Has the European Banking Exception Come to an End?

Nicolas Véron

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The ABN Amro saga of the last few weeks has shown paradoxically that banking in Europe is still a world apart from other sectors. Of the seven biggest banks by market value worldwide, only one is European and only just. It is HSBC, with less than one third of its business in Europe and, until 1994, its headquarters in Hong Kong. The other six are American (Citi, Bank of America, JP Morgan) and Chinese (ICBC, Bank of China, CCB). In other major business sectors the global top ten counts at least one company based in the euro area. But Santander, the eurozone's biggest bank by market capitalisation, only makes twelfth place.

It is also the least internationalised sector. Taking a sample of the 100 top European market caps, banks do on average more than one half of their business on their home soil, other sectors on average only one third. Why is this so? Above all because the sector is highly regulated. Since any bank failure entails an element of systemic risk, banks are subject to the supervision of public bodies such as the Commission Bancaire in France and the FSA in the UK. Regulators prefer borders to remain as tight as possible, in order to contain risk, but also to maintain existing cozy relations with 'their' banks. This tendency can go too far, as it did in 2005 when the governor of the Bank of Italy tried every trick in the book to ward off bids from foreign groups for two medium-sized banks, and ended up having to resign. But the trend is coming in for some punishment. In the Netherlands, too, the chairman of the Nout Wellink bank expressed serious doubts about Barclay's bid, then about the competing bid from RBS-Santander-Fortis, before doing an about-turn shortly afterwards in order to avoid the same fate as poor Antonio Fazio.

Such discreet protectionism through prudential supervision, coupled with differences in tax systems and consumer protection rules, explain the fragmentation of the European banking market and affects access to capital. Not for the largest corporations, who benefit from a competitive environment thanks to financial markets and the major investment banks. But for SMEs or households, the compartmentalisation of the banking sector probably makes financing less straightforward and more expensive. OECD studies show that new companies in Europe have more difficulties growing than their US counterparts, whereas big European groups account for an increasing slice of global market capitalisation. Work by economists such as Philippe Aghion at Harvard (1) demonstrates that problems with accessing credit handicap the growth of Europe's companies, especially the most innovative ones.

The internationalisation of the banking sector, still halting, started off with across-the-border deals, as with the creation of Fortis, Dexia and Nordea. Then came the purchase of Abbey by Santander and of HVB by UniCredit. With ABN Amro, a new step will have been taken towards the creation of truly European banks. Now this momentum is also driving change in supervision. As soon as big retail banks start doing their business in several different countries, systemic risk management will entail more and more transnational instruments. For the moment, these arrangements are *ad hoc*, such as the one under which the FSA would supervise Barclays if it upped sticks to Amsterdam. But this is a makeshift solution which may not be up to a crisis. Even though it will prove difficult, it is probably inevitable that more integrated supervisory tools at European level are on the way.

As everyone's eyes in France are on the second round of the presidential elections, the stakes in this issue are higher than generally realised. Bruce Stokes, a respected American journalist and one the more thoughtful observers of globalisation, commented that "the biggest question [in the poll is]: will the winner take on the entrenched French banking and retail sectors?", while finding (by mid March) none of the three main candidates convincing on this count. Outside witness is often the most telling. This is one of the key issues for economic reform in France, and elsewhere in Europe.

Nicolas Véron is a Research Fellow at Bruegel.

(1) See, for example, "A Primer on Innovation and Growth", www.bruegel.org.