

MA Thesis European Union Studies

EU member states outside the Banking Union
An analysis of the possible participation of Denmark

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I. Introduction

During the financial crisis and the European sovereign debt crisis the weaknesses in the design of the EU, such as a lack of crisis management structures and a lack of European banking supervision, became apparent. The financial crisis shook the global economy in 2008, and together with the design flaws it caused the EU to spiral into a sovereign debt crisis. As a result, the financial markets had little confidence in the European banking system and even calculated that the euro could fail (Hüttl & Schoenmaker, 2016). The problems of the EU were undeniable and economic recovery seemed far away. The European heads of states and government needed to act to face the crisis. They joined forces in 2012 to restore confidence by creating a Banking Union (BU). The BU was created to ensure regulation, supervision, and resolution for all the (larger) banks in the eurozone. It has become a key component of the Economic and Monetary Union and contributes to the financial stability in the EU.

All the eurozone countries participate automatically in the BU. Member states without the euro have the opportunity to opt in by entering into close cooperation with the ECB. However, this opt-in possibility was never used until October 2020 when Bulgaria and Croatia entered the BU. Multiple scholars (see for example Hüttl & Schoenmaker, 2016; Mack, 2020) have argued that joining the BU can have reasonable benefits for the non-euro member states in terms of economics and financial integration. Bulgaria and Croatia recognized these benefits, but they above all wanted to participate in the BU because that brings them a step closer to their goal of adopting the euro (Mack, 2020).

There are six member states that are still outside the BU: Czech Republic, Denmark, Hungary, Poland, Romania, and Sweden. This raises the question of why these member states do not participate in the BU, while scholars argue that it has substantial benefits. Romania has expressed willingness to enter the BU, Czech Republic, Hungary, and Poland have not, and Denmark and Sweden have considered and researched membership but have not yet reached a conclusion. There might be pressing considerations that outweigh the advantages of participation in the BU. I would like to gain more insight into these considerations. In this thesis, I focus on the debate in Denmark, a member state that has not reached a decision on BU membership. I focus on one of the outs, to ensure an in-depth analysis of the debate and the considerations that play a crucial role. The research question that is answered in this thesis is: *what factors shape the debate in Denmark about possible participation in the Banking Union?* To answer the research question, I address the following sub-questions:

What are the positions of different actors in the debate?

What are the main considerations in the debate?

What factors explain the positions and considerations in the debate?

To identify the crucial factors, this thesis conducts a within-case study and uses process tracing as the method. This thesis focusses on two explanations that could unravel how Denmark reached its' current position on BU participation. First, I look at structural factors. I examine if the factors that Howarth and Quaglia (2016) used to research the national preferences of some of the eurozone members in the negotiations about the creation of the BU, also apply to a member state outside the now established BU. Afterwards, I examine if Euroscepticism can explain the position of Denmark. The data used, is conducted thorough content analysis of primary and secondary sources and through semi-structured interviews.

In the academic literature the focus has been on structural factors to explain why some member states have decided to (currently) stay outside the BU (see Howarth & Quaglia, 2016). I apply these structural explanations, but to a case that has not been researched in this field before: Denmark. In addition to researching a new case, I also analyze an independent variable, Euroscepticism, which has not been explored in relation to the BU. Furthermore, Denmark is an interesting case because it officially opted out of the euro, and it is therefore not an incentive for them to join the BU. With this new case and independent variable, I aim to contribute to the academic literature.

The creation of the BU meant a significant transfer of power from member states to the EU and simultaneously increased differentiated integration in the EU (Howarth & Quaglia, 2016). By studying the outs of the BU, more insight can be gained in their position and how this differentiated integration took place in the Economic and Monetary Union. Perhaps there are certain characteristics of the BU that make joining less attractive for the outs. Or perhaps there is a general reluctance towards more European integration in the outs. The reasons behind the choices of the outs are important because it provides insight into not only how these member states view the BU but also into European integration in general.

The following chapter outlines the academic literature that has been written about the outs and the BU and shows how this thesis tries to fill a gap in this literature. Chapter three presents the hypotheses, the method of data collection, and the method of data analysis. Afterwards, I zoom in on why the BU was created and how it has developed since, as this is crucial to understand Denmark's position on BU participation. Chapter five addresses the financial and political context in Denmark and the positions of key actors. Subsequently I

analyze how the debate has developed and what the main considerations are within the debate. Furthermore, in chapter seven, I examine if structural factors and/or Euroscepticism can explain the position of Denmark. This is followed by the conclusion, in which the research question is answered, and the results discussed.

II. Literature review

There are multiple scholars who research if membership of the BU could be beneficial for the outs. Hüttl and Schoenmaker (2016) look at the linkages between banks inside and outside the BU to examine if the outs should join the BU. The main rationale behind the BU is cross-border banking. Hence, if there is enough cross-border activity, it could be useful for the outs to join the BU. Hüttl and Schoenmaker (2016) conclude that Denmark and Sweden have extensive outward banking towards the BU-area, which means that their banks have a substantial part of their assets in the BU market, and the other outs have substantial inwards banking from the BU-area, which means that a substantial part of the assets of the banking sector is foreign-owned. This means that joining the BU would be beneficial for all outs, because it provides financial stability through supervision and resolution. Nonetheless, Hüttl and Schoenmaker (2016) recognize that it also means losing sovereignty over the banking systems.

Belke et al. (2016) are more skeptical about joining the BU. They conclude that the experiences of the eurozone member states with the BU in the coming years will be crucial for the outs to decide if it is in their benefit to join. More recent research finds that the BU has increased European financial integration without threatening the functioning of the internal market and that the benefits could attract non-euro countries (Mack, 2020). Hougaard, Jensen and Schoenmaker (2020) look specifically at Denmark and Sweden and agree that there are strong arguments to join the BU. The SSM has significant resources and increasingly gets more extensive experience in supervising different types of financial institutions. This expertise within the SSM is a key benefit of BU participation (Hougaard, Jensen & Schoenmaker, 2020). Furthermore, the common resolution through the SRF is also a key benefit, especially for a country like Denmark with very large banks (Hougaard, Jensen & Schoenmaker, 2020). As most of the academic literature agrees that joining the BU could be beneficial for the outs, it is puzzling that most of them have refrained from joining the BU.

While the mentioned scholars have answered whether the outs should join the BU by carefully mapping the costs and benefits of BU membership, they have not focused on the actual developments of the debates in the outs, and why the outs do or do not want to be part of the BU. Hence, a needed addition is to gain more insight into which arguments have the most weight in the debate and which preferences play a crucial role. There are a few researchers who focus on this matter.

Spendzharova, and Bayram (2016) examine why Sweden has not joined the BU despite large cross border banking with the Baltic States. Through process tracing they identify that

decision-makers in Sweden were concerned that they would not be fully included in decision-making in the BU as they are not part of the euro. Second, the Swedish were not keen on the idea of having to pay for resolution of banks in other EU member states. Lastly, Sweden wanted to keep regulatory autonomy in crisis management. M  ro and Pirooska (2016) look at Czech Republic, Hungary, and Poland, to explain the opt-out choices. Through policy tracing they first examine if there is a causal relation between structural factors (concentration of banks, competitiveness etc.) and the opt out choices, but they do not find any evidence. What they do find is that banking nationalism is the decisive factor.

Similarly, to M  ro and Pirooska (2016), Howarth and Quaglia (2016) also look at the financial system. However, rather than looking at the outs after the BU was established, they look at the preferences of six eurozone countries during the negotiations on the BU. Specifically, they look at the features of the national banking systems and at the concern for moral hazard. Member states with a highly internationalized banking system, high foreign penetration and low banking nationalism were more likely to be in favor of the BU. Member states who can manage real and potential bank losses because they have a healthy banking system and healthy public finances are more concerned for moral hazard and therefore more skeptical towards risk sharing in the BU.

In conclusion, the literature about the BU and the preferences of member states focusses on structural factors. These factors have not yet been applied to Denmark. While there are no studies about the position of Denmark regarding the BU, there are studies that try to explain why Denmark did not join the euro. Some of the arguments that were important in the debate about the euro could possibly be of relevance for the debate about the BU. Denmark has kept its' own currency, but the Danish krone has been pegged first to the German Mark since 1982 and now to the Euro since 1999. Hence, the choice of Denmark to keep the krone is not a matter of sovereign monetary policy. It must be based on a different rationale.

