Banking union as one of the guarantors of economic security in the EU

dr Paweł Sitek
Wyższa Szkoła Finansów i Zarządzania, Wydział Prawa
Warsaw, Poland
pawel.sit@wp.pl

Abstract

Ending the global crisis and the European crisis pointed to further weaknesses and the areas for changes in the functioning of the European Union law. In the area of macroeconomics, the weakness of fiscal policy could be seen as well as some weaknesses of financial institutions in general. The strong influence of banks and financial institutions on the whole the EU's economic environment resulted the increase of the ability to compromise decision to introduce an integrated financial framework. This means that BANKING UNION could be created.

The purpose of this analysis is to raise the questions and then the attempt to find the answer in the following areas:

- Why does Europe need the banking union?
- What are the advantages and risks of the banking union?
- To what extent the solution proposed by banking union, in practice, will improve the financial security of the EU?

The nation security in the terms of economic, legal, political, etc. is a state of permanent work for the correction and improvement of many institutions. The European Union, as an entity even more complex than particular countries – consisting of 27 states, is faced with the challenge of making even greater levels of difficulty. It should be recognized that one of the most important areas that need to be reformed in the EU is to implement an integrated financial framework, which means the implementation of the banking union.

Key words:

banking union, a bank, an integrated financial framework, restructuring, orderly liquidation

Introduction

On 4th of June, 20014, Poland celebrated the 25th anniversary of the restoration of the full political and economic independence. This was a very important event not only for Poland but also for entire region of Central and Eastern Europe. That celebration was connected with various summaries, observations and conclusions for the future. While Poland is celebrating its regained independence, the conflict between Ukraine and Russia has been taking place for few months. It has to be agreed that in the past few years, Ukraine has neglected the issue of strengthening democracy and the implementation of the changes. Therefore, a noticeable reduction of the level of national security of this country revealed. When Ukraine tried to economically get closer to the UE, Russia using the weakness of this country, led to the annexation of the Crimea and to the real destabilizing of security in eastern regions of Ukraine.

In this context, it is worth emphasizing that freedom, independence and sovereignty of the country is not a permanent state given once and for all. In the security theory, it is assumed that "the security" is a state, and a process of duration, survival and development of every form of existence. To generalize, it can be said that in the twenty-first century, from the perspective of global value, the security is the highest value (Pokruszyński, 2013, p. 7).

The Polish President, in the message delivered to the National Assembly on 4 June 2014, summarized the past 25 years, but most of all drew attention to the "road map" for the Poland in the future. Speaking abuot the future, the President pointed out two critical challenges. The first is the Polish accession to the monetary union and the second is worrisome demographic decline (Komorowski, 2014).

The Polish accession to the Eurozone is still an open question and at the same time becoming more and more pressing problem. In addition, the matter is complicated by the fact that in 2015, the banking union will finally start functioning and it will become a real increase of economic security for eurozone countries. The banking union introduces several new tools within an integrated financial framework which in practice will result in increase of the development speed and in greater resistance to future crises for the monetary union countries.

Therefore it is reasonable to recognize the banking union as one of the guarantors of economic security. The aim of this study is multi-faceted presentation and discussion about the basic objectives of the banking union. The analysis will be guided by the thesis that banking union is one of the guarantors of economic security.

The economic security

The economic security, according to the Republic of Poland National Strategy of Security, is understand as: “The state security and its stabilisation must have permanent economic bases. A strong and competitive economy is one of the core strengths of the internal and external policies, as well as a factor in strengthening national identity. Overcoming the effects of long-term degradation and rapidly growing Polish economy determines the international position of the country (BBN, 2007,17).

In the literature, the economic security is often the subject of research. For exmple, V. Cable defines economic security in two areas. The first refers to the trade and investment, which directly affect the country’s ability to defend. We can specified here: the access to weapons, to the military technology and to the sources of military equipment provision. In the second area, V. Cable is linking the economic security with the action taken with the involvment of the instruments of economic policy which may be used for agresion or defence: the trade and investment boycotts or restrictions related to the energy source (Raczkowski, 2012, p. 83).

