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EU competitiveness in a changing world economy – and the banking sector

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The region as a whole is lagging behind the recovery of others in the world. The future shows a shift in global economic power, away from the established advanced economies, especially from those in Europe, towards emerging ones in Asia and elsewhere. Compared to earlier years, risks related to euro area economic conditions have increased. This influences the function and effectiveness of the banking sector as well. The global outlook has deteriorated. The top three prominent risks expected to affect the euro area banking system over the next years are: (1) economic, political, and debt sustainability challenges in the euro area, (2) business model sustainability, and (3) cybercrime and IT deficiencies. The study discusses these factors with special emphasis on banking supervision. It analyses EU bank regulation after the financial crisis and its prospects.

Keywords: economic and demographic outlook, monetary integration, banking union, banking supervision

1. Introduction

We see rapid changes in technology and big uncertainties in global trade and finance (Gál 2015). It has been said many times: "Europe is at a crossroads". But, maybe, "this time really is different..." There are new challenges before Europe both in environmental policies, digitalization, and defence. Finance plays a role in these changes.

A detailed analysis shows that the world economy really has arrived in a fully new era. We live in the age of digitalization, robotics, big data, and artificial intelligence. Since 2008 nothing is like it was before. The financial system had to change, too. The globalization of the former decades when world exports were growing quicker than world GDP, has ended. In theory, GDP grows alongside the credit/asset (financial deepening) – but asset backing cannot be higher than 100%. How then to give impetus to growth by financial deepening? Some economists think that we should not force growth, but rather stop it. If growth after all that arises, it will happen by robots. That means, we should tax the owners of robots and owners of data, and transfer it as basic income to those persons who fall out of the world of work… New ideas, new institutional solutions.

As the global economy evolves, how can Europe best position itself?

Christine Lagarde, the former IMF head, subsequently became the President of the ECB. She has a world-wide overview of global competitivness and of the factors influencing growth. Her field is monetary policy and banking system stability. There are intensive efforts in the EU to complete the banking union and to build a capital markets union. Will it be enough? Surely, competitiveness doesn't depend only in financial backing. But it is important, we may be convinced.

In some of her speeches, Lagarde tried to position the EU on a world scale. We do the same in the following.

2. Economic prospects

In the last decade, we can see a realignment of the world economic centres. It is to be found in the shift in global economic power away from established advanced economies, especially those in Europe, towards emerging economies in Asia and elsewhere. According to PwC analysis (PwC 2017), by 2050, six of the seven largest economies (in PPP terms) in the world could come from today's emerging economies (E7).

The E7 countries could comprise almost 50% of world GDP by 2050, while the G7's share declines to only just over 20%. Well, absolute figures of GDP depend on the population of the country, and the emerging market economies include the world's most populous countries. They clearly show the realignment, partly due to their large and growing populations, partly because of their high rate of per capita GDP-growth.

In 2018, China already overtook the US and is to become the world's larges economy (in terms of purchasing power parity –PPP). India currently stands in third place. But, in the projections, India is set to overtake the US in PPP by 2040. By 2050, France will no longer be among the world's ten largest economies on this basis. The UK will be on 10th place, while Indonesia could rise to 4th place by 2050.

Growth will be in the world economy driven largely by emerging markets and developing countries. The E7 economies, Brazil, China, India, Indonesia, Mexico, Russia, and Turkey will be growing at an annual average rate of almost 3.5% over the next 34 years. The advanced G7 nations of Canada, France, Germany, Italy, Japan, the UK, and the US will have a growth rate of only 1.6%. (PwC 2017)

Naturally, it doesn't mean that G7 countries will change places with these champion nations concerning GDP per capita. What is important for the citizens of countries, is really the per capita GDP. But even then, we may not say that absolute terms are irrelevant. Sooner or later, the E7 will influence the growth possibilities of the more advanced nations and indirectly, the working places and the living standard there.