During the debate about full membership of the EMU and thus the euro, arguments in favor were mostly based on economic advantages. Speculation against the Danish krone could be avoided by adopting the euro and more influence in the Eurogroup and the ECB could be achieved (Jensen & Nielsen, 2016). The arguments against were more political. These arguments emphasized the loss of Danish identity, the limitation of Danish autonomy in finance policy, and the worry that responsible member states would have to pay for less responsible members (Jensen & Nielsen, 2016). The political arguments won from the economic arguments in this debate. Friis (2002) identifies the struggle of finding a good fit between Danish identity and the EU as the essence of Denmark's relationship with the EU. Denmark and the other

Nordic countries strongly believe in their Nordic model and their exceptionalism (Friis, 2002). For the population to support European integration, the government needs to show that Danish identity is not threatened by (an element of) the EU.

According to opinion polls conducted after the referendum, only 11% voted in favor of the euro for economic reasons, 50% voted in favor to protect Danish influence, and 24% to deepen political integration (Friis, 2002). On the no-side, 37% voted no to more union, 23% wished to defend the Danish identity, and 23% mistrust the EU (Friis, 2002). This poll indicates that economic factors were not important in the decision of the population. Even though 80% of the political parties and a broad range of social partner organizations were in favor of adopting the euro (Jørgensen, 2000), the population voted against. It seems that it was largely driven by Eurosceptic sentiments. Because this was an important element in the decision to not adopt the euro, I examine if Euroscepticism can also, in addition to the structural factors, explain the position of Denmark on EU participation.

Euroscepticism can be divided in a hard and a soft variant. Hard Euroscepticism is the principled opposition to the EU and the whole project of integration (Taggart & Szcerbiak, 2002, p. 4). Soft Euroscepticism is not an objection to the whole European project but rather opposition to policy in one or a few areas, or the idea that the EU trajectory is currently not compatible with the national interest (Taggart & Szcerbiak, 2002, p. 4). Ever since Denmark joined the European Economic Community in 1973, after a small majority of the country voted in favor of membership, there have been Eurosceptic sentiments (Nielsen, 2015). While there are a few political parties (the Danish People's Party, the Red-Green Alliance, and the New Right) that support hard Euroscepticism, in general the Danes show a soft Eurosceptic tendency as there is high support for the EU but skepticism towards losing or sharing sovereignty (Sørensen, 2019).

Public officials consider the latent public opinion. This means that officials anticipate how the public might react to certain decisions and will try to avoid decisions that they expect to be greatly unpopular (Hutchings, 2003). If they fail to take the public opinion into account this can have negative consequences at the election, which is the primary mechanism in which the public can express its dissatisfaction and punish elected officials (Hutchings, 2003). However, public opinion is not always an important factor. When the public does not express much care about a certain topic, officials will also be less responsive (Burstein, 2003). How much influence public opinion has will differ from case to case and the academic literature is still in debate about the impact. Nonetheless, a Eurosceptic public opinion could be of greater importance in Denmark than in other member states because Denmark has a tradition of holding

referenda about EU matters. The Danes previously rejected the Maastricht Treaty in 1992, the euro in 2000, and the Justice and Home Affairs opt-in in 2015 (Folketinget, 2021). It is more difficult for a government to pursue a pro-European policy when all important EU-decisions need to be approved by the citizens.

Hobolt (2005) tried to explain voting behavior in referenda about European integration by looking at referenda in Denmark, Ireland, and Norway. She found that EU attitudes and partisanship are decisive factors. Voters who are skeptical about further European integration, are more likely to vote against the ballot proposal in an EU-referendum. Voters who support parties recommending a 'no' are also more likely to vote against. Whether voters can draw the connection between their attitude on European integration and the specific issue in the referendum depends on their individual level of political awareness and on the intensity of the campaign (Hobolt, 2005). The intensity of the campaign about the euro in Denmark was the highest in comparison with other referenda. Hobolt (2005) found that partisan polarization, perceived closeness of the race, campaign spending and news coverage contributed to this intensity. Not only was the intensity the highest in this referendum, the impact of EU attitudes was also the greatest. Hobolts findings thus support the idea that Eurosceptic attitudes can play an important role.

III. Methodology

When explaining Denmark's current position towards BU participation, it is essential to examine what has happened since the introduction of the first pillar of the BU in 2014. In this within-case study, I identify which factors played a crucial role in shaping the debate between 2014 and now. The approach that I use to draw conclusions is process tracing. Process tracing is one of the fundamental tools used in qualitative studies that can identify causal mechanisms (Collier, 2011). A causal mechanism explains how an independent variable connects to the occurrence of the dependent variable. Through the gathering of evidence from the data within a case, inferences about causal explanations can be drawn (Collier, 2011). Process tracing addresses the black box of causality by unraveling why certain causal forces lead to a certain outcome (Checkel, 2005). Process tracing can be seen as a form of detective work, in which evidence is gathered, put in a certain sequence, and compared to hypotheses (Checkel, 2005). Hence, it is a useful tool to analyze a decision-making process.

In this thesis, I use theory-testing process tracing to analyze the debate about BU participation. To apply process tracing to the Danish case about BU participation, the causal mechanisms between the independent and dependent variables must be hypothesized. In the case of Denmark, the debate about BU participation is still ongoing as no final decision has been made. Therefore, the dependent variable analyzed in this thesis is the current position of Denmark towards BU participation. Based on the literature (Howarth & Quaglia, 2016; M  r   & Pirooska, 2016), I examine the financial system in Denmark as an independent variable. I expect that features of the banking system can only to a limited extent explain the current position of Denmark. Howarth & Quaglia (2016) also focus on moral hazard as an explanation for the preferences of member states towards the BU. How well a member state can manage a financial crisis, which depends on their public finances and the health of their financial sector, determines if a member state is afraid for moral hazard in the BU. I expect that the concern for moral hazard will be high in Denmark because they perceive their manageability of financial losses also as high.

However, as explained in the literature review, I do not expect that the structural factors can explain the whole story. Various researchers (H  ttl & Schoenmaker, 2016; Hougaard, Jensen & Schoenmaker, 2020; Mack, 2020) conclude that joining the BU could have substantial benefits for the financial sectors in the outs. Therefore, I do not expect that financial arguments can fully explain why Denmark has not (yet) decided to become a BU member. My expectation is that political reasons play a decisive role in the reluctance of Denmark to opt in. Just as in

the decision about adopting the euro, I expect that a Eurosceptic public opinion plays an important role in determining the current position of Denmark. Thus, I will also look at Euroscepticism as an independent variable. The current government has promised to hold a referendum if it decides that joining the BU would be a good idea (Jyllands-Posten, 2019). The referendum practice in Denmark has proved to be an effective channel for Euroscepticism. Hence, I expect that the government will calculate very carefully if and when they will hold a referendum, because they do not want to endure high political costs that losing the referendum could cause.

Thus, the four hypotheses that are studied in this thesis are:

H1: The features of the Danish financial sector explain to a limited extent Denmark's position.

H2: Concern for moral hazard caused by the BU is high in Denmark due to a high perceived manageability of bank losses.

H3: A Eurosceptic public opinion shapes the position of Denmark towards BU participation.

H4: The political costs of (losing) a referendum about the BU withholds the government from taking a final decision.

The following step in process tracing is collecting the data to support or reject these hypotheses. I collect data from 2014 until 2021 to follow the entire process. A detailed description of the key variables is the foundation to analyze causation through process tracing (Collier, 2011). Hence, this thesis uses content analysis to provide a rich description of each of the variables. I draw on primary sources, such as the Danish central bank's assessment and reports about participation, the reports by the Danish Ministry of Industry, Business, and Financial Affairs, documents of parliament, opinions of politicians either expressed in parliament or in the media, speeches by the prime minister and actors in the financial sector, data on Danish public opinion towards the EU, and press-coverage of the BU in Danish media. In addition, I use a few secondary sources, mainly from Tænketanken Europa, an independent Copenhagen-based think tank focused on Europe.

To verify information from the written sources, to gain insight into critical moments in the debate, and to get the perspective from relevant actors in the financial sector and in political parties, I aimed to conduct semi-structured interviews. The interviews included in this thesis are with the Ministry of Industry, Business and Financial Affairs, and with Jan Høst Schmidt, a senior advisor of Tænketanken Europa. The Ministry was responsible for two reports in which

they assessed Danish BU participation. Hence, the Ministry has expertise on the workings of the BU, the financial sector in Denmark, and developments since the introduction of the BU. Schmidt has written about the BU and the public attitude towards possible Danish participation and can therefore shed light on this part of the thesis. Furthermore, I spoke with an actor in the financial sector, who provided me with relevant background information, but did not wish to be cited in this thesis. I also approached multiple actors in the financial sector and in the political parties, but they were not available or willing to participate.