From the point of view of the purpose of this article, it is worthy to quote the view contained in Frejtag-Mika, Kołodziejak and Putkiewicz’s book: “Economic security is the ability of the economic system of the country (group of countries) for such use of internal development and international economic interdependence, which will guarantee its unchallenged development” (Frejtag-Mika, Kołodziejak and Putkiewicz, 1996, p. 10). Due to the better understending of the banking union background, it will be helpful to cited the opinion of Moran and Kapstein. They treat economic security in the context of the opening up of national economies and the erosion of the autonomy of states. They suggest that the interest of researchers should focuse on the study of trade, financial integration and on the monetary dependencies (Kirshner, 1997, p. 16–17).

Taking into consideration above views and later developed assumption, it is worthy to propose three elements of the economic security, namely:

1. economic security means the ability of country to protect the economic and social structure of the society,

2. economic security means the ability of country to effectively regulate the market and to maintain the public integrity,
3. economic security means the ability of country to cooperate with other countries to establish international economic environment, the effect of which is to strengthen multifaceted cooperation in different sectors, as well as to obtain benefits from international cooperation.

Mentioned cooperation of countries in various sectors concerned sensitive areas such as: agriculture and food sector, industry, transport, raw materials and energy sector, financial system, budget system and monetary system along with banking union. (Jaźwiński, 2008). In the context of the Ukrainian-Russian crisis, the safety issues in the area of energy supply to Poland and to the EU became a very important problem. However, in the case of a banking union, we can observe its implementation with effect since 1st January 2015.

National authorities are expected to conduct an effective economic policy. The question is what this means in practice. May be recognized only by the effectiveness which means the positive economic growth of the country? It is generally accepted that the policy of the central government should adequately and quickly respond to the occurrence of a number of macroeconomic factors. The issue of determinants is discussed here. (see: Jaźwiński, 2011, p. 59–70). Those determinants decide about the purpose and direction of the state's economic policy. Determinants of economic security can be classified based on different criteria.

Table 1. Classification of the determinants of economic security

Criterion	Type of determinants
Source	1. internal – external 2. political, economic, cultural, geographical
Territorial range	1. world 2. continental (community) 3. national
Sector	1. agricultural 2. industrial 3. transport 4. energy 5. financial 6. budget 7. banking, monetary

Criterion	Type of determinants
Impact on economic security	1. neutral 2. positively affected 3. negatively affected
Importance	1. high rank 2. average rank 3. low rank

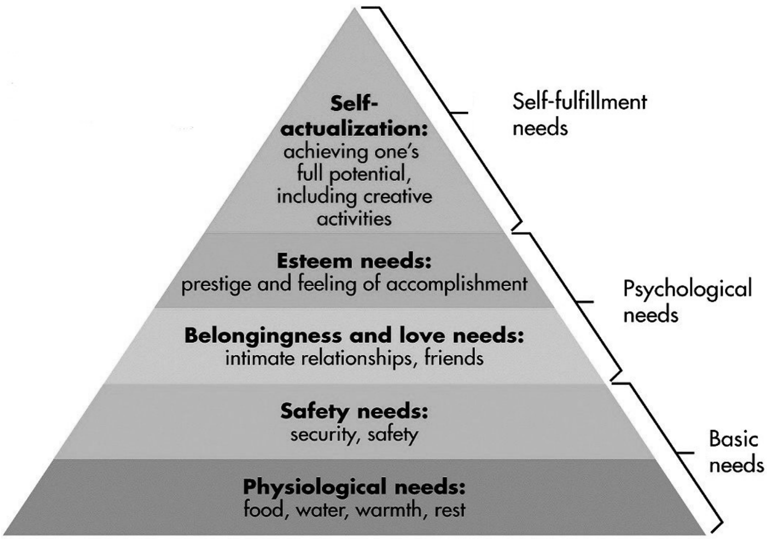
Source: own elaboration based on Jaźwiński, 2011, pp. 62–63

The above mentioned conditions should be still supported by completely different approach to the issue of security and banking union. Namely, economic security should be read from the perspective of the citizen. It is assumed in the literature that safety is superior human need (social groups) and as a priority existential objective. (Stanczyk,1996, p. 18). The absolute aim of the citizen or social group life is the need for duration, survival and improvement. Identifying and then meeting the needs of people is the basis activity of all companies offering products and services in order to give full effect to its entrepreneur policy. The state as a legal entity, located in specific competencies and tasks, must also recognize the needs of people in terms of economic security, which promotes democracy.

