THE CONTRIBUTION OF COOPERATIVE BANKS AND BANKING TO SOCIAL MARKET ECONOMY FOR EUROPE – MODERATION OF CAPITAL 'MARKET AND COMPETITION'

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The reserves of credit unions, credit cooperatives and cooperative banks in Europe have grown over a long period of time even over many generations of members and have contributed to build and to maintain the current network and federate structures. As stated in ICA principle 3 (Member Economic Participation), "members contribute equitably to, and democratically control, the capital of their cooperative. At least part of that capital is usually the common property of the cooperative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their cooperative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the cooperative; and supporting other activities approved by the membership." (ICA 1995). The individual capital of each member is maximally paid in up to the nominal amount of all shares held by a member and repaid when the member leaves (e. g. § 73 German Cooperative Act).

But times for banks have changed. If we look at cooperative systems in European countries, we realize an Anglo-American understanding of companies is increasingly shaping the way of doing business in (continental) Europe. Companies in the legal form of a (registered) cooperative should also follow the path of "emerging, growing and declining" of companies. This includes conversions and the range of possibilities of mergers and acquisitions. The more standardized a company is, the easier to handle in terms of processes and of valuation, in particular if its shares are transferrable and listed on a stock exchange. A listing has become the case already for parts of cooperative banking groups in countries like Italy (Banche Popolari), France (Crédit Agricole) and Austria (Raiffeisen Bank International) (see for Germany a discussion e. g. by Bartels 1994).

Similar is the understanding of the development of cooperatives published as early as by Hermann Schulze-Delitzsch (1808 to 1883), originator of the German commercial cooperative movement and author of the Cooperative Act (first 1867). He never changed his view on this (Waldecker 1916, p. 26, fn. 1). If subsequent generations had followed this understanding, many of today's credit cooperatives and cooperative banks would no longer exist. Bank services would then certainly be more expensive, or new

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local self-help organizations would have been formed, such as those credit unions found in the Anglo-American region and also in Eastern European countries, a movement attributed to Friedrich Wilhelm Raiffeisen (1818 to 1888).

Social Market Economy

Part of the (theoretical) understanding of a market and competitive economy is that institutions that are not viable can no longer survive as market participants. But it is only superficially companies that 'perish'; behind them are always people whose personal circumstances are affected, and who are sometimes seriously hurt. Therefore, the supporter of a market economy in the young Federal Republic of Germany, Ludwig Erhard, was persuaded that a social balance is needed – at least in the form of a social market economy (Fuhrmann 2017, Tügel 2018).

At European level, in connection with the banking and capital markets union, it is assumed that "stronger capital markets will complement Europe's strong tradition of bank financing … By opening up a wider range of funding sources, it will help to share financial risks and mean that EU citizens and companies are less vulnerable to banking contractions."(European Commission 2015, p. 3).[2] On the one hand, the fact is likely to be 'forgotten' that it was precisely the size of the market participants, their interdependence ("too big and too interconnected to fail") and capital market products that brought credit institutions and insurance companies into such difficulties that states and central banks have been challenged with rescue measures in the financial market crisis since 2007.

Safe cooperative legal form and federation

On the other hand, it remains in our memory that decentralized banking groups that widely act market-autonomously were less affected by the crisis, including the German cooperative FinanzGruppe – with the exception of two very large institutions, maybe those with strongest ties to capital market.

For European banks the European Banking Authority expects, based on a sample of 189 banks, regulatory capital requirements to increase by 135.1 billion Euro in the next few years, in particular for large banks (EBA 2019, p. 22).[3]

Where does the money come from?

[2] "It [The Capital Markets Union] aims to get investment and savings flowing across all Member States, benefitting citizens, investors and companies, regardless of where they are located." (European Commission (2020): p. 2).
[3] For 104 large banks 134.1 bill. Euro, with 82.8 bill. Euro for global systemically important institutions (8 G-SIIs) and 43.8 bill. Euro for other systemically important institutions (67 O-SIIs), EBA 2019, p. 22.

With respect to capital needs, European banking regulators seem to prefer the business model of a (listed) corporation for every bank as well as savings bank. Above all, international investors are solicited to invest capital. The plan to promote mergers into ever larger units (Mersch 2019,[4] also AWP 2020) is not immediately comprehensible if these units are only viable with higher capital, unless a change of ownership is being prepared at the institutions, which should gradually lead these institutions out of the market in an orderly manner and replace banking services with market services.