IV. The Banking Union explained

At the heart of the European sovereign debt crisis was the sovereign-bank doom loop. This doom loop contributed to the crisis because banks owned a large amount of the debts of their own governments. During the crisis the credit ratings of the European governments dropped and consequently the solvency of the banks fell. The other way around, failing banking systems in Europe led to the need to bail banks out, which was done the national governments. This had a severe impact on the budgets of the governments. To break this doom loop the BU was created.

To strengthen the financial sectors common supervision, a common resolution scheme, and a common deposit insurance scheme were envisioned. The first two have been implemented in the form of the Supervisory Mechanism (SSM) and Single Resolution Mechanism (SRM), in respectively 2014 and 2015. The SSM was created because national control of large-cross border banks was suboptimal. To solve this, the ECB directly supervises 115 significant banks of the participating countries in the SSM (European Central Bank, 2021a). Smaller banks are supervised by national authorities in close cooperation with the ECB. The SRM ensures that bank resolution is handled effectively through the Single Resolution Board and the Single Resolution Fund. It is set up to guarantee an orderly resolution of failing banks in the euro area with minimal costs for taxpayers and a minimal impact on the economy.

The BU is not yet complete because the third pillar, the European deposit insurance scheme (EDIS), is lacking. Through EDIS banks jointly cover all deposits below €100.000 of all banks in the BU. EDIS has not been implemented because different member states have diverging views. Some Northern member states, such as Germany, the Netherlands, and Finland, do not yet want to implement EDIS because they are afraid that they will need to pay for the banks in Southern Europe (Het Financieele Dagblad, 2020). Hence, no agreement about the introduction of EDIS has been reached.

The SSM, SRM and possibly EDIS in the future only apply to BU member states. However, there are a few other elements that are considered integrated parts of the BU that apply to all EU member states. The first is the Single Rulebook, which harmonizes the rules of the financial sector in the entire EU. The second is the Capital Requirements Directive and Regulation (CRD IV/CRR), which reflects the global standards of Basel III on bank capital adequacy. The third is the Bank Resolution and Recovery Directive (BRRD), which harmonizes resolution frameworks by obliging member states to set up ex ante national resolution funds. In

short, might the outs decide to join the BU, they join the SSM, SRM, and possibly EDIS. The outs are already part of the Single Rulebook, the CRD IV/CRR, and the BRRD.

Since the implementation of the first pillar of the BU in 2014 some progress has been made to strengthen the BU. In November 2020, the Eurogroup agreed on an early introduction of the common backstop for the SRF (Eurogroup, 2020). The common backstop entails that in the event that the SRF is depleted, the necessary funds can be lend from the European Stability Mechanism to finance a resolution. The early introduction was possible because the Eurogroup concluded that sufficient progress in terms of risk reduction has been made. The European banks have decreased their Non-Performing Loans (NPLs) and increased their own funds and eligible liabilities (Eurogroup, 2020). The latter form the buffer each bank holds to absorb losses and to prevent the need to use public money. Only Greece and Cyprus still have a high percentage of NPLs, respectively 35,5% and 18,1% (Eurostat, 2021). The COVID-19 crisis might slow some of the improvements down, but the risk reduction has been substantial over the past years, and the introduction of the common backstop is an important step in the finalization of the BU.

V. Context of the Danish debate

In this thesis, I analyze structural financial factors and Euroscepticism to explain Denmark's position towards EU participation. In order to do this, I first draw a picture of the financial and political context in Denmark and examine what the different positions of actors in the financial sector and in politics towards joining the EU are. This chapter thus answers the first sub question *What are the positions of different actors in the debate?*.

V.I Characteristics of the financial sector

Denmark has a relatively large financial sector with a few very large financial institutions (Finans Danmark, 2018). In comparison with GDP the sector is one of the largest in Europe. Table 1 shows the number of financial institutions, their total assets, and their assets in per cent of GDP. Both the banking sector, with 345 per cent of GDP, and the pension funds and insurance companies, with 190 per cent of GDP are large in comparison to other European countries (IMF, 2020).

Table 1 Structure of the financial system (in 2018)

| Financial institutions | Number | Billions (DKK) | Per cent of GDP |
|------------------------|--------|----------------|-----------------|
| Total | 373 | 14,159 | 630 |
| Commercial banks | 70 | 3,805 | 169 |
| Mortgage banks | 7 | 3,965 | 176 |
| Pension funds | 34 | 1,735 | 77 |
| Insurance companies | 78 | 2,539 | 113 |
| Other | 183 | 2,053 | 91 |

Based on IMF (2020)

The Danish banking sector consists of many small domestically focused institutions and a few big international groups, with the latter accounting for most of total lending (Danmarks Nationalbank, 2021). In comparison to the other EU countries, as can be seen in table 2, Denmark has a relatively domestically focused banking sector. This confirms the image of many smaller institutions that are focused on the domestic market. In table 3 the assets of the larger financial institutions in Denmark (with total assets of more than 100 € billion) can be seen. The largest bank, Danske Bank, is quite internationally orientated, and has almost half of its' assets within the EU. The other two large financial institutions are mostly domestically focused. This is explainable because they mainly provide mortgage loans.

Table 2 Assets in the outs (in 2018)

| | Total assets in € billion | Percentage of total assets | | |
|----------------|------------------------------|----------------------------|-----------------------|--------------------|
| | | Home country | Other EU countries | Third countries |
| Denmark | 1174 | 86% | 14% | 0% |
| Sweden | 1296 | 82% | 17% | 1% |
| Czech Republic | 312 | 16% | 84% | 0% |
| Hungary | 128 | 54% | 41% | 6% |
| Poland | 484 | 56% | 41% | 4% |
| Romania | 105 | 37% | 63% | 0% |

Based on De Haan, Schoenmaker and Wierds (2020)

Table 3 Assets of the largest financial institutions in Denmark (in 2017)

| Bank | Total assets in € billion | Percentage of total assets | | | |
|--------------------|------------------------------|----------------------------|----------------|-----------------------|--------------------|
| | | Home country | BU + Sweden | Other EU countries | Third countries |
| Danske Bank | 475 | 55% | 27% | 17% | 0% |
| Nykredit | 192 | 95% | 2% | 3% | 0% |
| Realkredit Denmark | 118 | 98% | 1% | 1% | 0% |
| Total | 785 | 71% | 17% | 11% | 0% |

Based on Duijm and Schoenmaker (2020)

Mortgage banks constitute about half of Denmark's banking sector, and the cover bond market in Denmark is the largest in Europe (Møller, 2019). It is therefore an important aspect of the financial sector. The Danish mortgage system is differently arranged than in other European countries. The Danish system is based on a match-funding principle, which means that there is a direct match between the mortgage loan and the covered bonds to finance this loan (Møller, 2019). The rate of the mortgage loan is determined by the market value of the bonds (Møller, 2019). According to the Danes this mortgage model ensures a high level of transparency and financial stability.





With regard to the health of the Danish banking sector, it has proven to be well-capitalized and resilient in stress tests conducted by the EBA (European Banking Federation, 2020). The sector has increased its' capitalization since the beginning of the financial crisis. The overall ratio grew from 14,8% in 2008 to 24,8% in 2019 (European Banking Federation, 2020). The credit rating of Denmark is triple-A. A government dept at 30 per cent of GDP (before the corona crisis), sound macroeconomic management and prudent fiscal policies underpin the health of Denmark's finances (European Banking Federation, 2020).

V.II Position of the financial sector

Table 4 shows the positions of the main actors in the financial sector. This table is based on publications and official reports of the actors, and on comments made in the media. The financial sector is divided on whether Denmark should participate in the BU, and many of the actors, apart from the central bank of Denmark, are also not very vocal about the matter.

The central bank of Denmark is one of the biggest advocates for BU membership and expressed its’ support as early as 2014. The Danish Economic Councils, an economic advisory body, concluded in 2015 that joining the BU would be a good idea, but some issues, such as the Danish mortgage system, had to be examined more closely (De Økonomiske Råd, 2015). Finance Denmark, the business association for banks, mortgage institutions, asset management, securities trading, and investment funds in Denmark, has made clear that they support the government in their research on the possible participation of Denmark, but they do not express an opinion about the matter. The most important concerns of Finance Denmark, as expressed in 2017, are the Danish mortgage system and the NPLs in other member states (Jensen, 2017). However, while the decision is of great importance, it is a political decision. Finance Denmark represents the whole financial sector and there is no consensus within the sector. Many of the smaller financial institutions and the mortgage banks are satisfied with the Danish supervision and have some concerns about what they can expect when Denmark joins the BU. Some of the largest institutions seem more positive. Danske Bank expressed enthusiasm in 2017 about the government conducting a new research into BU participation and expressed a positive attitude toward the BU (Ritzau Finans, 2017). However, the bank has not made an official statement about whether they are in favor, and therefore their position is qualified as unclear in table 4.