The security can also be defined by the threats. The problem is that modern people and society do not have the knowledge or ability to learn about and to define specific threats in conjunction with the need. The role of the state and the specialized services is conducting such activities to popularize the current or future threats so that the citizen felt the need to provide him or her with safety. This argument is part of that social skepticism in Poland to the monetary union and the lack of awareness of banking union.

The classification of human needs was presented A.H. Maslow. These needs are presented in the hierarchical ranking according to the desired fulfillment order. Maslow distinguishes five groups of these needs, which are subject to strict regularities.

Table 2. Maslow's Hierarchy of Needs



Source: Hoffman, 2013

Reminder the pyramid of needs is to better understand the mechanism of people's functioning and consequently the mechanism of democratic elections. As long as the lower need is not met, the higher needs have disturbed chance of existence. First, the physiological needs must be met, and then it is possible to identify and to meet the higher needs such as economic security (Czerska, 1994, p. 98).

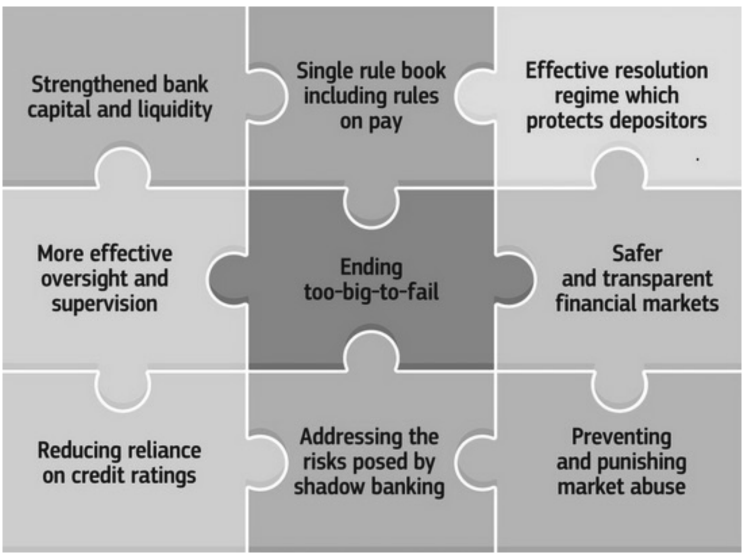
The need of economic security includes the need of stabilization, the need of care, freedom from fear and chaos, the need of order structure, the need of law and the lack of threat in meeting the living needs. Undoubtedly, this need should be considered more broadly, also in relation to the large legal systems, such as monetary union or banking union.

The economic crisis certainly realized specific need of increasing institutional and legal security in the EU. Therefore, the euro zone countries established a far-reaching agreement which will increase the level of economic safety in future. A major challenge for now is to realize this necessity to the widest possible range of citizens of the European Union, including people in Poland.

The banking union as a guarantor of financial stability in the euro zone

The European Commission and other economic and financial bodies have begun of arrangements and consultation about necessary new solutions since the beginning of the economic crisis. These solutions were to increase the resilience of the EU and the monetary union to unexpected internal and external economic shock. The Commission has proposed 28 new regulations, which aim was to build a new, stronger integrated financial framework. The main recipient of the planned reform was the financial sector with a new effective supervision and with reorganized restructuration. Most of these regulations have already entered into force, or are expected to enter into force.

