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The difficulties with the European Union's financial sector's legal regulation

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Abstract. After the 2008 economic downturn the EU has seen an increasing demand for strict regulation, especially in the financial markets whose volatility is being considered as one of the main reasons for the failing of banks and debt problems of sovereign nations. The Treaty Establishing the European Stability Mechanism in 2012 has been a milestone in the initiation of centralized EU policy within the financial sector. The so called Banking Union within the EU is planned to be fully operational in 2016. The author uses descriptive, logical, inductive and analytical methodology to showcase the juristic implications of a centralized financial policy in the EU and submits relevant regulation changes. The conclusion of the paper is that at the time of writing a centralized Banking Union creates the peril of unifying volatility into a systemic risk, because of the nature of debt creation within the financial sector.

Introduction

Global economic processes determine the contemporary policy making approach of unifying legal regulations in order to advance the particular field of economic relations [1]. However, there is still an aftermath of the so called global financial crisis which showed the western nations what can happen if global economic processes are advanced in such a manner that it only takes a few failing members for the whole economic chain to be considerably affected.

The author considers the contemporary policy making approach of the European Union (EU) with respect to the financial sector to be minimally researched in the field of law because of the mere dynamic of these events [2]. Therefore the author considers it even more important to actually seek a fundamental legal base for appropriate financial sector policies in the EU. The paper has been recorded by the author for listening[1] and both works have a creative commons license[2].

The research area is EU public law, the subject of the paper is monetary regulation. The aim of the research is to describe the legal basis regarding the financial sector of the EU, determine the intended legal benefit of the so called Banking Union and make conclusions with respect to possibly needed legal corrections. The used methods are: descriptive – for the textual description of the conditions, logical – for the structural representation of the research content, deductive – for individual conclusions from general premises, comparative – for the comparison of similar conditions, and legal-technical – for the reasoning of juristic merits. As a result of the research the author proposes the evaluation of suggested legal acts

[1] See also: list of public files by Lauris Bočs. Available at: `http://files.fm/laurisbocs` [last viewed 31.05.2015.].

[2] Creative Commons license CC BY 4.0. Available at: http://creativecommons.org/licenses/by/4.0/ [last viewed 31.05.2015.].

to be scrutinized according to EU member state financial market data without relevance to the official currency.

The legal nature of the financial sector within the EU

The legal nature of the financial sector of the EU lies within human rights, especially the right to property. The banking, insurance and investment sector are all individually multi-billion euro segments of a unified approach of effective asset allocation in an ever-changing economy [4]. The need to make transactions, increase returns and prepare for risks enables people to use their basic economic rights.

However, the uniting factor for all of these is the crucial role they have on market volatility within the EU. In the recent five years the EU has seen a great shift towards a unified market for not just goods and services, but for capital flow as well. The Treaty on the Functioning of the European Union elaborates not just the main functioning principles of EU institutions, but also conditions under which particular freedoms shall be regulated. For example, Article 63 prohibits EU member states to restrict the movement of capital. The author considers this to be one of the self evident concepts relating to market liberalization in the EU. The modern day approach of policy makers is to actually connect with more and more markets around the world. Yet, the true benefits of these policies cannot be fully understood until its intricacies are exposed during times of hardship.

The links between EU member states relating to economic difficulties after 2008 are a useful example in the study of financial sector regulation aspects. While market access has several potential benefits when operated under steady conditions, the modern day economy does not necessarily reflect a politically motivated regulation, i.e., the wished conditions may not develop in real life [5]. When market conditions become volatile the need for a sophisticated system becomes more important.

The author concludes that the basic legal nature of the financial sector is to protect and enhance private property as a cornerstone for modern market efficiency. By itself it has no attached legal weight, yet the single market concept of the EU showcases several potential legal ambiguities regarding the quality of financial sector participants. While there are several issues regarding the stability of a mosaic type financial sector, the author pinpoints government debt as a sufficient indicator for a representation of economic productivity in relation to financial insufficiency [3]. That is not to say that government debt is not a useful tool, but to showcase that, for instance, in 2014 average government debt in the EU has not been in accordance with one of the so called Maastricht Criteria that government debt should not exceed 60% of the gross domestic product. The author notes that these criteria were set in 1992 with the Treaty of Maastricht and 20 years later there is still considerable incongruence (Fig. 1).