Table 4 Position of key actors

| Financial sector | In favor | Against | Unclear |
|---|---|----------------|---|
| Central bank of Denmark <i>Danmarks Nationalbank</i> |  | | |
| Finance Denmark (business association) <i>Finans Danmark</i> | | |  |
| The Danish Economic Councils <i>De Økonomiske Råd</i> |  | | |
| Danske Bank | | |  |

V.III A closer look at Danish politics

Denmark is a representative democracy with a multi-party system. The parliament consists of 179 members. Of those members, 175 are elected in Denmark, two in Greenland, and two in the Faroe Islands. Since the 20th century no single party has had a majority in the parliament. It is not uncommon in Denmark to form a minority coalition. The current government only consists of the Social Democrats who have 49 seats and is headed by Prime Minister Mette Frederiksen.

Because the Social Democrats have no majority in parliament, they need to seek support from other political parties. The government can seek support from different parties on different issues, but to make the process easier it often seeks out so-called supporting parties at the beginning of the term. Currently the Social People's Party, the Social Liberal Party, and the Red-Green Alliance are the supporting parties. Together these three parties have 42 seats and can provide the Social Democrats with a small majority in parliament.

The system in Denmark is characterized by inter-party compromising. With a minority administration, the power of the parliament is relatively strong in relation to the government. This power is even stronger in EU-related matters. In Danish politics there is a rule that the Danish European Affairs Committee, which currently consists of 29 members of parliament (MPs) of 9 different parties, needs to give a negotiating mandate on matters of major significance to the government before European Council meetings (Jensen and Nielsen, 2011).

V.IV Position of the political parties

Table 5 shows the positions of the political parties. I have determined their positions through analysis of the party programs and of statements by politicians in the media. The table includes all political parties with more than one member of parliament (MP). Additionally, there are six political parties with one MP, and seven MPs without a party affiliation. Because they have been left out, the table shows 166 of 179 seats. Of these 166 are 69 in favor, 36 against, and 69 unclear.

Of the supporting parties the Social People's Party was the first party in 2014 to declare its' support for BU membership. They saw more benefits than costs and find it important that Denmark has influence within the system by being part of it. The Social Liberal Party, a pro-European party, later also declared their support. However, the third supporting party, the Red-Green Alliance, is firmly against. The Red-Green Alliance is a Eurosceptic party in general. They reject the BU because they think it is the wrong kind of cooperation because it strengthens the influence of banks on financial regulation and paves the way for big banks to grow even

bigger (Villumsen & Søndergaard, 2019). The Social Democrats, as the biggest party and the only party in government, has a pivotal position in the debate. However, the party has refrained from taking a stance.

The biggest opposition party, the Liberal Party, is in favor of joining. The Danish People’s Party and the New Right are Eurosceptic parties. They want to leave the EU and see therefore no reason to join the BU. The Liberal Alliance wants a small EU and is of the opinion that Denmark needs to govern its own economy and BU membership does not fit into that picture (Liberal Alliance, 2021). The Conservatives People’s Party remains undecided.

Table 5 Positions of key actors on joining the BU

| Political parties 179 seats in parliament* | In favor | Against | Unclear |
|--|----------|---------|---------|
| Social Democrats (49) <i>Socialdemokratiet</i> | | | ? |
| The liberal Party (40) <i>Venstre</i> | ✓ | | |
| Danish People’s Party (16) <i>Dansk Folkeparti</i> | | ✗ | |
| Social People’s Party (15) <i>Socialistisk Folkeparti</i> | ✓ | | |
| The Social Liberal Party (14) <i>Radikale venstre</i> | ✓ | | |
| The Red–Green Alliance (13) <i>Enhedslisten – De Rød-Grønne</i> | | ✗ | |
| The Conservative People’s Party (12) <i>Det Konservative Folkeparti</i> | | | ? |
| New Right (4) <i>Nye Borgerlige</i> | | ✗ | |
| The Liberal Alliance (3) <i>Liberal Alliance</i> | | ✗ | |

VI. Main considerations in the debate

In this chapter, I answer the second sub question of this thesis: *What are the main considerations in the debate?*. To get a clear picture, I look at how the debate has developed since 2014 until now. Afterwards I assess what the current state of the debate is and give an overview of frequently used arguments in the debate on possible Danish participation in the BU.

VI.I Development of the debate

In table 6, I collected the most important developments from 2014 until 2020. There are three phases in the debate about BU participation, according to interviewee I. In the first phase the BU was created, and decisions were made in the EU. Denmark took the lead in ensuring that non-eurozone countries could join the BU on equivalent terms. Table 6 starts with the second phase: the assessment phase. During this time the workings and consequences of joining the BU are thoroughly assessed in different reports. This assessment phase starts with the announcement of the set-up of an expert group at the Ministry of Industry, Business and Financial Affairs in 2014. They have written two reports, which are comprehensive assessments of possible Danish participation. I will address them in more detail below. Furthermore, the second phase also includes reports from other actors, such as the central bank of Denmark, and it includes statements from Prime Ministers Helle Thorning-Schmidt (PM until 2015), Lars Løkke Rasmussen (until 2019), and Mette Frederiksen (from 2019 onwards). Most of the outstanding questions about Danish BU participation have been answered in the second report of the Ministry of Industry, Business, and Financial Affairs that was published at the end of 2019. It marks the start of the third phase, in which no longer assessment is needed, but more political questions need to be discussed. However, the third phase never really took off and not much has been discussed since the end of 2019.

| Table 6 Key moments in the debate | |
|--|--|
| Date | Event |
| February 2014 | Set-up of Coordination Group for Financial Stability to examine the possible participation of Denmark in BU. |
| 20 March 2014 | Prime Minister Helle Thorning-Schmidt: ‘Denmark will not decide hastily. We will make a thorough balance of the BU and Danish interests. What we have done throughout is to negotiate in a way that Denmark has a wide range of options. So that Denmark can be both in and out the BU.’ Ussing & Crone (2014) |

| | |
|------------------|--|
| 3 April 2014 | Lars Rohde, CEO central bank of Denmark : 'It is the central bank's view that Danish interests are best served by Denmark participating in the banking union.' Berlingske (2014) |
| 8 oktober 2014 | Danish Bankers Association : despite the benefits there are a few significant uncertainties. The decision to join the banking union should therefore await further clarification. Finansrådet (2014) |
| 15 April 2015 | Report I by Coordination Group for Financial Stability Ministry of Industry, Business and Financial Affairs (2015) |
| Spring 2015 | Report from the chairmen of the Danish Economic Councils : participating in the BU could have great economic benefits, with the SRF as the largest benefit. However, the common backstop is not defined. More information about the consequences for the Danish mortgage system is needed. De Økonomiske Råd (2015) |
| 20 March 2017 | The Danske Bank large money laundering scandal comes to light Jung, Lund & Bendtsen (2017) |
| 4 July 2017 | Order for a new report by Coordination Group for Financial Stability |
| 15 December 2017 | Prime Minister Løkke : 'The EU's banking union is a good idea for Denmark. But the final decision will not be taken before 2019, when the second report is finished.' Christensen (2017) |
| 1 October 2018 | The Scandinavian bank Nordea moves its headquarters from Stockholm to Helsinki. CEO Casper von Koskull: 'The move is about becoming part of the banking union with stable and predictable rules as well as a level playing field.' Høie (2018) |
| 4 November 2018 | Prime Minister Løkke : 'There are more and more indications that it would be wise to join the banking union. We see more and more bandits, who commit cross-border economic crime. We have seen money laundering scandals where there is no doubt that stronger cooperation between European countries' financial supervisors would have been best.' Berlingske (2018) |
| 20 November 2018 | Central bank of Denmark : the risk of transfers between countries to rescue banks is minimized in the BU. Danmarks Nationalbank (2018a) |
| 3 December 2018 | Lars Rohde, CEO central bank of Denmark : 'Rule-based international cooperation is now, after all, the best solution to cross-border challenges. Not least for a small country like Denmark.' Danmarks Nationalbank (2018b) |
| 17 October 2019 | Prime Minister Frederiksen : promises to hold a referendum if the government advises in favor of joining the BU. Denmark will only join the BU if a majority of the citizens vote for participation. |

| | |
|------------------|---|
| | Hjøllund & Gjertsen (2019) |
| 2 December 2019 | Lars Rohde, CEO central bank of Denmark : ‘The position that Denmark should become a member of the BU has only been strengthened in the last five years.’ Danmarks Nationalbank (2019) |
| 5 December 2019 | Forenet Kredit , Report on the Danish mortgage lending model: the report outlines the risks of BU participation for the Danish model. It also provides recommendations to limit the risks and to main the benefits of the current mortgage lending model. Oliver Wyman (2019) |
| 19 December 2019 | Report II by Coordination Group for Financial Stability Ministry of Industry, Business and Financial Affairs (2019) |
| 11 December 2020 | Prime Minister Mette Frederiksen: ‘We have not taken a position on the banking union yet. It will come. I’m not going to put an exact date on it.’ FinansWatch (2020) |

Report I

According to interviewee I, the report provides insight into BU participation through different perspectives by answering the following questions. What do we need to do to integrate banking markets? Can the BU promote cross border activities? How can we get the best supervision for our credit institutions? Are we better equipped to deal with crisis situations inside the BU? How is the Danish mortgage credit treated within the BU?

