Does the financial crisis spell the end of the European Single Financial Market

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PhD seminar

Vera Anstey Room

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The Single Financial Market has been a central feature of the European project for two decades

- a deep and broad capital market to rival the US
- Benefits for savers and borrowers: Cecchini report claimed big impact on GDP
- Financial Services Action Plan: 92 directives or regulations – now in theory complete

But there has always been disagreement about both the purpose and methods:

- UK government (and some others) have seen it primarily as an exercise in removing barriers to competition
- Others, especially in the Eurozone, have seen it as promoting full harmonisation of rules and practices.

To simplify, directives can take three forms:

- Mutual recognition
- Minimum harmonisation
- Maximum harmonisation

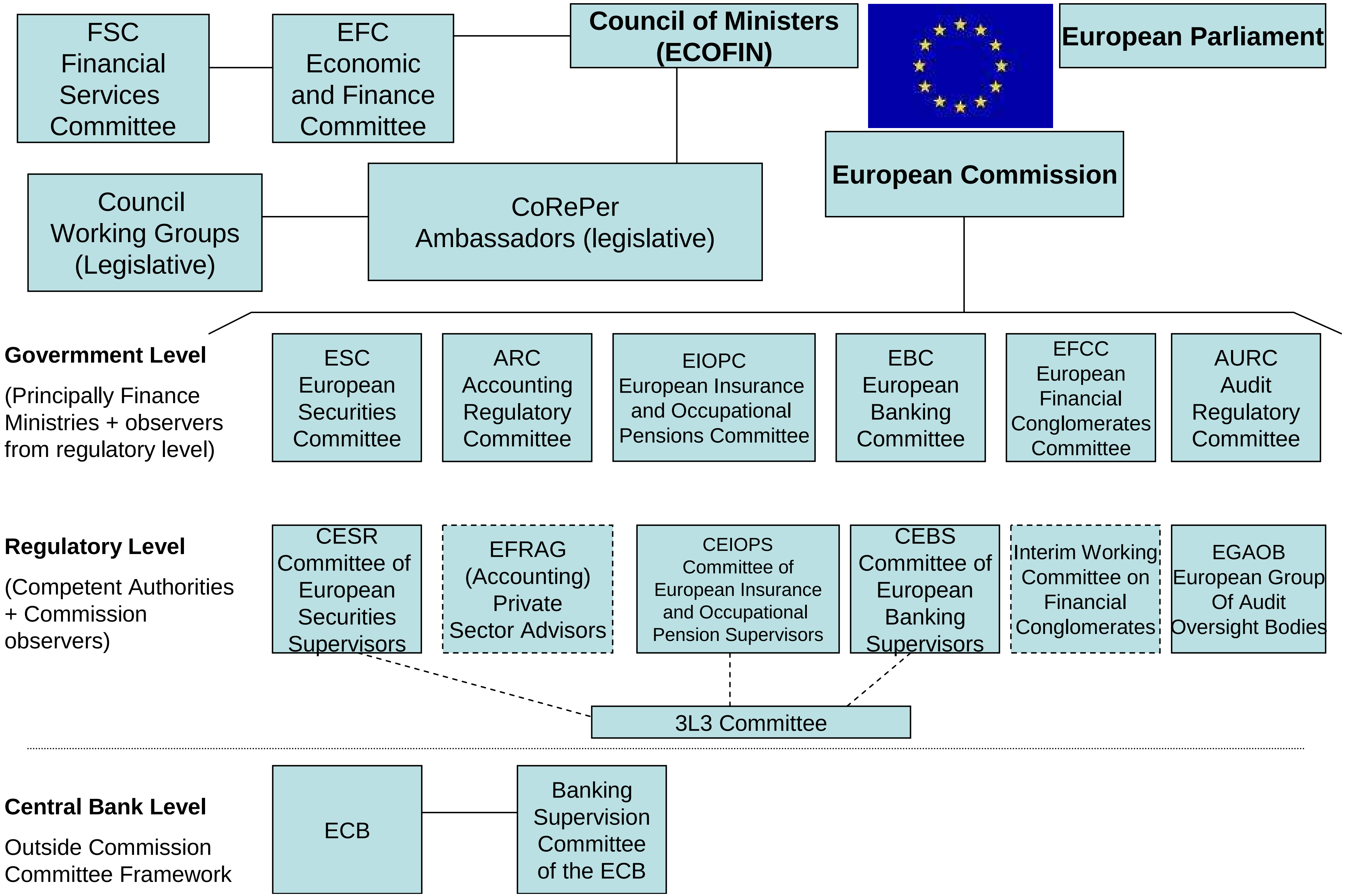
With the last, the question of regulatory structure also arises. i.e. do we need a single European regulator?

