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EU Competitiveness and 19th Century U.S. Banking Policy

Europe is in a competitiveness crisis. Reports by former Italian Prime Ministers Mario Draghi and Enrico Letta have pointed out just how dire the economic situation is in Europe – start-ups that cannot scale, a fragmented financial sector and unofficial internal barriers across the EU Single Market reaching up to 40%. EU leaders worry that continuing like this will mean becoming irrelevant in the global arena.

The problem is not that Europe does not have its own banks; the EU and the U.S. have a similar number of banks, 4886 and 4983, respectively. The problem is that European banks are competing in small national markets, limited by national competition law. The question is not why, it is how we can successfully integrate larger and smaller banks at the European level.

European policymakers have pointed to an EU banking union as a key solution to this challenge – currently, European banks compete at the member state level, which limits how large they can become. An EU-wide union would allow for larger banks to scale at the continental level with larger credit pools and more liberal interest rates. The financial history of the U.S. provides an example.

Alexander Hamilton's early vision for the U.S. banking system was tightly linked to his broader plan to promote national industry and economic growth. He believed a strong central financial institution – the Bank of the United States – could stabilize public credit, manage federal debt and create the reliable flow of capital necessary for industrial expansion. In his 1791 *Report on Manufactures*, Hamilton argued that an energetic federal government should actively support new industries through measures like loans and subsidies, with the banking system serving as the mechanism that supplied credit to entrepreneurs and manufacturers. By concentrating financial resources and encouraging investment, Hamilton saw a unified banking system as a tool to accelerate the transition from a primarily agrarian economy to a diversified, industrial one. His ideas laid the foundation for a close relationship between federal financial policy and the development of American industry.

The U.S. banking system started off with a fragmented, state-based banking system in which interstate branching and acquisitions were prohibited, much like in Europe today. Federal reforms following the Great Depression stabilized the system with robust supervision from the Federal Deposit Insurance Corporation but retained geographic restrictions in place to keep banks local for decades. In the 1980s, the savings and loan crisis triggered a wave of mergers as regulators encouraged healthier banks to acquire failing ones, setting the stage for broader, national consolidation. The major turning point came with the Riegle–Neal Act of 1994, which finally allowed banks to buy institutions in any state and, by 1997, to operate fully across state lines. Subsequent deregulation, including the 1999 repeal of key Glass–Steagall provisions, fueled the rise of nationwide banking giants through expansive mergers and interstate branching.

The benefits were palpable to all – banks suddenly had larger credit pools with which to issue more debt, leading businesses to access more cash and expand their operations more and more quickly. From 1999 to 2008, U.S. GDP grew by $5.4 trillion. Customers went from having two to five banking options to more than 20, leading to competitive loan systems that benefited the savings of these customers. This latter trend would become unregulated and eventually fatal in the 2008

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financial crisis; however, proper regulation could have led to the highest period of prosperity in American history. The benefits and structural improvement of mergers and interstate branching should serve as a lesson to the European Union, but it will not be a simple transition.

Opposition to an EU banking union ranges from entire countries to rural populations. Rome and Madrid have demonstrated firm objections to even their national banks merging, hinting at views about a larger banking union. Even though the ECB approved the deal, Rome imposed strict conditions on UniCredit's €14 billion takeover bid of Banco BPM, leading to the deal's collapse. Similar challenges took place in Spain with BBVA's bid for Sabadell, which would have made the merged entity Spain's second largest bank. The two governments, known for not being the most business-friendly in Europe, were worried that these merged entities would be too large to regulate and that malpractices in them could lead to the devastation of citizens' savings. While Spain and Italy's regulatory interventions may not come as a surprise, Germany's pushback against UniCredit's growing stake in Commerzbank stands out. As a champion of EU integration and pro-business policy, Germany's stance exemplifies how nationalism plays a factor in cross-border mergers.

Italy's interventions are not in its own best interest, as the country would be a clear beneficiary of merged banks. Small European banks have toxic assets that pose serious liquidity and stability problems, bringing risk to customers and clients. Yet public trust remains fragile: European senior populations are already skeptical of banks, reminiscent of older times when cash was king and banking systems were less regulated. This only reinforces the high amounts of cash held by older citizens, worsening the cash economies present in Mediterranean countries.

If more bank mergers and acquisitions are approved, assets would grow, requiring concrete financial intelligence for crime prevention. Without an effective system in place, trust will erode over time. Implementing Basel IV, which simplifies and strengthens global bank capital rules, would build trust by ensuring that banks hold more consistent and trustworthy capital, reducing unnecessary risks and toxic assets.

ECB supervision would be an added layer of trust, but also protection for the system. While Draghi goes as far as calling for a "28th Regime," a parallel framework of simplified regulation at the EU level that would allow companies to operate within and outside national borders safely. The idea, simply put, is to admit that continental harmonization of laws is a lengthy and politically expensive process, as bureaucracies will rightly seek to keep their way of doing things. However, through the creation of a new dimension of regulation coordinated at the EU Council with their respective capital market authorities, Brussels could create a new space for pan-European banks to compete. A similar proposal is under consideration to promote European technology and innovation. If the tools for future growth and prosperity are being considered for such an approach, the industry that will manage such wealth should be as well.

An EU banking Union has the opportunity to increase local trust in both the financial sector and the EU through uniform yet robust banking standards and gradual bank integration. Creating trust at the local level among the unbanked and Euroskeptics will not be an overnight task and will require robust systems such as the Anti-Money Laundering and Countering the Financing of Terrorism (AMLA), which signed a memorandum of understanding with the ECB on collaboration. Effective systems like the AMLA will be crucial for encouraging Europe's older generations to deposit their cash in banks. Similarly, while antitrust rules should be modified to allow for these cross-border mergers, the strictest regulations on debt exposure and liquidity requirements should be enforced.

The EU faces challenges to both grounds of its legitimacy and effectiveness in serving its people. Delivering a prosperous future requires industrial leadership and new investments, provided by European rather than national banks. In a financial world increasingly dominated by global titans, Europe cannot walk as 27 entities but must move as one. Constructive banking reform, à la Hamilton, needs to stimulate competitiveness and improve the lives of Europeans across the Union; it is the EU's future.