The first report by the Ministry of Industry, Business, and Financial Affairs draws some conclusions about the impact of BU participation (Ministry of Industry, Business and Financial Affairs, 2015). Firstly, participation will strengthen the ability to promote Danish interests in the area of financial affairs in the EU. Secondly, the joint supervision and settlement can strengthen competition in the internal market in the longer term. Thirdly, access to a larger settlement fund can be beneficial for financial stability. The report assesses that it could be an advantage to participate in the BU but points out that some factors need more clarification. For example, the Danes want more clarity about the impact of BU membership on the Danish mortgage credit system (Folketingets Europaudvalg, 2016). Furthermore, as there is not much experience with the BU yet, the results of the BU in practice, such as the quality of joint supervision, could not be observed in this report and need further examination at a later point. Accordingly, Denmark wants to see how some factors develop, such as NPLs and the negotiations on strengthening the BU (Folketingets Europaudvalg, 2016). Hence, the government concludes that more information is needed and does not take a final stance. In 2017

the government decides to set up a similar working group to clarify the mentioned subjects and to review the developments after 2015.

Report II

Interviewee I explained that the working group organized discussions with experts and met with governments, banks, and authorities within the EU to hear about their experiences with the BU. The report has clarified the outstanding questions and topics of the 2015 report. The conclusion of this report is that much speaks in favor of participating in the BU. The international expertise and the broader basis for comparison in the BU could lead to better supervision (Ministry of Industry, Business, and Financial Affairs, 2019). Furthermore, Denmark would have more influence on the ECB's supervision and on the development of financial regulation within the BU. This is more than ever an important factor because the work of the ECB has more and more become the standard and the BU might become the starting point for financial regulation, as interviewee I pointed out.

Simon Kollerup, Minister for Industry, Business and Financial Affairs, responded after publication of the second report that there are still a few factors that need for more clarity. The Minister specifically points to the position of Sweden, Brexit, Basel, and the ongoing work on strengthening the BU. A big part of the latter issue is EDIS, which is not yet introduced. Denmark is positive about the idea of implementing EDIS, but wants a package deal, in which RTSE, and crisis management need to be covered, according to interviewee I.

Denmark keeps a close eye on the developments in Sweden regarding the BU. Interviewee I explains that it will have large consequences for Denmark if Sweden decides to join the BU. The dynamics within the EU would change because Denmark would be the only country with a large financial sector outside the BU. In addition, interviewee I points out that the Swedish decision is of great importance because the Swedish and Danish financial markets are highly integrated. However, it does not seem likely that Sweden will take a decision on BU participation anytime soon. The views in Sweden are divided. The Central bank of Sweden is in favor, the Swedish Financial Supervisory Authority is critical, the Swedish banking association does not take a side, and the Confederation of Swedish Enterprises advises Sweden to wait with deciding until the financial risks are clearer, and the BU is more developed (Stortinget, 2020). Interviewee I points out that Sweden is also a step behind Denmark in assessing all the consequences of participation. Sweden has just assessed whether it should join, which is what Denmark did in its' first report in 2015. In 2015, Sweden did not want to join but the government seems slightly more positive now, according to interviewee I.

The third factor that needs consideration before a decision on BU membership can be taken according to the Minister is Brexit. The UK leaving the EU means losing the biggest non-BU country. There is a fear in Denmark that without the UK the actual decision-making process will mostly take place in the Eurogroup instead of the Ecofin Council, which means that Denmark would lose influence on decisions (Jensen, 2017). Interviewee I confirms that the Ministry of Industry, Business and Financial Affairs shares this worry. Furthermore, The UK was an important ally within the EU for Denmark on many subjects. The UK had similarly to Denmark some exceptions in the form of opt-outs. With the UK gone there is a powerful member state less to help ensure that exceptions are accepted. This might make it more difficult for Denmark to make sure that the Danish mortgage system will be taken into account in the BU (Houmann, 2016).

Lastly, according to Interviewee I, the upcoming revision of Basel, the capital requirements, can potentially have a big influence on Denmark, because it determines the framework that banks work within. The Basel revision is not directly related to the BU, because it covers all banks. However, interviewee I explains that the government sees a calm environment, in which it is clear how the framework works, as an important prerequisite to discuss BU-membership. Hence, Denmark wants to see how the revision plays out before making a decision on BU participation.

Minister Kollerup stated that the government will return to discussing possible participation in the BU when there is more clarity on these issues. However, he does not explain how much information is needed and when there will be enough clarity.

VI.II A wait and see approach

It becomes apparent from looking at the development of the debate that a lot has been done to assess the consequences of BU membership, and that there is a lot of information on which a decision could be based. However, during the whole period from 2014 until now the public debate has been very limited, according to interviewee I and II.

After the first report in 2015 many parties still desired more information. The government of Løkke Rasmussen therefore announced in 2017 that a second report would be made, and that the government would take a decision afterwards (Christensen, 2017). Many people, such as professors and the top of the financial sector, predicted that Denmark would join the banking union (Andersen, 2017; De Boer, 2018). However, the second report came out when the government of Løkke Rasmussen was replaced by a new government headed by Frederiksen. A discussion about the conclusions of the second report and which choice

Denmark should make did not occur, neither amongst the political parties, the media, nor the public. Frederiksen never indicated when a decision would be taken, nor did her party, the Social Democrats, express whether they are in favor or against BU participation.

The approach of Denmark can be qualified as a wait and see approach. Even after the whole assessment phase, with the different elaborate reports, there is a desire for more information and more clarity. Interviewee II expects that the Danish politicians will postpone a decision until agreement has been reached in Brussels about the implementation of EDIS, faster reduction of NPLs, and how to deal with large exposure of banks to their own state. Due to the pandemic and the lack of progress in discussion about the BU in the EU, Danish politicians do not feel the immediate need to address BU participation. There is no legal pressure to take a decision, no deadline after which participation is no longer possible, and no imminent pressure of a financial crisis as there was in the years following 2008, explains interviewee I.

While BU participation has not been thoroughly discussed, throughout the years some arguments have been frequently used. These are summarized in table 7. The arguments come from reports of the central bank, the Ministry of Industry, Business, and Financial Affairs, the Economic Councils, and Tænketanken Europa. In addition, also media coverage and the interviews conducted for this thesis are reflected in table 7.

Joining the SSM is seen as a way to strengthen supervision by supporters of BU participation, while opponents are convinced that the tailored approach of the national supervising authorities is better capable to supervise the financial sector, and especially the Danish mortgage system. Supporters see the SRM as a good safeguard against a financial crisis, while opponents fear that Denmark will need to pay for bad banks in other member states. Supporters view BU membership as a way to exert more influence within the EU with regards to financial regulation, while opponents see it as a loss of sovereignty. Lastly, there are some other factors. The first three are mainly reasons, expressed by the Minister of Business, Industry and Financial Affairs, of why it would be wise to take a wait and see approach, which I addressed previously. The last two are examined in depth in the next chapter.

Table 7 Main arguments BU participation

In favor

1. Supervision by ECB
 - High quality
 - Banks can be too big for national supervision
 - Common supervisory standards can promote competition
 - Raises the expertise of national authorities involved in the joint crisis management

1. Insurance Scheme of the SRF
2. A seat at the table and therefore more opportunities to exert influence

Against

1. Supervision by Danish Financial Authorities
 - High quality
 - No risk that other member states want to resolve Danish banks for competitive reasons
 - No risk of having to change (parts of) the Danish mortgage system
2. The risk of paying for banks in other member states
3. Relinquishment of sovereignty

Other factors

1. The decision of Sweden
 2. Brexit
 3. The development of the BU
 4. Public opinion
 5. Referendum
-

VII. Explaining the position of Denmark

In this chapter I answer the third and last sub question: *What factors explain the positions and considerations in the debate?*. I first look at structural explanations and afterwards at Euroscepticism as an explanation.