Nowadays, the small oil-rich countries are on top of the list in high GDP/capita. The USA is ranked only at 11–12. (We looked at different data collections: IMF, WB, CIA.) Among the top contenders are Luxembourg and Switzerland. In the first 10, are the Norwegians. Surprisingly the Irish are 5–7th. Germany's ranking is only 17–19, Japan's: 25–28. Hungary is: 45–46th.

2.1. World trade and the EU

The division of labour usually results in higher GDP. Therefore the trade activity of the different nations (regions) is very important.

In the early 1980s, Europe's share in world trade was overwhelming. By 2019 it had been shrinking significantly. But even today, it has a leading role.

The EU-28's share of world trade in 2018 in goods was the largest in terms of exports. China had almost exactly the same share (16.2 %). The EU was the second-largest in terms of imports, behind the United States (18.3 %). The United States had the third-largest share of world exports of goods and China the third-largest share of imports, with Japan recording the fourth largest shares for both exports and imports. Canada and South Korea had the fifth and sixth largest shares of exports and import of goods, with Canada having more imports and South Korea more exports, while Mexico had the seventh largest share.

Turning to services, regardless of whether analyzing exports or imports, the United States had the second-largest share of the world's trade in services, followed by China and Japan. South Korea, Canada, and India had the next largest shares of imports, whereas India had a higher share of exports than South Korea or Canada. The EU-28's contribution to world trade was even greater, totaling 24.7 % of exports and 21.1 % of imports. In the field of services, the EU is a net exporter. The EU-28's extra-EU trade in services was clearly larger than any of the other G20 members, both in terms of exports and imports (EC 2018).

2.2. Trends in demography

The populations of 55 countries or areas are projected to decrease by one percent or more between 2019 and 2050 because of sustained low levels of fertility, and, in some places, high rates of emigration.

More than half of the projected increase in the global population up to 2050 will be concentrated in just nine countries: the Democratic Republic of the Congo, Egypt, Ethiopia, India, Nigeria, Pakistan, the United Republic of Tanzania, Indonesia, and as one exception, in a developed country: the United States of America. Disparate population growth rates among the world's largest countries will re-order their ranking by size: for example, India is projected to surpass China as the world's most populous country by around 2027.

A total of 21 countries are projected to experience a population decrease of between 10 and 20 percent between 2019 and 2050, many of which are located in Eastern Europe (and the Caribbean). The largest relative reductions in population size over that period, with losses of around 20 percent or more, are expected in Bulgaria, Latvia, Lithuania, Ukraine, (and the Wallis and Futuna Islands). The number of deaths has been exceeding the number of births in: Belarus, Estonia, Germany, Hungary, Italy, Japan, the Russian Federation, Serbia, and the Ukraine. In some of those countries, immigration compensated for the diminishing number of births, namely in Germany, Italy, and Russia.

With regard to emigration: net inflow in 14 countries exceeded 1 million people over the past decade. All 14 were among the high-income or upper-middle-income countries.

Ten countries experienced a net outflow of more than 1 million migrants between 2010 and 2020. For many of these, losses of population due to migration mainly involve temporary labour movements. Some of them – from Syria, Venezuela – were real refugees. (According to the international institution's definition). However, migrants coming from Africa, (who can be seen in Serbia, nowadays, and partly in Turkey) do not look like refugees, rather temporary work-seekers or, (as some information in the northern countries would have it) in most cases: social support seekers…

The clear tendency is that populations will be diminishing in the European region. The American population will not be reducing in the coming period. But in Europe, the eastern part of the continent will see the greatest losses compared with other parts of the world. Interestingly, the international organizations do not deal with the question, *why.* A few years ago the World Bank published a study with the title: "From red to gray". Now, 30 years after the political changes, nobody is interested in *that* legacy of the socialist times… It cannot be incidental coincidence, that *most of the countries with the greatest population losses are former CMEA members*… Nobody is analysing the impact of socialist dictatorship on the East European countries. This dictatorship has left its mark not only in the deficit of capital in these countries, but also in the low number of babies born. Lost hope in the future results in low fertility ratios. And it is reflected in emigration, too… The political changes came so quickly, that the transition time was not long enough to recover the skills of the people which would have been necessary for free-market - type entrepreneurship. And the lack of capital, which was the legacy of socialist planning, forced the transfer of national wealth in those countries into foreign hands. All this resulted in a hopeless future, instability, weak local cooperation of the countries' youth. The low living standard in these countries and the better wages in the West drained a lot of people from these countries.