Table 3. Imaging of the main elements of the EU financial reform



Source: European Commission, 2014, MEMO/14/294, p. 1

The spread of the crisis proved that the countries connected by the monetary union due to the increased interdependence, were most affected by the global crisis. Mechanism of the vicious circle of negative relationship between the banking system and public finances could be observed. The key was the agreement concluded between heads of states in June

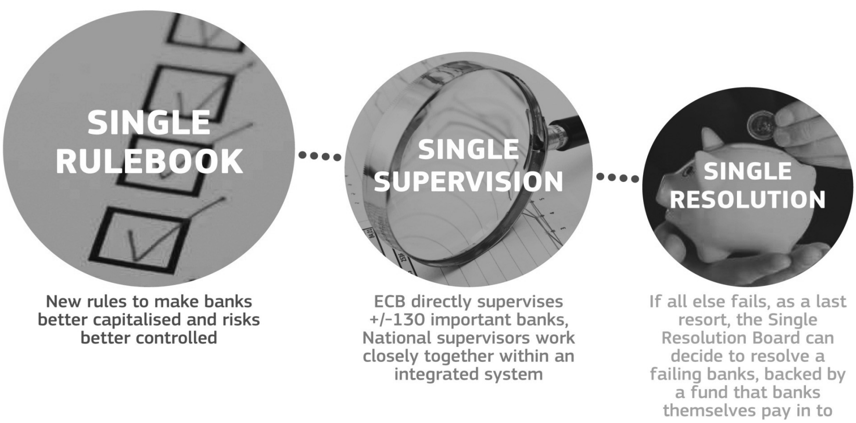
2012. It was the creation of banking union. It assumed the implementation of uniform legal regulation strengthening the economic and monetary union for the countries belonging to the euro zone and countries, such as Poland, from outside the euro area, who wanted to join it.

The banking union creates new regulatory framework with common rules for banks in all 28 Member States. This regulation should help to prevent bank crises (in particular Capital Requirements Directive and Regulation – European Commission, 2013, MEMO/13/690).

The banking union also gives a set of new regulation on restructuration and orderly liquidation. The bank which is in difficult situation will be placed under the orderly liquidation procedure (Directive on Bank Recovery and Resolution – European Commission, 2014, MEMO/14/297). In addition, the protection of all bank deposits up to 100 000 euro will be guaranteed in the entire EU (Directive on Deposit Guarantee Scheme – European Commission, 2014, MEMO/14/296).

Since November 2014, the European Central Bank will have the control and supervision on every of 6000 banks in euro zone (European Commission. 2013, MEMO/13/780). The ECB, in order to control such large number of banks, needs to have full knowledge about those banks. Therefore, the ECB, using additional institutions, provides comprehensive evaluation of the financial stability of them.

Table 4. From single rule to single resolution



Source: European Commission, 2014, MEMO/14/294, p. 2

In addition, it is understood, that new mechanism could not be enough effective and in some rare cases, the restructuration or liquidation will be necessary. Therefore, the new regulations have been applied which are cutting public sector accountability of such circumstances. The Single Resolution Mechanism was created. Thanks to it, the process of restructuration and liquidation may be managed more effectively through a Single Resolution Board and a Single Resolution Fund (European Commission, 2014, MEMO/14/295).

Table 5. The vicious circle mechanism

The Eurozone sovereign debt crisis highlighted the potentially vicious circle between banks and sovereign debt.

The banking union will help to break the link between banks and sovereigns:

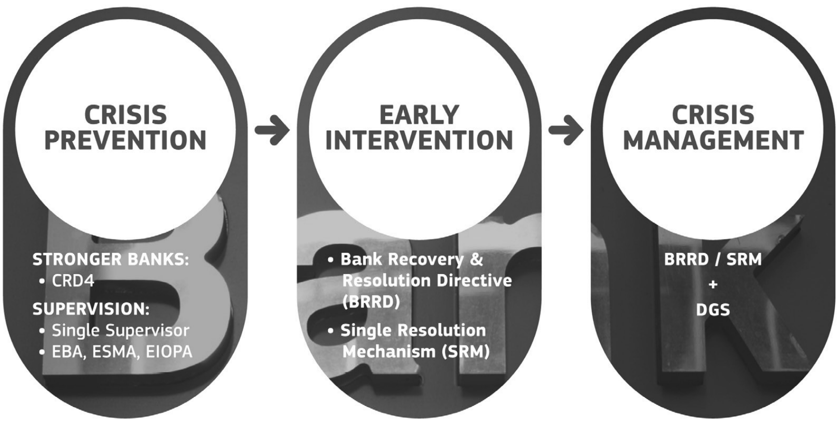
- **<u>Banks will be stronger and more immune to shocks</u>**: Common supervision will ensure effective enforcement of stronger prudential requirements for banks, requiring them to keep sufficient capital reserves and liquidity. This will make EU banks more solid, strengthen their capacity to adequately manage risks linked to their activities, and absorb losses they may incur.
- **<u>Failing banks will be resolved without taxpayers money, limiting negative effects on governments' fiscal positions</u>**: bank resolution will be financed by banks' shareholders and creditors, and by a resolution fund financed by industry. Banks should not be bailed out and government fiscal position will not be weakened further.
- **<u>Banks will no longer be "European in life but national in death"</u>**, as they will be supervised by a truly European mechanism and any failure will also be managed by a truly European mechanism