VII.I Structural factors

If Denmark would join the BU it means joining the SSM and the SRF. In this chapter. I examine the structural factors that determine the position of Denmark towards the two pillars of the BU.

Supervision

The main question that is at the heart of the debate is: would supervision be better at the national or European level? As we have seen in chapter 5, Denmark has a relatively large financial sector with many domestically focused financial institutions and a few large internationally orientated financial groups. In comparison to the other outs the internationalization of the sector is relatively low.

An element that is specific for the Danish financial sector is how the mortgage system works and how important the mortgage banks are within the financial sector. Concerns about the impact of the SSM on this Danish mortgage system are highlighted in every report. The Danes are worried that their system will not fit into the BU because it is different from mortgage models used in other countries. Louise Caroline Mogensen, CEO of Forenet Kredit, an association of two big mortgage lenders, even claims that the Danish system to finance houses is probably the best and cheapest in the world and has created stability and security for more than 200 years (Mogensen, 2020). Hence, protecting the Danish mortgage model is an important factor in the debate and is vocalized by both the financial sector and the political parties.

The Social Democrats stated that if the Danish system cannot be protected in the BU, joining is not relevant (Pedersen, 2017). Forenet Kredit warns that Danish BU participation will have severe negative consequences if Denmark does not negotiate special arrangements with the EU (Mogensen, 2020). The Danish authorities have taken a tailored approach to supervision of their mortgage institutions and a risk could be that the ECB requires different supervising standards that impact the Danish system (Oliver Wyman, 2019). The second report of the Ministry of Industry, Business, and Financial Affairs specifically addresses the implications of Danish BU participation on the mortgage credit system. The expert group of the Ministry investigates 14 concerns related to the mortgage system and concludes, through dialogue with

the European Supervisory Authorities, that ten concerns are manageable, while the remaining four still need some clarification (Ministry of Industry, Business, and Financial Affairs, 2019). Because the second report has not been debated, it is unclear whether some of the skepticism about the possible functioning of the Danish mortgage system in the BU has been reduced.

On the other hand, there has been a growing realization since the financial crisis that some banks are maybe too big and internationalized to be supervised by national authorities. An event that contributed to this awareness was the money laundering scandal of the Estonian branch of Danske Bank. This was the largest money laundering scandal in Europe. It received a lot of attention and was a highly political subject in Denmark, according to interviewee I. Supporters of BU membership saw the money laundering scandal as an example of the fact that European supervision is needed (Bocian, 2018). However, interviewee I points out that the contribution of the BU to battle money laundering is quite limited, because supervising the compliance of financial institutions with the anti-money laundering requirements is an exclusive competence of the national authorities. Furthermore, the European Anti-Money Laundering Action Plan was made on the level of the Council, which also includes Denmark (European Central Bank, 2021b). While the money laundering scandal does not have much to do with the BU, it did strengthen the argument that national supervision has its limitations.

The structural factors give a mixed image of whether Denmark should be in favor of participating in the SSM. The large financial sector makes Denmark vulnerable to possible crisis in the sector. There are some institutions that are too big to fail and perhaps too internationalized for national supervision. Furthermore, the Danish economy is strongly dependent on developments in the rest of the EU and especially on developments in the eurozone, according to interviewee II. These characteristics of the financial sector suggest that Denmark could benefit from BU participation. However, the relatively low internationalization of the Danish banking system, and the unique Danish mortgage system, create less incentive for Denmark to become a BU-member. These mixed incentives match well with the actual attitude of Denmark: a wait and see approach.

Resolution

Denmark has a healthy banking sector and low public debt, as was explained in chapter 5. It is likely that when Denmark joins the BU, Danish banks will contribute more to the SRF than they will draw on it, because the Danish banks are more resilient to crises than many other banks in the BU (Ministry of Industry, Business and Financial Affairs, 2019). Danish banks are relatively healthy in terms of core capital, NPLs, and sovereign exposure (Ministry of Industry,

Business and Financial Affairs, 2019). The concern of having to pay for other banks in the BU is an often-heard argument against participation, according to interviewee II. It is vocalized not only in the public opinion (Schmidt, 2019), but also by business association Finance Denmark.

The central bank of Denmark tried to take away the concerns of having to pay for other European banks and is convinced that this argument should not be at the core of the debate. The SRF serves as a disaster insurance, but there is only a small chance that it is needed in practice (Danmarks Nationalbank, 2018a). And even if the SRF is needed, it is unlikely that Danish taxpayers and banks will need to pay for banks in other member states. While the SRF is filled with contributions by the European banks in the BU, making the banks responsible for each other's risks, creditors of the failing bank need to have absorbed losses of at least 8% of the liabilities of the bank through the bail-in tool, before the SRF can be used (European Central Bank, 2016). In a bailout, taxpayers carry the costs of a failing bank, while with a bail-in the costs shift to shareholders and creditors of the failing bank (European Central Bank, 2016). Interviewee I explains that paying for banks in other EU member states is not seen by the expert group of the second report as a reason to postpone a decision on BU participation. The SRF will probably only be used when the EU is hit by a crisis worse than the financial crisis. Nonetheless, interviewee II assesses that the concern for moral hazard has not disappeared and that it remains an important argument for opponents of BU participation.

The size of the financial sector and of the biggest banks gives Denmark an incentive to be in favor of a common resolution scheme. If a financial crisis would hit Europe, shared coverage would give Denmark more certainty. Furthermore, the dependency of Denmark on the developments in the Eurozone means that the impact of what happens in the BU is large, whether Denmark participates or not. However, there is a belief in Denmark that the country is performing better than the other EU member states and that Denmark can afford to stay outside, according to interviewee II. The health of the public finances and the financial sector contribute to this perceived manageability of a financial crisis, and it strengthens the concern for moral hazard.

VII.II Euroscepticism

When asked about their opinions of the EU, Danes are most skeptical about relinquishing sovereignty to the EU (Sørensen, 2019). Another cause for some opposition is the level of democracy in the EU (Sørensen, 2019). On the other side the Danes are very positive about the internal market and the influence of the EU on the Danish economy (Kjems, 2018). Half of the Danes are even willing to pay more to the EU budget, if this strengthens the areas they find

most important, such as security, the green transition, migration, and the fight against tax havens (Schmidt, 2018). A large majority of the Danes support EU membership, but they want to keep the Danish opt-outs (Sørensen, 2019). The Danes are in fact significantly more positive about EU membership than other member states. Of the surveyed Danes 77% think that the EU is a good thing, while the average in the EU is 59% (Eurobarometer, 2019). In short, there is no large, shared desire to leave the EU, but there is opposition towards further integration.

With regard to the BU, the Danish population seems skeptical. In different polls over the years there has always been a greater percentage against BU membership than in favor, as can be seen in table 8. The year 2014 is an outlier in the sense that a very large part of the population did not have an opinion on BU membership. While the topic has not been debated very intensely, more people have become familiar with the BU as a concept over the years. Nevertheless, one fifth of the population still does not have an opinion on BU participation. The limited debate and the complex and technical nature of the matter are at the root of this.

Table 8 Public opinion on BU membership

| Year | In favor | Against | Do not know |
|---------------------------------|-----------------|----------------|--------------------|
| 2014 Skovgaard (2014) | 18 | 30 | 48 |
| 2018 Christensen (2018) | 38 | 41 | 21 |
| February 2019 Schmidt (2019) | 31 | 44 | 20 |
| May 2019 Mandrup (2019) | 36 | 44 | 20 |

The study of Schmidt (2019) also looks into the reasons behind the support or opposition towards the BU, as can be seen in table 9. The risk of having to pay for other bad banks is the main argument against BU participation. The other two arguments are not wanting the EU to decide more in Denmark and not wanting Denmark to give up sovereignty. These can be classified as Euroscepticism. When it comes to sovereignty many people do not realize that the economic sovereignty of Denmark is already limited and that Denmark is very dependent on economic developments in the eurozone, according to interviewee II. The Danish crown is pegged to the euro through ERM II, a mechanism to manage the exchange rates between EU

currencies (Høegh, 2014). Denmark does not have to participate in the ERM II because of the euro opt-out, but it decided to participate anyway.

A remarkable outcome of the study of Schmidt (2019) is that the advice of the government, financial institutions and businesses has a very limited impact on the opinion of Danish citizens. Especially the government has very little influence as only 5% of the citizens state that the position of the government affects their decision. He explains in the interview that while Danish citizens normally have high confidence in the Danish political system, they attach less value to what politicians say when it regards EU-matters. The fact that politicians often blame problems on the EU does not create a lot of support in the population in general.