Aging is another characteristic phenomenon in the developed world, especially in Europe (in China, too, where the one-child program from Deng Xiaoping will bring about a radical shrinking of the population and a growing proportion of elderly people). In 2018, for the first time in history, persons aged 65 years and over outnumbered children under age five worldwide. Projections indicate that by 2050 there will be more than twice as many people over 65 compared to children under five. By 2050, the number of people aged 65 years or over globally will also surpass the number of adolescents and youth aged 15 to 24 years. It will have its impact on the state-household financial equilibrium of the countries involved. Pension financing will be more difficult, the labour force diminishing, payed pension contributions and taxes less, volumes of allowances more; demand on health services will also increase…

There are projections in the EU for the coming 50 years. The old-age dependency ratio (people aged 65 and above relative to those aged 15 to 64) is projected to increase by 21.6 percentage points, from 29.6% in 2016 to 51.2% in 2070.

This implies that the EU would go from having 3.3 working-age people for every person aged over 65 years to only two working-age persons (EC, 2018).

2.3. Consequences of aging

The European Commission summarizes the economic consequences for Europe as follows:

"The evolution of aging-related costs, however, will vary widely among Member States, with costs falling in eight Member States (Greece, Croatia, France, Latvia, Estonia, Italy, Lithuania and Spain); increasing by up to 3 percentage points of GDP in ten Member States (Portugal, Denmark, Cyprus, Poland, Sweden, Romania, Bulgaria, Finland, Hungary and Slovakia); and rising by more than 3 percentage points in the remaining ten Member States (Netherlands, Austria, Ireland, Germany, United Kingdom, Belgium, CzechRepublic, Slovakia, Malta and Luxembourg).

Long-term care and healthcare costs are expected to contribute the most to the rise in age-related spending, increasing by 2.1 percentage points. Public spending on pensions is expected to rise until 2040, before returning close to current levels by 2070. Education expenditure is projected to remain unchanged by 2070. Unemployment benefit expenditure is projected to decline by 0.2 percentage points.

Pension reforms have made it possible to stabilize public pension spending as a share of GDP over the long term, through by increases in the retirement age and changes to the parameters of pension systems, including pension indexation. As a result, the public pension benefit ratio, which describes the average public pension in relation to the average wage, is projected to fall by 10.6 percentage points on average in the EU. In Member States with supplementary private pension schemes, the total value of pensions relative to average wages is projected to be 10.5 percentage points higher than in Member States without. Moreover, retirement ages will be higher in the future in general." (Aging Report 2018)

All these estimations take for granted the trends in fertility. They do not see any factors which could change the trends in society. The only possibility they see is to adjust to the trends: simply raising expenditures for health purposes, raising retirement ages, and other parametric changes in pension systems. We hardly see active arrangements which would try to change the trends. As if everything were fated for mankind, as if we were not human beings of intelligence and free will… As if there were only private interests, and no public good… However, economic policy could be active in influencing social trends. The diminishing of the population is slower in countries boasting active pro-family social support. Unfortunately, even that is not enough to change the main tendencies.

Why are demographic changes relevant to the competitiveness of the region? Because it is a growing burden on the financing of the ever-increasing share of the elderly in the region compared to the active population. Those parts of the world, where the demographic structure of society is more balanced between the younger and the elder groups, the burden of the pension systems is not such a big challenge for both employees and employers. That is, *the region is more competitive*.

