Is Europe ready for 1992?

A half-dozen experts look at the difficulties of melding the regulatory philosophies and practices of the dozen members of the EEC into a single financial Eurosystem.

Kathryn Moran

The advent of the EEC's 1992 economic plan for economic integration has European regulators and bankers examining the workings of their financial systems. For some, 1992 merely means fine-tuning their existing regulations and practices. For others, however, it will mean a whole new way of life.

At the November 1989 conference on globalization, co-sponsored by the Federal Reserve Bank of Chicago and the Mid America Institute for Public Policy Research, a panel of bankers, regulators, and academics gathered to discuss the implications of 1992. Panelists representing the United Kingdom (David Llewellyn, Loughborough University), the Federal Republic of Germany (Randall J. Pozdena, Federal Reserve Bank of San Francisco), Italy (Giorgio P. Szego, University of Rome), France (Jean-Pierre Patat, Bank of France), and Switzerland (Georg Rich, Swiss National Bank) discussed developments in these countries and a representative from the Bank for International Settlements (Joseph R. Bisignano) provided an overview on the effects of globalization throughout Europe.

Some are more ready than others

The panel members representing the United Kingdom, the Federal Republic of Germany, and Switzerland viewed the Europe 1992 plan as an extension of existing banking practices. Randall Pozdena, in addressing the German banking system, noted that "some argue that the evolution of the German banking and financial markets domestically might be a precursor of what will happen internationally, perhaps including providing a model of the potential political challenges posed by these developments." Speaking of banking in the United Kingdom, David Llewellyn noted that the U.K. also has a very open system when it comes to wholesale banking, but that traditional, internal restrictions and the high entry costs to the retail banking industry may leave it vulnerable to global market pressures.

Perhaps the country with the longest experience in international finance is Switzerland, which has been a source of capital internationally since the 17th century. Georg Rich observed that the lack of restrictions and regulations on domestic and international finance, coupled with the banking secrecy laws, served to make Switzerland an attractive source of capital funds. However, on the eve of Europe 1992, Switzerland is finding that its competitive edge is eroding, the result of liberalization of banking laws in other countries.

The panelists representing France and Italy viewed Europe 1992 as a challenge for both regulators and bankers in those countries. In France, Jean-Pierre Patat stated, regulators and members of the financial services community have recognized the need to become more international in character. In the last decade, France has increased its participation in the international bond market from 1% of its Gross Domestic Product to 50–60%.

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However, Patat did not see deregulation as an inevitable consequence of the opening of the financial services market. Rather, regulators "need now a pragmatic approach [to the] diversified information" to encourage globalization. That is, he believed that regulators have an important role in the globalization of French banking, and that the regulators must recognize this and act accordingly.

Giorgio Szego, on the other hand, viewed Italian regulators as a barrier to the globalization of Italian commercial banks. In Italy, commercial banks operate as "the arm through which the government monetary policies are activated and [are] kept as legally separated bodies" with a very limited range of permissible activities. Therefore, multi-functional financial services firms have developed that offer many banking services domestically, while Italian commercial banks have been buying foreign branches in order to increase the range of services they can offer in the international market. As a result, Italian commercial banks are losing market share domestically to nonbank financial services firms and to foreign banks even as they are gaining market share abroad.

Joseph Bisignano of the BIS provided a broader view of globalization in Europe. While concurring that many members of the European community have begun to move toward globalization, the sheer variety of financial and regulatory practices that now exist in Europe challenge the success of the 1992 plan. "I think one way to look at finance in Europe [is] as basically a dual economy, ... as a developing country...[with] one sector which has been, for a number of years, protected from foreign competition, where prices and commissions are very strongly regulated, and where government has played a very strong role in supporting that industry... The second sector is the more competitive...where you have substantial deregulation, substantial competition in price and commissions, where the industry is subject to large elements of foreign competition, and where government has managed to stay away from overregulation." Due to this complexity in the European financial market, no one form of banking or regulation stands out as the solution for Europe 1992. Bisignano agreed with the other panelists that government regulation plays varying roles in the financial services industry in Europe. However, even in countries that seem to have fairly open systems or very active universal banks, regulation plays a greater role than one might expect. For example, despite Germany's history of universal banking, its bond market is highly regulated. Thus, even in progressive countries the effects of government control can be felt in international financial services.

But everyone has concerns

When the panelists addressed their concerns about Europe 1992, their responses were quite varied. Llewellyn saw wholesale banking in the U.K. as already global. It is in the retail sector that the greatest internal restrictions exist and where he found the greatest need for adjustment. As a result, the retail banking structure will be vulnerable to global restructuring pressure.

Pozdena believed that German banks are ahead of their time. However, he sensed political concerns, both within Germany and without, about the concentration of economic power that universal banking presents. There have been attempts in Germany to limit, through legislation, the powers of universal banks, and he believed that the similar legislative efforts could arise in the European community post-1992.

According to Pozdena, the German securities market presents a very real barrier to globalization for the German financial services industry. It is subject to many regulations and has not made the inroads in the international market that German banks have.

Rich expressed a similar concern regarding the Swiss securities market. The Swiss securities tax laws, coupled with a failure by the members of the stock market to compete on an international level, have caused the Swiss securities industry to lose its edge. Furthermore, Rich saw a parochialism in the Swiss financial community that has allowed price-fixing agreements and other restrictive practices to exist. In order to compete internationally, he argued, Swiss banks must change these practices and begin to improve their service to their customers.

In France, Patat found that the French government in general and the monetary regulators in particular need to make adjustments.

Banks, he stated, have taken steps to become international. It is the regulators who must begin to think globally—both in the effects of their policies and in their relations with regulators from other countries.

Szego agreed that regulators must broaden their outlook. He argued that Italian regulators must enlarge the scope of permissible domestic banking activities. As long as domestic commercial banking remains highly restricted, Italian banks will be unable to compete domestically on an equal footing with foreign banks.

Bisignano found many different barriers to globalization. Government plays a pervasive role in financial services throughout Europe. But, that role is different from country to country. In some countries, government regulation is limited to a few areas, such as capital markets, while in others government regulation is visible in virtually all aspects of financial services.

Bisignano also argued that there is a general misconception about banking in Europe. Despite the advent of universal banks and the appearance of a highly international banking scene, economic power in Europe is not concentrated. Rather, many financial services are handled by small regional banks or any of a number of nonbank financial institutions, such as finance companies and trust companies. These may present a very real obstacle to rapid globalization.

Common ground

It was on the role of regulators that the panelists found common ground. As David Llewellyn stated, "So I think if globalization is about competiton...it's about competition between financial systems." The panelists agreed that if Europe 1992 is going to work, regulators must recognize their role in the plan. They will need to review their definition of banking and the restrictions they have placed on banks. They will need to enhance the areas where they already have an edge, such as deposit insurance, underwriting, or universal banking. They must be aware of and communicate with regulators in other countries. Most importantly, they must assist their financial services industry domestically in order for it to compete globally. If they do, then the European community will be prepared to meet the challenges of 1992. If they do not, the pessimistic scenario described by Giorgio Szego may come to pass—"If home rule will be the rule, let us look for the most hospitable home."