Source: European Commission, 2014, MEMO/14/294, p. 3

The banking union increases the security of banking sectore, prevents crises and protects taxpayers and depositors

The banking union in the current legal form is an integrated financial framework. The above listed intruments and tools, should cause that in the financial market environment, there will be banks which are more resilient to economic shocks. In addition, in the case of large economic problems in a particular bank, the supervisory authorities may intervene during an early stage. It also provided a pessimistic scenario, which regulates the restructuring and orderly liquidation.

Table 6. Three components of a new banking system



Source: European Commission, 2014, MEMO/14/294, p. 3

The European Commission's single initiative should give the bases for the creation of single market of the financial services. This solution is advantageous for banks, entire financial sector, as well as for citizens, consumers and taxpayers. Finally, it must be said that this is very beneficial for the economic security.

The single supervisory mechanism gives to the EBC powers of supervision of banks in the euro zone and in other Member States participating in the mechanism, including Poland. The prudential supervision has to be transnational, which involves disabling the current efforts of countries to protect only their own interests. The package to strengthen the capital base of banks, so-called: CRD IV implements to the EU's regulation, the new global capital standards for banks. These regulations are commonly known as the regulations "Basel III".

The financial sector projecting on the economic security of the EU will be based on a more solid and reliable legal framework. The new regulations require banks obtaining troubling financial result to develop recovery plans describing the measures to be taken in order to maintain the basic bank functions in the event of a deterioration of its financial situation. In the case when the bank cannot be longer rescued, the restructuring plans or even orderly liquidation scenario could be implemented. The banking union body responsible for this is the ECB. These plans should include certain scenarios, along with the planned restructuring instruments. New restructuration instruments include: the instrument of sale of separate parts of the company, the instrument of bridging institutions, the instrument of assets separation and the instrument of redemption or conversion of debt.

The analysis of the causes of the crisis has demonstrated quite clearly that rescue banks by public money caused an increase in public debt which in turn is passed on to taxpayers. The USA is a good example of country from outside the EU where huge federal money was used for rescuing several financial conglomerates. The purpose of this action was to stop the domino mechanism. However, it clearly shows that the effects of the crisis in the USA were paid by taxpayers.

The approved state aid measures in the form of recapitalization bank by public money in the time between October 2008 and December 2012 cost €591.9 billion, what is 4.6% of the EU GDP in 2012. If we include guarantees, this figure will increase up to €1.6 trillion or 13% of the EU GDP in 2012. Those figures apply only to the period between 2008 and 2010 (European Commission, 2013, IP/13/1301).

Implemented banking union, the integrated financial frameworks assume that in the case when the financial situation of a bank to give any hope for recovery, banks' shareholders and creditors will have to pay their share of the costs through a "bail-in" mechanism. The banking union guarantees the mechanism of restructuration or orderly liquidation of bank. Thanks to those mechanisms, very complicated and complex decision regarding large transboundary institution will be made very quickly and those decisions will be in force for all banking union members. We should underline here, the very broad powers of Single Resolution Board, where in addition to the permanent members there are also included representatives of: the EU Council, the European Commission, the European

Central Bank and the national bodies for bank restructuration and liquidation. It is also worthy to notice, that the time framework are very strict and the decision must be made without delay.