Table 9 Arguments that influence Danish citizens in their position on BU membership

In favor

- 25% There should be joint supervision.
- 21% The BU makes banks better equipped for a next financial crisis.
- 19% Cases about money laundering.
- 19% BU membership gives Denmark influence in the EU regulation of the financial sector.

Against

- 36% Risk that Denmark will need to pay for bad banks in other member states.
- 27% EU should not decide more in Denmark.
- 25% Denmark should not give up sovereignty.

Other factors

- 13% Recommendation of the Central Bank of Denmark
- 8% Recommendation of Danish businesses
- 5% Recommendation of the government

Schmidt (2019)

Mainly voters from the Socialist People's Party, the Danish People's Party, the Red-Green Alliance, and the Social Democrats are against BU membership (Schmidt, 2019). It is not surprising that voters from the Danish People's Party and the Red-Green Alliance, which are traditionally Eurosceptic parties, are in majority against participation in the BU. Regarding the voters of the Social Democrats, Interviewee II explains that the voters are not necessarily more Eurosceptic than the average Danish voter, but they do not have a very favorable opinion of the banking sector and everything that is related to it.

The public opinion in Denmark is however not set in stone. The opinion of the Danish citizens changes when they are asked about strengthened banking cooperation instead of a banking union. Schmidt (2019) shows that 31% is in favor of BU-membership and 44% is against, but if the BU is replaced by strengthened banking cooperation 43% is in favor and 35%

is against. This might be because there is a more positive association with cooperation than with a union. Union might evoke associations with relinquishing sovereignty, while cooperation sounds less far-reaching and more as a means to achieve mutual benefits. The government also calls the BU '*styrkede banksamarbejde*', a strengthened banking cooperation, in its reports and communication. Interviewee I explained that this term is used because it reflects the essence of the BU better, as it is a cooperation between authorities with joint supervision and crisis management. Nonetheless, interviewee II expects that if the subject is more heavily debated, people will not be fooled by the name.

Referendum

The negative public opinion towards the BU becomes even more important since the government has announced that it will hold a referendum if it decides in favor of BU participation. When Mette Frederiksen, the current Prime Minister and leader of the Social Democrats, was Minister of Justice in 2015 she investigated whether the Danish constitution requires a referendum about possible participation in the BU (Munkholm, 2018). The conclusion was that it does not, because BU participation does not imply an additional transfer of sovereignty to the EU (Munkholm, 2018). Nonetheless, Mette Frederiksen stated at the end of 2018 that it was best to hold a referendum to ensure a democratic conversation (Munkholm, 2018) and in October 2019 she promises that a referendum will be held if the government takes a position in favor of BU participation (Hjöllund & Gjertsen, 2019). The Danish People's Party, the Red-Green Alliance and the Liberal Alliance have also expressed their support for a referendum (Jensen, 2020). In short, there is already a promise that a referendum will be held while the government has not yet decided its' position.

According to interviewee I the question whether to participate in the BU can be divided into two different debates. The first is about whether the BU strengthens financial regulation, supervision and resolution. Many experts have looked at BU participation from this point of view. The second is not necessarily focused on the elements of the BU but rather on the EU in a broader sense. Interviewee I expects that due to the referendum a shift will take place towards the second debate, in which not all the technical implications of the BU will be discussed but in which attitudes towards EU integration will become important.

In the past, the Danes have rejected the Maastricht Treaty in 1992, the euro in 2000, and the Justice and Home Affairs opt-in in 2015 (Folketinget, 2021). The Danish citizens have proven to be skeptical towards 'more EU'. The promise to hold a referendum about BU participation does not make the decision-making process any easier for the government. As was

previously mentioned, the voters of the current government and two out of three supporting parties are against BU participation. This makes it unattractive for the government to decide in favor of BU participation and to hold a referendum. Not making a decision might be the least politically costly.

Interviewee II explains that also politicians in favor of the BU worry if they will be able to convince the citizens. The subject is complex. Citizens do not experience the role of banking supervision in their everyday lives, and many will not be aware of what BU participation entails. Hence, a great effort is needed to provide the right information to the citizens and great enthusiasm from the politicians is needed to persuade the citizens, according to interviewee II. Nonetheless, it remains difficult. For example, in the referendum in 2015 about the JHA opt-out the politicians and the media were in favor, but a majority of the citizens voted against. Thus, the public opinion and the promise to hold a referendum explains why the government adopted a wait and see approach and remains ambiguous about the subject.

Conclusion

With this thesis, I aimed to contribute to the international relations literature focused on the EU by clarifying the main reasons of one of the outs to (not) participate in the BU. I analyzed the research question: *what factors shape the debate in Denmark about possible participation in the Banking Union?* To answer this research question, I conducted a within-case analysis and used process tracing as the method.

I expected, based on Howarth and Quaglia (2016), that the characteristics of the Danish financial sector would play a limited role in explaining Denmark's position on BU participation. I found that the size of the financial sector, the size of the largest banks in Denmark, and the dependency of the Danish economy on the eurozone gives the country an incentive to participate in the BU. However, the relatively low internationalization of the financial sector and the Danish mortgage system give rise to a more negative attitude towards the BU. Especially the mortgage system received a lot of attention in the debate. All key actors agree that the Danish mortgage system works well and should be preserved. This could either be achieved by negotiating favorable terms with the EU in which the benefits of the system can be kept while participating in the BU, or by staying out of the BU.

Furthermore, in line with Howarth and Quaglia (2016), I expected that the concern for moral hazard would be high in Denmark because of a high perceived manageability of bank losses. This was confirmed by my findings. Denmark has the belief that it could manage bank losses, even outside the BU, because of its' relatively healthy financial sector and public finances. Because the Danish financial sector is better prepared for a financial crisis than many other EU member states the concern of having to pay for bad banks in other member states is an often-heard argument in the debate.

My findings with regard to my first two hypotheses are thus in line with the theory of Howarth and Quaglia (2016). The structural factors explain why some key actors are in favor, some against and some undecided. However, it does not explain why the debate has developed as it did, and why it resulted in a wait and see approach. Hence, I also looked at Euroscepticism to explain the process.

I expected that a Eurosceptic public opinion shaped the debate. I found that the Danes are very satisfied with the EU, but they do not want to lose any more sovereignty to the EU. In opinion polls a relative majority of citizens is against BU participation. However, the opinion of citizens changed when instead of Banking Union the term strengthened banking cooperation was used. A relative majority was in favor of strengthened banking cooperation. This shows

that the attitude of citizens strongly depends on how an EU-issue is explained and framed. Furthermore, one fifth of the citizens do not have an opinion on BU participation. This means that the public opinion is not set in stone. Nonetheless, it is a crucial element in the debate because the government announced that it will hold a referendum if it decides that Denmark should participate in the BU.

The promise of a referendum plays a key role in the debate. My last expectation was that it results in a postponement of a decision by the government. I found that even after a thorough assessment phase, with two elaborate reports from the Ministry of Industry, Business and Financial Affairs, there is a desire for more clarity on how the BU will develop, and a wait and see approach is taken. This approach can be explained by the promise to hold a referendum. In the past the Danish citizens have voted against many of the important EU-matters in referenda, and this has left its mark on Danish politics. Currently the outlook for politicians who want to participate in the BU is worrisome because the public opinion is against BU participation. Furthermore, it is a complex matter, which is not visible in people's day to day lives, and the against side can easily play into Eurosceptic sentiments. The politicians know that it will not be easy to convince the public. A very strong informative campaign would be essential.

It is currently not very attractive for the governing Social Democrats to choose in favor of BU participation, not the least because their voters do not view the banking sector favorably. On the other hand, based on the assessments there is also no convincing ground to reject participation. Thus, the result is that taking a decision on participation has low priority in Denmark. Decisions in Brussels about the development of the BU could pressure Denmark to deal with the matter, but as long as some elements remain unsolved in the BU, Denmark can continue with their wait and see approach.

In conclusion, similarly to the findings of the literature about the debate about the euro in Denmark, Euroscepticism and public opinion also play a crucial role in the debate about the BU. The literature showed that a referendum makes Euroscepticism even more important because people tend to vote based on their opinion on European integration. It is unclear if this would be the case for a referendum about BU participation, because it has not yet taken place. However, the promise of a referendum does give much weight to the sceptic public opinion about BU participation.