The Lamfalussy Report in 2000 set up three committees to promote regulatory convergence. Since then, there has been an uneasy truce:

- The Commission has proposed few new directives
- The three Committees have gradually assumed greater significance

But the underlying uncertainty has remained.

European Committee Structure

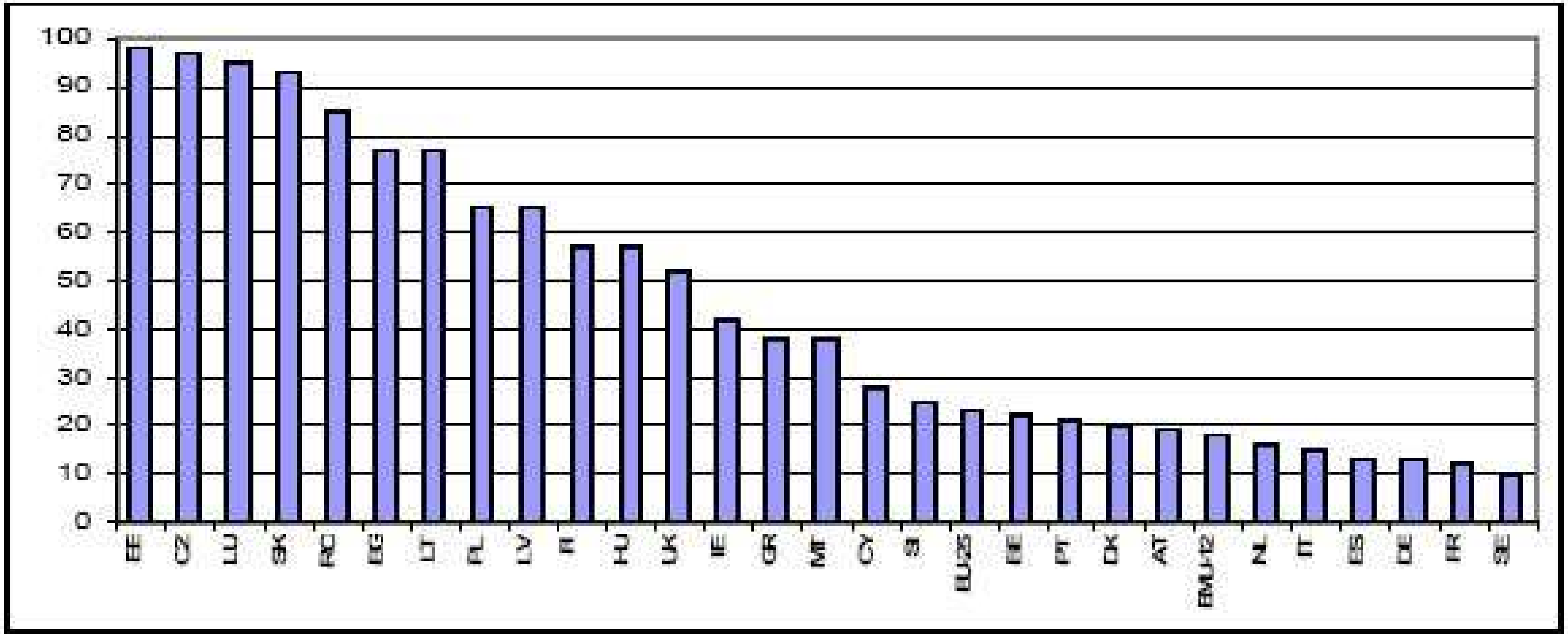


The crisis has now highlighted flaws in the framework

- the Icelandic bank collapse showed the problems of home: host relationships, and the lack of harmonised deposit guarantee schemes
- the Fortis collapse showed uncertainties on lender of last resort and bankruptcy procedures
- the withdrawal of liquidity from Eastern Europe by Western European banks again showed the vulnerability of host regulators.

As Adair Turner has said – we now need either more Europe or less Europe.