If the general approach has been breached or is not applied correctly, the unification process puts not only the efficiency of the regulation at risks, but also the legal interests of the general public for sustained economic development. EU citizens are not expected to be understanding if states demand to obey fiscal consolidation measures and budget cuts while at the same time the state is being careless with respect to international obligations regarding domestic debt policy. The author concludes that the legal merit of politically and financially sound EU regulation has a direct link to the protection of property rights and general economic rights of EU citizens by allowing a jurisdiction in which prosperity could be based on long term goals and sustainable results. Therefore any possible breach by individual member states puts a direct toll on the overall system.

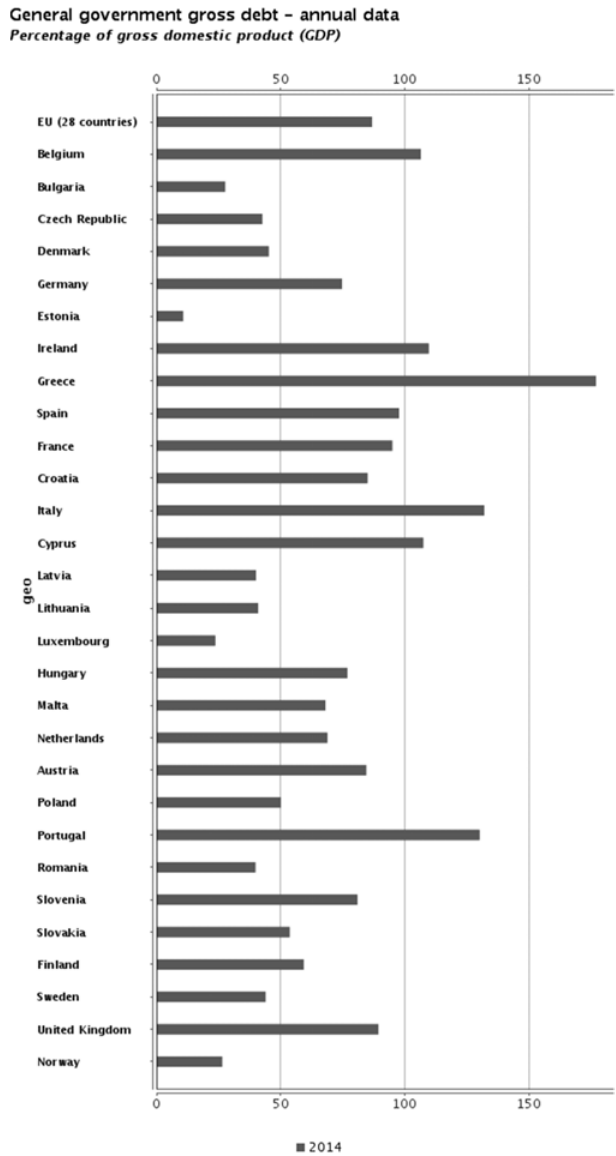

Figure 1. EU general government gross debt in 2014. *Source: Eurostat*[3].

Practical difficulties for unified regulation in the EU

The legal framework for the EU's financial market does not exclude national sovereignty with regard to productivity, service availability and incentivized rules. The practical example of Latvia could be viewed as an exhibit of sovereign state affair management within the EU. Latvia fulfills the so called Maastricht Criteria and has a financial sector leverage ratio of more than five to one (Fig. 2). In legal terms it means that the contractual liabilities in monetary

[3] Available: `http://ec.europa.eu/eurostat/tgm/graphDownload.do?tab=graph&language=en&plugin=1&pcode= teina225` [last viewed 31.05.2015.]