In the cause of offering a business model that is attractive for investors, risks and additional capital requirements for banks are both interactively increasing. The risks increase in order to maintain the prospect of higher earnings and have to be covered by additional equity capital because the risk of default increases. The institutions themselves should pay for this in order not to burden the state and thus the general public again. At the same time, the possibilities for risk diversification are limited by requiring ever increasing backing with equity capital for certain assets, such as company investments (Cluse, Cremer, Farruggio 2019, p. 5).

The dilemma of a so regulated business model for banks lies in the fact that customer deposits are at stake. The interests of owners of listed banks and bank customers continue to diverge. Bank's management has to endure this balancing act. If investors sit in the management, then at least ownership and control match in the corporate governance. How about the expectations of customers and the general public in keeping deposits safe and using them for responsible lending? This seems to exclude focusing only on earnings and high profits for the owners of a bank (apa/red. 2020).

Therefore banks which are owned by particularly profit-oriented owners, i. e. investor-owned banks (Birchall 2013.2, pp. 9, 11-13), should have their own deposit insurance. It is important to protect banks with largely coincident interests of customers, owners and management. These are banks that – in the worst case – cause the least problems, provided that this coincidence of interests is taken into account. This type includes cooperative banks with their support of members as well as savings banks with their focus on the common good, but both more and more for all customers.

A listing on a stock exchange and thus the market orientation of a bank always means that interests diverge – unless the customers themselves hold the shares. But how long will they do so? If these institutions also become attractive for financial investors, then – as the market prices for the major European banks have already indicated (Raoul Pal in Onvista/dpa-AFX 2019) –the end of a longstanding

[4] "Our risk-aversion is not meant to block market-driven consolidation initiatives – and should not be understood as such." (Mersch 2019), for a different perspective on the influence of regulation on the market see Nowotny in Hämmerle (2019).

institution is emerging, which would also be the end of an alternative to the market, although it is itself structured like a market.

Capital markets aren't perfect, but theoretically they should function on transaction costs as low as possible. Not surprisingly, markets, e. g. stock exchanges, were originally conceived as cooperatives and associations – the sponsors, stock exchange associations, in Germany but e.g. also in Switzerland. In these cases benefits from the market mechanism are directly available for all organized market participants.

A (purely) commercial business model contradicts the nature of credit institutions, banks and savings banks. Increasing the focus on profit in banking is one reason why the institutions finance their (re)financing by comparing prices with market prices and invest in market products that have been difficult to understand in terms of their complexity and thus their risk– in the crisis even by rating agencies.

Continuing specialized activities in the (German) banking system

Today banks are well advised to go back to their roots as long as they are solid and there is scope to cope not only with technologically difficult phases of change and crises. But at the moment it seems that cooperative associations are working against their members and for the capital market when they offer negative interest rates for (new) private customers or (would) recommend that savers invest their money into investment funds (apa/dpa 2019). The lack of alternatives via information technology solutions standardizes the banking business so much that the degrees of freedom and scope for decision-making at the individual cooperative bank continue to decrease and in the end a pure market (intermediate) function remains.

Many generations of members, private and commercial customers, before today, have relied on the continued existence of their cooperative bank. They have increased reserves and provided for the current generation and future generations. If this – social – dimension of cooperative banks (Blisse 2020), which is not vulnerable to capital markets, is maintained, then there is the prospect of moderating the market and (price) competition, similar to what happens in the housing industry (Feichtinger, Schinnagl 2017).

What gives a bank even greater reason to exist today, that is, contrary to a "banking is necessary, banks are not" idea, is that savers can trust in the institution 'bank' and in its ability to keep money safe (and with interest) on the one hand and on the other hand to make savings available to people and companies who need money for larger and long-term projects – certainly with regional or local relevance. This constellation is comparable to a market, but the institution is owned by its customers (Birchall 2013.1) and is able to make socially responsible decisions about the lending of money – with regard to credit-worthiness, but also with regard to the kind of project.

Protection for cooperatives and reserves

Money serves the society based on the division of labor and contributes to social cohesion because the flow of money corresponds to and regulates the flow of trade, goods and services. Money in cooperative banks doesn't come under the influence of only a few institution(al investor)s – again controlled by a few – but remains under control of a broad (member / owner / citizen) base – leading to the understanding of "banks are necessary, listed banks are not".

To further enable cooperatives in general and cooperative banks, credit cooperatives and credit unions and similar banking entities in particular to continue their social and sustainable role in an even more dynamic market and competitive economy, they need some kind of protection to persist (Henrÿ 2013, pp. 69ff.). This could be similar to the Constitutions of Italy (Art. 45 (1)) and Greece (Art. 12). Possibly the law can explicitly be at least related to the reserves of prior generations of members, to protect this social contribution, which was built in the past for the future of the cooperative. Then cooperatives would act and contribute as moderators in a market- and competition-driven economy.

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