BANGOR BUSINESS SCHOOL

Back to Brussels?

Are there benefits to banks of rejoining the European Union, asks John K. Ashton, Professor of Banking, Bangor University.

On 1 January 2021, the United Kingdom finally left the European Union [EU] after more than 40 years' membership. The Brexit debate directing this departure has been one of the UK's most divisive and emotional political developments in living memory. In this national dialogue there have been many strong words and assertions as to the possible benefits and costs of leaving the political and economic union.

These debates continued over time as the UK went through an agonisingly prolonged period of negotiation to secure a deal in order to leave the EU on the best terms possible. Of course, while assertions to the efficacy of these benefits or costs remain unclear, now the UK has finally departed the EU we are beginning to gauge at least the short-term effects of this decision.

This new information will engender future discourse as to whether this was a good decision or otherwise. If the 'leaver' arguments that Brexit will be a fantastic success appear to be incorrect, overstated or misguided, determining the effects and implications of rejoining the EU may become a pressing policy question. Such a discussion could occur across the UK or potentially for Scotland if it leaves the United Kingdom in future.

New research from Bangor University, in collaboration with Mardin Artuklu University in Turkey, has considered the impact of joining or undertaking accession to the EU for the banking industry. This work from John Ashton and Mehmet Maksud Onal has quantified these benefits through examining how the process of accession influences both bank financial performance and one aspect of banking regulation – that of corporate governance for banks.

This assessment is undertaken for banks from nations that have joined or tried to join the EU in the past 20 years. Specifically, the experience of 211 banks between 2000 and 2015 from 11 'new' EU member states, five candidate states and a control sample of banks from four long-standing EU member states is examined.

We report the accession process whereby nations join the EU has a substantial benefit for banks. Adherence to and compliance with new and progressive corporate governance regulation is greater for nations undertaking the accession process relative to banks from long-standing member states. For example, board independence, CEO duality and female representation on boards is enhanced far more for banks from candidate states, relative to banks from EU member states. Further, the financial performance of banks from candidate states is seen as superior to those from member states . Therefore, actually joining the EU can bring substantial financial and regulatory benefits for the banking industry, relative to being a bank from a long-term EU member state.

Why would this outcome occur? To join the EU a candidate state must fulfil several accession conditions and abide by the Copenhagen criteria to improve their economic, social, political and cultural standards. After EU accession, new member states must apply and comply with all extant European Directives together with existing members of the EU.

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Of course, as we know clearly from the Brexit episode, not all nations fully embrace all EU laws and directives and may be more or less keen on implementing these changes. Indeed, candidate states do not always engage with the accession process and nations may join the EU as much for political opportunism and the potential economic benefits of membership as a commitment to

EU values. This can have adverse future consequences, including backsliding on past agreements and ongoing dissatisfaction with EU agreements.

Alternatively, joining the EU may lead to fundamental economic and social change as collective EU values are embraced in a 'lesson-learning' process. During the accession period, candidate states and their companies may experience radical change fostering convergence with EU rules and resolving existing national policy challenges. Not least convergence with EU standards and values can present national benefits through encouraging inward investment, establishing a favourable policy regime and attracting foreign investors. The EU also encourages greater compliance through persuasion, whereby progress towards accession goals is rewarded and its benefits are withdrawn for a lack of compliance.

Using a number of descriptive and inferential statistical approaches and re-examining the sample from a range of perspectives, we formally test whether nations join the EU for purely economic and external benefits by examining if banks adopt a cost-benefit approach to implementing regulations. Alternatively, if regulations are adopted through 'lesson learning' and embracing EU ideals, compliance is expected to be more successful. We report findings consistent with external incentives motivating accession. While banks from candidate nations adhere to regulation and in turn have superior financial performance, once EU membership is achieved slower corporate governance compliance emerges. This lower adherence to EU regulations and laws is linked to lower financial performance in the banking sector of these member states.

Returning to the issue of Brexit, what does this result tell us going forward and from a UK perspective? Initially, we can infer that many nations have also faced less than full satisfaction with EU principles. Indeed, such dissatisfaction appears to be widespread among new member nations. A key difference is, of course, rather than leaving the EU, the preferred method for managing this state of affairs is less compliance with EU directives and regulations once full membership is attained.

Further, having to navigate the accession process, whereby EU laws and regulation must be achieved to ensure membership, provides financial benefits for banks from candidate nations. Indeed, the journey towards accession is far more influential than actual membership of the EU on ensuring new EU regulation is introduced. If the UK were to revisit rejoining the EU, substantial institutional, legal and regulation would be required, at least during the accession period. While such a process would be disruptive, it would also bring financial benefits, at least until full membership is attained. CB