Let us summarize the situation: The main factor in the former growth of Europe was the very intensive participation in the world trade. The EU is now shrinking in the world economy because other countries are growing quicker, both in terms of GDP and trade. They are able to do so because their internal market is enlarging thanks to the growing population and the massive capital inflow, which is making use of the qualified and relatively cheap labour there. For the EU, an aging societiy means a burden. In that sense, some emerging markets are more competitive than the EU.

3. Banking union

We may say that the shrinking share of the EU in world trade is in a certain sense, a sign of diminishing competitiveness of the region compared with other parts of the world economy. We have seen that the competitiveness of the region is dependent on aging, too. But many experts say that a more integrated financial system in the USA contributes to the better functioning of American economy, and this is the direction where the EU must seek to raise the competitiveness of the economy of integration. We may say, that the ideology in the EU leading organisations has *turned back to the concept of deepening cooperation*. (Not only *enlarging* integration by the admission of the Eastern countries in the European Union.) The EU realized, that it is not enough to raise the competitiveness of the core countries by adding more countries to the Union. It must, in a certain sense deepen the integration mechanism, too. The financial system, the euro, and the banking system must be an effective support of more robust growth in the region.

But the financial crisis not only caused a drop in GDP-growth but it threatened the collapse of the whole banking system. It demonstrated how problems can spread throughout the financial system and how they directly affect people's lives. The slow recovery in the EU since then has been indicating, that there are great and deep problems in the European economies. It is necessary to stimulate a more liberal allocation of capital, which must be guaranteed by the free flow of capital.

The European Banking Federation's Board called on governments in Europe to recognize the key economic role of banks in funding growth and supporting prosperity:

"Looking ahead to the upcoming policy cycle in the European Union, the Board reaffirmed the European banking sector's constructive commitment to sustainably and responsibly financing businesses and households. Specifically, banks recognize their role in society when it comes to developing sustainable finance and supporting the energy transition together with other industries in order to meet international climate change objectives… Banks are fully committed to supporting further European integration, specifically in the EU financial services markets through the completion of the Banking Union and the creation of an effective Capital Markets Union (CMU). This is particularly important at a time of increasing political and regulatory global fragmentation, in order to ensure that sufficient financing will remain available for the European economy" (EFB 2019).

Ineffective and excessively burdensome regulations clearly have a negative impact on the European economy.

If the capital market and banking is fragmented in the EU, it surely will continue to lag behind the US, the latter having a more integrated banking market as a result of liberalization in recent decades. With regard to banking, following the establishment of the Single Market in 1993 in the EU, banking became increasingly cross-border in nature. But this was not accompanied by the development of a regulatory framework at the supranational level. This became obvious during the crisis.

“The segmentation of banking markets within the euro area is one of the more concerning legacies of the financial crisis. Banks were bailed out by national governments, under a loose coordination framework defined by the Council, and with lighter scrutiny exercised under the State aid framework. Integrated cross-border groups were broken down along national lines to allow national tools to be deployed to manage crises; and the often difficult negotiations to bring about these results dented the trust between Member States” (Enria 2020).

The national states played the role of crisis managers, and oriented the banks towards the internal economy. As a result, a *sharp decline* happened in cross-border banking, even within the euro area.

