dueling agendas flow three notable developments. First, despite evident functional pressures for a coordinated and global approach to bank regulation following the crisis, regional arrangements have dominated instead. Second, reduced international capital flows and bank activity were as much the result of national and regional regulatory measures as they were a function of market conditions. Third and finally, where national retrenchment has prevailed at the expense of international regulatory harmonization, we see risks for further international financial instability.

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One of the most important developments in post-financial crisis governance concerns the competing pressures for supranationalization versus national retrenchment in bank regulation. The near global reach of the US financial crisis that started in 2007 is now widely recognized. Contagion and impact were most severe, however, among the advanced industrialized economies, particularly in the United States and Europe. In both regulatory jurisdictions, the structure and activities of the largest banks were a primary cause of nearly unprecedented financial and socio-economic instability. Moreover, the international character of the crisis, as well as the international reach of banks at the center of that crisis, suggested strong incentives for enhanced global and regional standard-setting, regulation and supervision in the management of the largest cross-border banks – that is, the supranationalization of bank governance. Despite those very compelling functional pressures, national regulatory retrenchment has been at least as pervasive in the aftermath of the crisis as international coordination and supranationalization.

In Europe, Eurozone members have moved toward European Banking Union, which implies the harmonization of rules and centralization of supervisory authority. The United States' response has been much more nationally oriented, however. In turn, as intra-European coordination has increased, Transatlantic cooperation on banking reform has been more limited. This special issue addresses this critical dilemma confronting states engaged in banking re-regulation. Our aim is to outline what is at stake by explaining the nature of the challenges confronting states seeking to manage the risks associated with the world's largest banks. We then focus on explaining why states have opted for either supranationalization and Transatlantic coordination, or retrenchment through renewed emphasis on national discretion and autonomy. We argue that how states have responded to this regulatory dilemma has both far-reaching distributional consequences and profound implications for financial stability.

We draw three broad conclusions from this collection of articles. First, regionalism instead of internationalization has dominated the post-crisis regulatory response. Second, the volume's findings suggest that the retreat in international capital flows stemming from the crisis was not just a function of market conditions, but very much also a result of national and regional regulatory measures. Third and finally, we draw a particularly concerning conclusion based on our observations of the supranational versus national governance dilemma: while more limited financial flows going forward may decrease financial volatility and contagion, the emerging institutional context is potentially *more* conducive to financial instability. This is because of the relative paucity of international regulatory coordination in the wake of the crisis – despite strong functional pressures for enhanced cooperation.

In order to explain why supranationalization or retrenchment has prevailed with respect to various regulatory questions, the special issue examines the dilemma on three levels. The first six original articles in the volume concern Transatlantic dynamics – both in terms of interactions between the United States and the European Union (or its constituent members) and from a comparative perspective. Our central conclusion in this first part of the volume is that Transatlantic cooperation has been exceedingly difficult in the post-crisis context. Disagreements have ranged from what the appropriate forum for regulatory coordination should be (Jones and Macartney) to more substantive questions concerning mutual recognition of regulatory standards (Howarth and Quaglia) and which countries are equipped to cooperate on bank resolution (Germain). A recurring theme is retrenchment by the United States, which compared with the EU, has worked more quickly and in some cases more decisively toward tighter bank rules and oversight, particularly on Basel III (Young). A second recurring theme in this part of the volume questions the effectiveness of re-regulation for protecting taxpayers, preventing future crises and for containing contagion, particularly given the dual role of banks as both public utilities and seekers of shareholder returns (Ertürk). We also highlight here the extent to which cases as different as the United States and Germany can both fall victim to regulatory failure and banking crises (Cassell).

The last four articles in the volume focus on Europe, where both supranationalization and national retrenchment were simultaneously on display through the immediate post-crisis period, and several years later. In 2015, with Greece's banks on the verge of 'accidentally' causing that country's exit from the Eurozone, the crisis was not over. Nor were the EU's institutional fixes fully formed. In some cases, we see both supranationalization and retrenchment at work in the very same policy innovations. While European Banking Union represented a major transfer of regulatory and supervisory power away from Eurozone member states to the supranational level (Epstein and Rhodes) it was also true that mutually funded backstops fell short of ensuring stability in banking going forward (Donnelly).

Turning to the third level of analysis, but still focusing on Europe, the last two articles in the issue point to particular national or even bank-level concerns and their ensuing effects on national policy within the EU. Arguably a major distinction between the United States and Europe is the much greater institutional and political complexity within the EU, starting with the fact that only 19 of 28 EU members are also part of the Eurozone. Thus aspects of national retrenchment not only shaped European Banking Union, but have led some non-Eurozone states to forgo joining the Banking Union altogether (Kudrna). In addition, national retrenchment has at times been led by the financial sector, which would rather live with already-existing bank structural reforms at the national level rather than abide a ratcheting up of restrictions within the EU (Spendzharova *et al*). Taken together, while we believe the EU as a whole has put its common currency, the euro, on a more sustainable path with reforms undertaken so far, particularly with the continuing evolution of Banking Union, there are still substantial national divergences within Europe, as well as between the EU and the United States.

Remarkably and unfortunately, 8 years after the US housing and financial crisis began, the Transatlantic community of states is still suffering from its effects. Whether it is reduced labor market participation and lower home-ownership rates in the United States or sky-rocketing youth unemployment, slow growth and still-mounting public debt in Europe, recovery has been difficult, if not impossible, for some countries to achieve. While banks and banking regulation were not the sole source of vulnerability for the severely affected states, they were nevertheless critical to the gravity and trajectory of the crisis. The aim of this special issue, by uncovering the politics behind the re-regulation of banks after the crisis, is to pinpoint both the strengths and weaknesses of reform in the interest of more effectively protecting financial stability going forward.

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