Market share of foreign-owned banks (% of total assets



Source: de Larosière

The de Larosière review concluded that:

- ‘a single financial market cannot function properly if national rules and regulations are significantly different’
- ‘diversity if bound to lead to competitive distortions’
- ‘diversity goes against group approaches to risk management and capital allocations’
- ‘the management of crises is made more difficult’

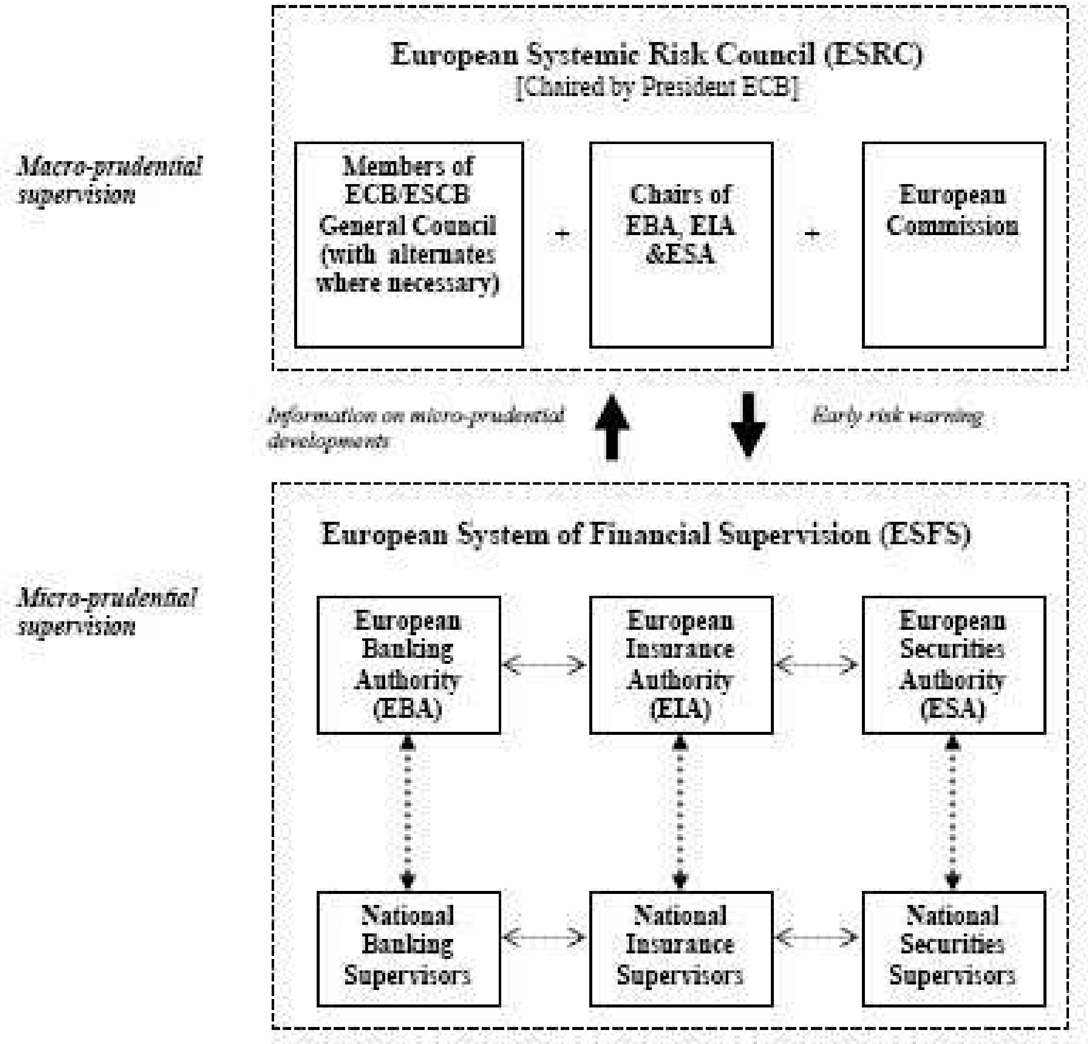
So he recommended (among other things)

- a harmonised set of core rules
- harmonised deposit guarantee schemes
- harmonised crisis management

In addition, he argued for

- a new European Systemic Risk Council under the ECB, and, over time
- three new Authorities, building on the Level 3 committees, making up a European System of Financial Supervision
- a Single European voice in global bodies

A new European Framework for Safeguarding Financial Stability



Source: de Larosière

The battle lines are now being drawn up;

- the Commission has proposed legislation this year: a faster process than de Larosière recommended
- Alistair Darling has (reportedly argued for)
  - one body not three (the FSA model)
  - no powers over national supervisors
  - ESRC reporting to the European Council, <u>not</u> the ECB

Three options:

- ‘more Europe’ on de Larosière model
- ‘less Europe’ i.e. break-up of pan-European groups
- Euro-fudge

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