Let me quote a longer text from an ECB analysis: “The EU’s banking sector is not only the largest in the world, but also accounts for the bulk of the ‘financial de-globalisation’ observed in cross-border banking since the global financial crisis. In this paper we provide an anatomy of the great cross-border banking retrenchment in the EU and investigate a wide range of possible drivers of this phenomenon, including indicators of banking sector performance and stability, prudential policies and bank levies. Using a granular breakdown of cross-border bank lending by instrument and counterparty sector, we are able to identify the most affected components of cross-border lending and shed light on the underlying causes. Banks located in the euro area and in the rest of the *EU reduced their cross-border bank claims by around 25% since the global financial crisis*, driven by a sharp and sustained reduction in intra-EU claims, which make up 60% of total EU cross-border claims. Within the EU, banks have cut their cross-border loans by around 40%, which particularly affected cross-border interbank lending. Our empirical analysis shows a significant link between deteriorating asset quality and the great retrenchment in cross-border banking, highlighting the spillovers from national banking sector conditions across the EU. We also find evidence that prudential policies can entail spillovers via cross-border banking in the EU, albeit with heterogeneity across instruments in terms of direction, magnitude and significance. In particular, our results suggest that regulatory arbitrage might be possible via the use of foreign branches, while stricter policies at home may preclude banks from direct lending activities abroad, even though this does not apply within the euro area. For newly introduced bank levies, we do not find a discernible link to the great retrenchment, but they may have affected the composition of cross-border banking by incentivising lending to the non-bank sector. Our analysis suggests that tackling the persistent asset quality problems in the EU is pivotal in order to reap the potential benefits of cross-border banking which relate for instance to risk diversification and risk-sharing. Hence, the findings of this paper make a case for completing the banking union. For instance, the rulebook for financial actors in the EU needs to be amended by adding a chapter on a harmonised approach to the resolution of non-performing loans (NPLs), complemented by countryspecific elements in each high-NPL constituency…” (Emter–Schmitz-Tirpák 2018; italics mine)

So, the banking groups lack a Europe-wide identity: they are broken into parts along national borders. It is really difficult to envisage the centralized management of capital and liquidity at the parent level, when there is no clear understanding of how to deploy capital and liquidity support to subsidiaries within the banking union, in the event of shocks in some countries. The branching structure is still not really being used more widely (at least within European banking supervision). The production of a single passport of the sort already planned many decades ago in the late 1980s, is still not a reality.

"European corporate and consumer protection laws and our insolvency and tax regimes have formed more of a patchwork of legal, regulatory and supervisory approaches, with national practices overlapping in some aspects and colliding in others. In many areas this still holds true today" – cites Andrea Enria, Chair of the Supervisory Board of the ECB (Enria, A. ECB 2020)

In recent years EU leaders have often spoken about how to "complete the banking union." But, it raises the question of what criteria should be used to assess the banking union's "*completeness"*?

Can the playing field for European enterprises be equal, when governments are too strongly connected with their county's banking institutions? When the banks are stimulated even by taking risks to support some "important" national enterprises, in the hope, that the government will not let them fail? And, when in exchange, they support the goverment in financing the deficit stemming from irresponsible expenditure motivated by politics?

It is clear: the *stronger members of the EU did not* – and still do not – *want to bail out governments which are in trouble.* Even not by bailing out the banks. They think the government forced them – or they were anyhow ready – to buy the governments' bonds, that is, monetize the government deficit.

When will we be able to say that there is completeness in the banking union? "A narrow interpretation, based on euro area leaders' past commitments, equates that with breaking the bank-sovereign vicious circle; a more ambitious long-term vision for complete banking union implies the removal of all cross-border distortions within the euro area banking market. Even the minimalist version, however, entails more reforms than those publicly under current consideration" (Schnabel and Véron, 2018).

Sovereign risks and bank risks are highly correlated. Irresponsible management in big banks may lead to sovereign crises and badly managed state budgets can result in bankrupt governments… It may cause a vicious circle, a "doomloop". (In economics, a doomloop is a negative spiral that can result when banks hold sovereign bonds and governments bail out banks.)

The indebtedness of the Greek government was not just a question of the link between domestic banks and government. Buying sovereign bonds was a bonanza for other buyers as well, not only domestic banks, because the bonds were offering high-interest rates. Banks in the euro-zone have willingly bought them... Nevertheless, one has to question, why did they not think the fact over a bit, as in how could the interest-rates for those bonds be so much higher, compared, for instance, to the German state bonds? Did they not think, that it indicates greater risks? We may assume that investors thought that EU would in no way let governments go bankrupt in the euro-zone.