Limitations and suggestions for further research

A limitation of this thesis is the small number of interviews. It would have been interesting to get the view of politicians on the debate, because they ultimately need to make the decision about BU membership. Due to the pandemic, but also the wait and see approach of Denmark, the BU is not a pressing matter for the politicians, and no politician participated in an interview. It would be of significant value if future research could get more clarity on the perspective and decisions of key actors. New research would be most relevant when the wait and see approach of Denmark shifts to actual decision-making. If a decision is made by the government the politicians might be more keen to express their views. The same goes for the financial sector. The financial sector is currently not very vocal about the matter because many actors do not want to interfere with what they see as a political decision. Furthermore, if a referendum takes place in the future, it would be relevant to see if a Eurosceptic public opinion plays a significant role, as this research suggests.

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Appendix

I. Summary interview Ministry of Industry, Business, and Financial Affairs

Interviewee: assisted the expert group of the second report on Danish participation in the BU

Date: March 10, 2021

Report on possible Danish participation in the BU

The focus of the second report was specifically on subjects that were emphasized in the 2015 report and on the developments afterwards, since there was more experience with how the BU works in practice and how the regulations performed. The expert group organized discussions with professors and met with different governments, banks, and authorities within the EU to hear about their views and experiences.

Both reports speak about strengthened banking cooperation instead of Banking Union. This term reflects the BU more precisely because the BU is about cooperation between authorities and about joint supervision and crisis management.

The first and second report aim to answer questions, such as: what do we need to do to integrate banking markets? Can the BU promote cross border activities? How can we get the best supervision for our credit institutions? Are we better equipped to deal with crisis situations inside the BU? How is the Danish mortgage credit treated within the BU?

After the first report, the financial crisis was less present, and many countries had healthier economic situations and more capital. While there are still some issues, we saw developments in decreasing NPLs. In general, the Danish banking sector is still stronger than the banking sector in many other member states, but we do not see this as a reason to postpone a decision. Furthermore, we saw that the ECB has become to a greater extent the standard for how things are done, and the BU might get even more important in the future. By participating Denmark would have more influence on the supervision of the ECB and how EU financial regulation develops. Moreover, money laundering scandals happened in Denmark. They received much attention and were highly political. The working group looked into the meaning in connection to the BU. The conclusion was that the effect of the BU on money laundering is quite limited because supervision is still predominantly national.

The conclusion of the 2019 report is that much speaks in favor of participating in the BU and outstanding questions of the 2015 report have been clarified or specified. No third report has been planned.

Ongoing developments

A big part of the ongoing discussion about strengthening the BU is EDIS. Is there a need for it and if so how will it be put in place? Denmark is positive about the idea of introducing EDIS but does want a great focus on risk sharing. We see it as a package deal. Along with EDIS, the RTSE, and crisis management need to be discussed. A package with risk reduction measures would be positive for Denmark. The development of the discussions on strengthening the BU is important, but so far the progress has been limited.

Next to the developments in strengthening the BU, Sweden, Brexit, and Basel are important factors to consider. A decision by the Swedish government is important for Denmark. Denmark has a very integrated market with Sweden and if Sweden would decide to join the BU, Denmark would be the only country with a large financial sector on the outside. This could possibly change the dynamic between BU and non-BU. Sweden is currently where Denmark was in 2015, still assessing whether it should join, while the Danish report in 2019 was more about clarifying. When Denmark published its' first report in 2015, Sweden did not consider joining, but the government seems slightly more positive now. Furthermore, when the UK leaves, the biggest non-BU country leaves. We might see that the design of financial regulation will shift more towards the BU. Lastly, the upcoming revision of Basel, the capital requirements, can potentially have a huge influence on Denmark, because it impacts the framework that banks work within. Basel covers all banks, so BU-membership does not matter in this sense. But a discussion about the BU would be more difficult if we do not know how the framework looks.

The government has not explained if it wants clarity on all four factors and has not put a specific date on a final decision. There is no legal pressure to take a decision, no deadline after which participation is no longer possible, and no imminent pressure of a financial crisis as there was after 2008.

Public debate

There are three phases in the debate. First there was the decision phase in the EU, where Denmark negotiated to get equivalent terms if they decide to participate. Afterwards, there was the assessment phase, in which the 2015 and 2019 reports were published. Currently, we are in the third phase in which the matter is debated, and the outstanding issues are of a broader political nature. However, the debate after the second report has been limited. The BU is a technical and more difficult subject than many other issues that dominate the public debate. Furthermore, the government did not take a final decision and other political parties did not

take a very active stance. The corona crisis is of course an important reason why there has been no focus on the BU the past year.

Referendum

The referendum is not needed in a legal sense, but it will be held if the government decides to be in favor of joining. The regulation of banks is an important societal question, and a referendum might provide a broader acknowledgement for the final decision. You can look at the BU in terms of two debates: financial regulation and the EU in a broader sense. Our expert group focused on the first. When you have a referendum, the debate might move more towards the role of the EU. Holding a referendum is not the easy way because the record for outcomes in previous EU-debates was not always in favor of more integration. The BU is a difficult subject and citizens do not see it in their day to day lives. Hence, there will be an important role for communication and education, in which the Ministry could assist.

II. Summary interview Jan Høst Schmidt

Jan Høst Schmidt is senior advisor of Tænketanken Europa. The views expressed are his and do not necessarily reflect the position of Tænketanken Europa.

Date: June 28, 2021

Main considerations on BU participation

The Eurozone needs the BU to reduce the risks of a financial crisis. Denmark is very dependent on the economic developments in the Eurozone. A financially stable eurozone is therefore key to a sustainable Danish economy. It would be in the interest of Denmark to join and push for the creation of a stable and sustainable BU. Furthermore, Denmark has a few very large banks. The assets of the three biggest banks equal something to 250% of GDP. If a disaster should happen, it would be better for Denmark to not stand alone and to share the coverage. In addition, this is a bit controversial because it is also used against joining the BU, but in my view becoming a member would be good for the Danish mortgage system. As a member Denmark would be in a better position to influence the supervisory practice in the BU. It is difficult to ask for specific considerations on the outside and joining would create an even better understanding of the Danish system within the SSM.

However, the questions remains how the population can be persuaded to join. The Danish population so far does not seem in favor. Paying for bad banks in other member states is the main argument against participation. It is an easy argument for the opponents. The expert group showed that the Danish banks are better prepared than eurozone banks, in terms of core capital, NPLs, and sovereign exposure. Therefore, there is a risk, although small, that if resolution is needed Denmark will need to pay more often than other member states will need to pay for Danish banks. There is a belief that Denmark is doing better than the others and that Denmark can afford to stay outside. Furthermore, national sovereignty is important. The population does not seem ready for more EU interference in Danish affairs. People do not understand that we Denmark is not on the outside, because the Danish economy is very interlinked with the eurozone. Also, the sovereignty of Denmark is limited, because it is bound by Basel, which applies to all banks.

The debate

There is no debate since a long time, due to the pandemic, but also due to the lack of progress in the EU with regards to discussing developments of the BU. There is no agreement on a common deposit insurance scheme, on faster reduction of NPLs, or on how to deal with the

large exposure of especially southern banks to their own state. Hence, Danish politicians do not see it as a pressing issue that needs immediate attention. The politicians will most likely postpone a decision on participation until more decisions in Brussels have been made and they have a clear view on what that means for Denmark.

The financial sector is not very active in the debate because they probably do not want to take part in a political EU discussion about sovereignty. If there were a decision in favor of BU participation Finans Danmark would probably also take a more favorable and clear position.

Referendum

Once Mette Frederiksen announced that Denmark needs a referendum on whether it should join or not, everyone knew it was going to be difficult. All the politicians, also the ones in favor, are concerned with whether they can convince the population. The referendum makes public opinion crucial. All the referenda about major EU issues since '92 have led to a negative result. For example, with the referendum on JHA in 2015, there was a clear majority of political parties and media in favor, but the majority of citizens voted against.

With the BU you already start with a majority of the population against, as became apparent from an opinion poll conducted by YouGov for the Thinktank Europa in January 2019. People are against because they do not want to pay for other European banks, they think that the EU should not decide more in Denmark, and that Denmark should not lose sovereignty. Of the Social Democratic voters, a relative majority of 43% is against BU participation. These voters traditionally do not have a positive outlook on the banking sector. Hence, it is not a popular issue for the Social Democrats. Of the voters of two of the three supporting parties, the Social People's Party and the Red-Green alliance, a majority is also against.

Because of the skepticism in the public opinion, it would require all politicians, including the PM, to be very strongly and convincingly in favor of BU participation to convince the citizens. However, only 5% of the people say that the opinion of the government is crucial in their decision. Usually, Danes have much confidence in the Danish political system, but they seem to attach less value to what politicians say when it regards EU-matters. The fact that politicians often blame problems on the EU does not create a lot of general support in the population.

It might also be difficult to convince citizens about the benefits of BU participation because the BU is a technical subject and people might not realize how important a stable eurozone is for them.