Due to the rule that taxpayers will not take the risk and will not pay for the bank bankruptcy, all the UE banks will have to contribute for the special fund. Those financial resources will be used in the case of necessary resolution process. The banks in the EU will be obliged to pay for the Single Resolution Fund since 2016 and finally the funds will reach the amount of EUR 55 billion by 2024.

Integrated financial frameworks, thanks to legal basis, guarantee that in the case of bankruptcy, the deposits up to 100 000 euro will be saved. This mechanism, by larger stability of banking deposits and avoiding the panic, in real way should increase the level of security among citizens of the EU. In addition, the Bank Recovery and Resolution Directive guarantees that people and small business with deposits above 100 000 euro will be treated preferentially; it means that they will have priority during the final auction of assets of the bankrupt bank.

Conclusion

The economic crisis pointed out the weakness of the existing legal and institutional solutions. At the same time the crisis has confirmed that the economic security of the state requires a permanent action on his behalf.

Referring to the three elements of economic security presented at the beginning of this article, it is necessary to emphasize that banking union is implemented in conjunction with a noticeable violation of those three mentioned element, namely:

1. the economic situation of Poland indicates too little ability to protect the social and economic structure of society,
2. the current ability of Poland to effectively regulate the market and to maintain the society integrity is too low – level of unemployment, the result of elections to the EP,
3. the low ability of Poland to cooperate with other countries in order to establish international economic environment and to strengthen multifaceted cooperation in different sectors, as well as to obtain benefits from international cooperation – decrease in the value of foreign trade, etc.

Introducing all of motioned solution requires Member States to a sense of common purpose and the creation of a common understanding and social acceptance. The EP and national parliaments should be strongly involved to strengthen the dialogue with the social partners. Despite considerable effort of the EU's institutions in preparing and implementation of the banking union, the key might be the transparency of this process. Such transparency in the implementation process of banking union, in the case of Poland should be an opportunity for the public information campaign in order to explain and convince the Polish society towards monetary union (Gotz, 2013, p.10).

The monetary union, in Polish situation, is a very delicate matter. The balance of power which exists in Polish Parliament may cause that Poland will not enter to the monetary union for long time. In our legal system, it is necessity to make some changes in the Polish Constitution and that will be something very difficult.

It may be recalled that the present time is very hard work for the ECB and the European Banking Authority, who shall assess the condition of banks and test their economic condition. In the case of finding a bank's capital deficiency, the recapitalization action will be undertaken. In Polish reality it means that bank needs to find additional capital in the financial market or from other sources. If those actions end up without success, the national public money can be used but the very strict conditions about public help must be met. If the national mechanism is ineffective, there is the possibility to use the European stability mechanism. In the case of bank which do not show any chance for recovery, the liquidation process, consistent with the regulations of the country, can be introduced (Council of the EU, 2013, p.3-4).

In the case of Poland, the banking union is an opportunity to open the dialogue about making changes in the Constitution and about entering into euro zone. It requires the agreement of different political parties in our country which is directed to new strategy of integration. This new integration should make possible to enter to the monetary union by our country. In that case, the social dialogue is necessary. The education, from primary school to university, can play a very important and significant role in this mission. Also, it is worthy to notice the role of mass-media which are predisposed and have big power to inform society about advantages and disadvantages of Polish accession to the monetary union.

The statement can be formulated that the Polish accession to the euro zone will be much more difficult than the Polish accession to the EU on 1 May 2004. But despite of this, the implementation of the banking union and eventually entering to the monetary union by Poland are in present time the most real of economic security, Poland is not fully using these guarantors what creates the risk of remaining one of the states of “second speed”.

References

Biuro Bezpieczeństwa Narodowego. (2007). Strategia Bezpieczeństwa Narodowego Rzeczypospolitej Polski. Retrieved (10.06.2014) from http://www.bbn.gov.pl/pl/publikacje-i-dokumenty/dokumenty/1144,dok.html

Council of the European Union. (2013). Council statement on EU banks' asset quality reviews and stress tests, including on backstop arrangements. Retrieved (10.06.2014) from http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/139613.pdf

Czerska, M. (1994). Motywacja.w: A. Czremiński, M. Czerska, D. Nogalski, R. Rutka (ed.), Organizacja i zarządzanie (pp. 95-113). Gdańsk : Wyd. Uniwersytetu Gdańskiego.