The banking sector in the EU must answer the big challenges of our times. The responsibility of the sector for the world-wide crisis is unquestionable. In the EU even the greatest achievement of the European integration process, the creation of the euro, could be in danger. Even more: the EU itself may fall into pieces.

4. Changes in regulation

As a reaction to the financial crisis, the EU has planned a lot of changes in the financial sector regulation. As a first reaction, it established the European System of Financial Supervision (ESFS) in 2010. This was a new supervisory architecture at the European level, consisting of three European Supervisory Authorities on the field of capital market, banking and insurance, (ESAs: ESMA, EBA, EIOPA), and a board to monitor systemic risks – the European Systemic Risk Board (ESRB). The ESAs and the ESRB started their operations in January 2011.

EBA, the European Banking Authority, had started to harmonize banking regulation EU-wide. It published over 250 guidelines, regulatory standards, and implemented technical standards. So, since then the *single rulebook* has become a reality. These rules are designed to prevent bank crises from happening in the first place, for example by increasing the amount of capital that banks are required to have (Capital Requirements Directive/Regulation). It is not just a matter of the amount of capital held by the banks. It also is a question of capital quality. That, too, has improved dramatically as a result of regulatory reforms in 2010. Euro area banks focus now on Common Equity Tier 1 (or CET1), the highest quality of capital (EU, 2016). In terms of capital ratios as a measure of the resilience of banks, in 2016 it was a couple of percentage points away – since 2008, banks in the euro area have increased their Tier 1 capital ratios from 8.4% to 13.7%.

If banks should get in trouble, there is a common framework to manage the process of winding the banks down. (Directiveon Bank Recovery and Resolution). The rules would also help protect consumers if banks should get into difficulty. For instance, deposits of up to € 100,000 are guaranteed throughout the EU, which should help prevent panic withdrawals if a bank is threatened. But, the Deposit Guarantee Schemes (DGS) remained national in nature (until 2020). The Commission had reviewed the functioning of the DGS Directive by 2019 and was looking for a single, pan-European DGS in the context of the banking union.

Let us start at the beginning. The years after 2010 were burdened with weighty discussions of the Greek case. The recent financial crisis demonstrated how contagious problems in the financial sector of one country can be, especially in a monetary union, and how these problems can directly affect citizens across the euro area. It was urgent to go ahead with the deepening of financial-monetary integration…

The establishment of the Single Supervisory Mechanism (SSM) in 2013 was a great step forward. (With the creation of the SSM, changes were made to the European banking authority's (EBA) voting arrangements to ensure countries participating in the SSM would not unduly dominate the EBA's board of supervisors, because some countries are not members of the eurozone).

SSM has been created to oversee banks in the euro area and other participating European Union (EU) countries. The SSM is the first pillar of Europe’s banking union. The second is the Single Resolution Mechanism, which aims to deal quickly and efficiently with failing banks. The Single Resolution Board and the Single Resolution Fund have been created as an important element of the infrastructure. (The safety net is not yet fully established at the European level. As long as deposit insurance remains national, Member States will have an incentive to ring-fence their banking sectors. This is why there is a need to finalize the banking union by establishing a European deposit insurance scheme.)

The aim, anyhow, was to put in place the banking union. To help lay the groundwork for the SSM, an Asset Quality Review was carried out, involving an in-depth expert examination of some € 3.7 trillion of euro area banks’ assets. A series of stress tests were also carried out. The aim of the exercises, which were concluded in October 2014, was to assess the resilience of EU banks in the face of adverse economic developments, in order to understand remaining vulnerabilities and give the ECB a clearer idea of the banks' financial health. The stress tests and the comprehensive assessment together helped to dispel doubts and restore confidence in EU banks.

There is no official or legal definition of what the banking union should be. The most common definition is that it means shifting banking-sector policy instruments from the national to the European level. The creation of a truly European supervision mechanism weakens the link between banks and sovereign nations. This indirectly helps to rebuild trust in Europe’s banking sector.