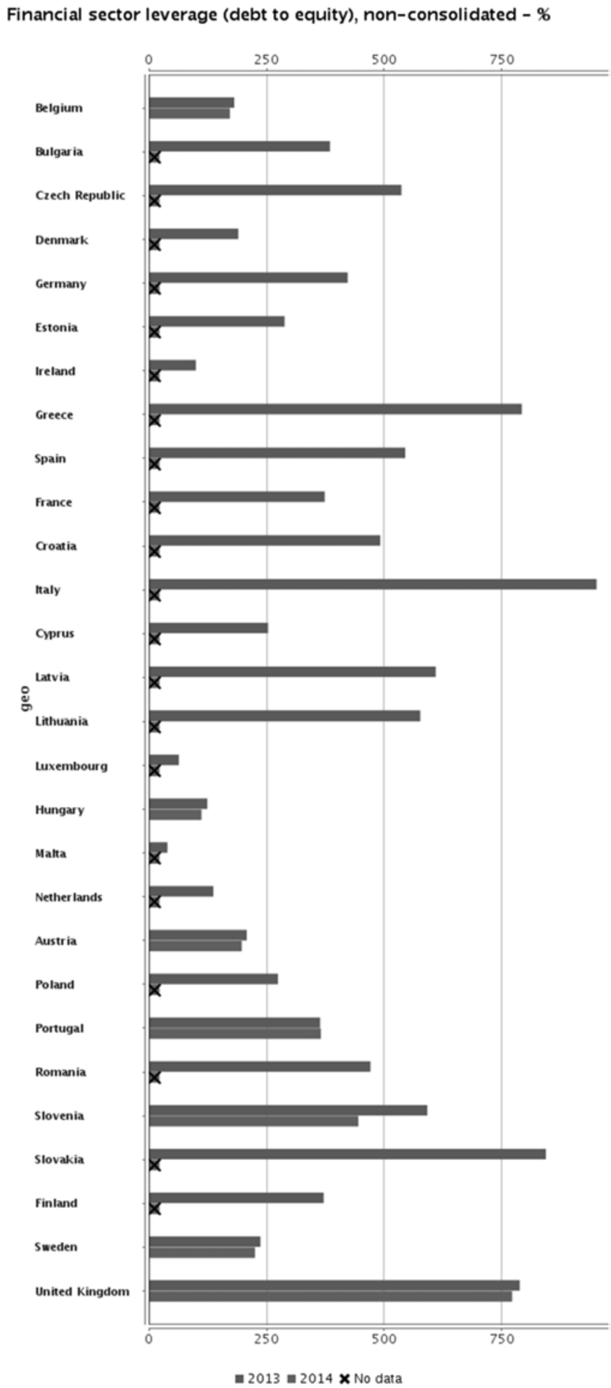

Figure 2. EU's financial sector leverage in 2013 and 2014. *Source: Eurostat*[4].

[4] Available: `http://ec.europa.eu/eurostat/tgm/graphDownload.do?tab=graph&language=en&plugin=1&pcode=tipsfs20` [last viewed 31.05.2015.]

value within the national financial sector are five times more than their related actual assets. It must be said that this is not unusual – not for the EU and not globally. However, with respect to the conclusions made earlier, it must also be noted that the need for financial market stability arises from the legally protectable interests of the general public. Yet, leverage is a somewhat for speculative purposes by special interests [6].

With regard to the principle of proportionality it could be argued that the interests of the public outweigh the special interests of individuals. However, leverage could mean that an institution is so indebted that it has a systemic importance in which case the government supposedly in the interests of the general public ensures the liquidity of the special individuals in order to safeguard the system [7]. The author concludes that this is to a very large extent the same within the EU policies regarding financial sector reforms. The intent is to supervise, control and speed up resolution in the Banking Union, which has a direct link to the euro as national currencies. Yet, the author notes that *inter alia* the banking sector of the EU does not differentiate between jurisdictions and therefore currencies with respect to transaction and capital movement have no limiting properties.

The author notes two different measures for evaluating the goal oriented policies – efficiency and effectiveness. One could be considered a task that can be done properly and the other could be considered a proper task. Therefore the right to property with respect to the economic rights of the general public is to detach the euro as a criteria for monetary policy and instead focus on the debt accumulation of public and private institutions which could end up as a systemic risk not just for their particular state, but also for the whole EU since it consists of several participants whose financial sectors are less than favorable. The author suggests a simplistic viewpoint of differentiating the doing of things right from the doing of the right things within monetary supervision and it is the obligation of the science of law for it to take hold in the legal framework. The sustainable development of EU economies depends upon it.

Conclusions

The author concludes the following:

1. The artificial centralization of the EU's financial market supervision powers creates the peril of unifying volatility into a systemic risk.
2. Notwithstanding the EU's efforts of unifying the financial market policy, the member states, as can also be seen in the charts, are proceeding with a sovereign financial market regulation which does suggest a mistrust of the centralized legal regulation, at least in the current form.
3. To reflect social change the law has to recognize a need for it and, since information technology nowadays allows rapid transition of information, it becomes even more important to reflect the general social welfare with minimum effort and maximum results, therefore the author proposes the concept of juristic hedonism to be used in the science of law as a somewhat accurate purpose statement for legal regulation, i.e., increase of sustainable well being for the majority in a democratic society.

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