European Commission. (2013) Capital Requirements – CRD IV/CRR – Frequently Asked Questions. MEMO 13/690. Retrieved (10.06.2014) from http://europa.eu/rapid/press-release_MEMO-13-690_en.htm

European Commission. (2013). Legislative package for banking supervision in the Eurozone – frequently asked questions. MEMO 13/780. Retrieved (10.06.2014) from http://europa.eu/rapid/press-release_MEMO-13-780_en.htm

European Commission. (2013). State aid: Commission's new on-line state aid benchmarking tool shows less aid to banks. IP/13/1301. Retrieved (10.06.2014) from http://europa.eu/rapid/press-release_IP-13-1301_en.htm?locale=en

European Commission. (2014). A Single Resolution Mechanism for the Banking Union – frequently asked questions. MEMO 14/295. Retrieved (10.06.2014) from http://europa.eu/rapid/press-release_MEMO-14-295_en.htm

European Commission. (2014). Banking union: restoring financial stability in the Eurozone. MEMO 14/294. Retrieved (10.06.2014) from http://europa.eu/rapid/press-release_MEMO-14-294_en.htm

European Commission. (2014). Deposit Guarantee Schemes – Frequently Asked Questions. MEMO 14/296. Retrieved (10.06.2014) from http://europa.eu/rapid/press-release_MEMO-14-296_en.htm

European Commission. (2014). EU Bank Recovery and Resolution Directive: Frequently Asked Questions. MEMO 14/297. Retrieved (10.06.2014) from http://europa.eu/rapid/press-release_MEMO-14-297_en.htm

Frejtag-Mika, E., Kołodziejak, Z., Putkiewicz, W. (1996). Bezpieczeństwo ekonomiczne we współczesnym świecie. Radom: Wydawnictwo Politechniki Radomskiej im. K. Pułaskiego.

Gotz, M. (2013). Reflections on the Eurozone's Challenges. *Contemporary Economics* 7(4), pp. 5–24. Retrieved (10.06.2014) from http://www.ce-.vizja.pl/en/issues/volume/7/issue/4#art322

Hoffman, E. (2013). Abraham Maslow: A Brief Retrospective. Retrieved (10.06.2014) from http://www.saybrook.edu/newexistentialists/posts/09-06-13)

Jaźwiński, I. (2008). Bezpieczeństwo gospodarcze w aspekcie kapitału ludzkiego. A paper presented at the national conference at Szczecin University: „Z tarczą czy na tarczy? Bezpieczeństwo Polski a Polska w bezpiecznym świecie".

Jaźwiński,I. (2011). Determinanty kształtowania polskiego bezpieczeństwa ekonomicznego. *Przegląd Strategiczny* 1(1), pp. 59–70. Retrieved (10.06.2014) from http://studiastrategiczne.amu.edu.pl/wp-content/uploads/2012/04/8_jazwinski.pdf

Kirshner, J. (1997). Political Economy in Security Studies After the Cold War. Ithaca, NY : Cornell University Peace Studies Program.

Komorowki, B. (2014). Orędzie Prezydenta RP przed Zgromadzeniem Narodowym w dniu 4 czerwca 2014 roku. Retrieved (10.06.2014) from http://www.prezydent.pl/aktualnosci/wypowiedzi-prezydenta/wystapienia/art,198,oredzie-prezydenta-rp-przed-zgromadzeniem-narodowym.html

Pokruszyński, W. (2013), Filozofia bezpieczeństwa, Józefów: Wydawnictwo Wyższej Szkoły Gospodarki Euroregionalnej im. Alcide De Gasperi.

Raczkowski, K. (2012). Percepcja bezpieczeństwa ekonomicznego i wyzwania dla zarządzania nim w XXI w. w: K. Raczkowski (red.), Bezpieczeństwo ekonomiczne. Wyzwania dla zarządzania państwem (pp. 69–148). Warszawa : Wolters Kluwer.

Stańczyk, J. (1996). Współczesne pojmowanie bezpieczeństwa. Warszawa: Instytut Studiów Politycznych PAN.