To strengthen oversight of the banking system, the SSM is a new system to supervise banks in the euro area (and other participating EU countries.) The ECB as a monetary authority was first of all responsible for money creation, the value of the euro, and the monetary policy of the euro-zone. Its tasks are now enlarged. In cooperation with the national supervisors, it is responsible for the functioning of the SSM. Its Board also includes national supervisory authorities as members. So, the legal standing of the Board is unique: different from other EU institutions, though member-state institutions are represented in it. According to Annunziata Filippo: „it provides a peculiar model of centralization and cooperation amidst European and national institutions in the field of banking supervision within the Euro area. Since its birth, the SSM has received wide attention from scholars and practitioners, raising an overriding amount of discussions and debates. As much as the SSM becomes mature, the underlying legal structure becomes clearer, and recent jurisprudence shows that it may well be referred to as a highly experimental field of EU Legislation. Indeed, also considering traditional topics such as the allocation of powers between Member States and EU institutions, or the relationship between EU law and national one, the SSM is providing new insights, that might also provide for fruitful developments at a broader level of EU Law” (Annunziata 2019).

The Supervisory Board is part of the ECB, an autonomous entity. At the same time, its functions (fulfilling the supervisory tasks), are strictly separated from the monetary policy of the ECB. To avoid any conflict of interest between the two, restrictions enforce the division; for example, by allowing for the exchange of sensitive information only when certain safeguards are observed. (Or so the regulations say…)

As a guard of financial stability, ECB by SSM has the role of mitigating the prospect of disruptions in the financial intermediation process, to avoid severe impact on real economic activity. Financial stability can be defined as a condition in which the financial system – which comprises financial intermediaries, markets and market infrastructures – is capable of withstanding shocks and unraveling financial imbalances.

The role of banking supervision on ECB level doesn't mean only micro-prudential supervision of the influential big banking institutions, but fulfilling macroprudential policies. This activity has different dimensions. Macroprudential policies – according to ECB publications - aim to:

– prevent the excessive build-up of risk, resulting from external factors and market failures, to smoothen the financial cycle (time dimension)
– make the financial sector more resilient and limit contagion effects (cross-section dimension)
– encourage a system-wide perspective of financial regulation to create the right set of incentives for market participants (structural dimension) (EU regulation – ECB 2013)

The ECB directly supervises significant banks. A bank may be qualified as significant depending on its size, its importance to the domestic banking sector or whether it has been recapitalized by public funds. The ECB has the authority to do the following: (I quote the relevant regulations, EU2013):

"–conduct supervisory reviews, on-site inspections and investigations;
– grant or withdraw banking licenses;
– assess a bank's acquisition and disposal of qualifying holdings;
– set higher capital requirements ('buffers') to countercurrent or future financial crises;
– impose sanctions for any breach of EU law on credit institutions, financial holding companies and mixed financial holding companies.
– Indirectly supervise banks that are considered to be less significant and are directly supervised by their national supervisory authorities."

National supervisors remain responsible for issues such as consumer protection, money laundering, payment services, and the supervision of branches of banks in EU countries that are not part of the SSM.

Peterson Institute, the independent foreign relations research center also studied the EU competitiveness issue. Experts from the Institute summarized their views immediately after the start (2013) of the SSM's aim, the banking union, as follows:

"Beyond centralizing supervision, the plan as envisioned by euro area leaders has three pillars:

(1) minimizing the near-term need for taxpayer contributions to rescue troubled banks;
(2) preventing moral hazard at the euro area country level by minimizing the euro area backstop for troubled banks; and
(3) preventing moral hazard at the financial institution level by designing rules to force shareholders, creditors, and depositors to share in the cost of a future rescue" (Ubide 2013).

Together these proposals amount to a policy of "national bail-ins" (as most investors in the banks are locals) to avoid "euro area bailouts."

Some experts found it troublesome that the interest rates are different for the periphery than the central economies of the EU because such rates reflect higher perceived risk for banks and borrowers. "As long as private lending rates in each country are allowed to reflect the location, rather than the ECB's policy stance, monetary policy in euro area countries with troubled banking systems will remain too tight, discouraging demand and keeping banks' balance sheets fragile" - wrote one of the the Petersen Institute's (PIIE) experts (Ubide 2013).

5. New challenges

Finance is likely to undergo intensive change over the coming decade for other reasons as well. One of the newest challenges for the EU – for the banks and banking supervision – is the appearance of innovative technology in all fields of the economy. Dealing with banking regulation we must take into consideration that competitive banking must be at the same time secure.

The attitude of bank clients has changed worldwide. Across Europe, 59% of internet users now do their banking online, and this number is on the rise. Interesting, that for instance in some aspects Sub-Saharan countries are much further ahead in use (by adults) of electronic money, than Europe (Relevant data: 25% to 10%). In Europe, there is a developed banking infrastructure. It does, as one would put, lower the progress in some fields... But European banks have also begun to implement a range of innovative technologies. Prime examples are artificial intelligence, or AI, for analyzing big data, mobile wallets, and cloud computing. AI and big data help banks overcome information asymmetries efficiently: the new tools help banks assess credit scores for clients with a limited credit history, at low costs. Without these new tools, it would be very difficult to analyze huge amounts of unstructured data.

This is an opportunity for banking supervisors as well. Enlargement of the tasks of the EU- level regulation needs more concentration on the information technology. It is more and more important in the banking business, and so for the supervisors. Automated reporting, for instance, could ease the burden on banks, and allow the authorities to collect data more efficiently. At the same time, machine learning could help them to validate – and even analyze – the data.

A new phenomenon is the appearance of the *new fintech institutions*. How to evaluate all this from the point of view of stability in the banking sector? Fintechs step in some of the banks' playing fields, and are competitors for them. They compete with banks in parts of the value chain. They are no banks, but it is important to closely follow their activity, when they do step in the field of banks, and engage in core banking business. Then they must be treated as banks. As fintech banks might come under the scope of banking supervision, it is needed to tackle the relevant risks. There are general discussions with the national authorities and the European Banking Authority on how to supervise fintech banking. This joint approach is crucial. Some countries, like Germany, have already carried into effect a licensing practice concerning fintechs. Fintech is a new phenomenon. For this reason the ECB has to have the chance to take a common European stance, right from the start. In April 2020 the ECB will have a workshop on the topic of fintech supervision.

6. Conclusion

We have collected some forecasts on the future role of the European integration in the world economy. To preserve the competitiveness of the region- even if its share in world GDP and trade will sink in the coming decades-, with special importance on the evolution of the banking sector. So we have surveyed the changes in the banking regulations over the last quarter of the century, how it helped banking to be more effective in the region. The review paid special attention to the period after the worldwide financial crisis. Partly, because the crisis had a negative legacy on the integration process of the sector, partly, because fully new phenomena have been observed in technology in recent years.

Everything is changing very quickly, so the stability of the banking system is a vital question. The study could only be a snapshot of the current situation of the banking system and its supervision in Europe. But for countries in the Eastern part of the continent, it is worth thinking about the overall European attitude. The free movement of labour has been a reality since 2007. Now banking integration is for the greater free movement of credit and capital across borders, (though, in a more controlled, supervised way). Were it is not necessary to evaluate, what does it mean, for all the longed after freedoms in the EU- for instance, the free movement of labour –, regarding the East European countries?

Will the banking union and the free capital movement *really serve the interests of the whole population* of the EU? Or, is it not necessary to put into operation certain smoothing mechanisms - more, than what still exists - in different aspects of the economy, within the integration? The attenuate results of the banking union over the last decade, certainly do not provide strong incentive to join the euro for those countries who are still outside the zone.

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