Finance Focus Breakfast: The changing role of the state in finance: a global perspective

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Speakers

Martin Cihak, Lead Economist for Financial and Private Sector Development, The World Bank

Gert-Jan Koopman, Deputy Director General State Aids, European Commission DG COMP

Chair: **Nicolas Véron**, Senior Fellow, Bruegel

The finance focus breakfast provided an opportunity for Martin Cihak, lead economist for Financial and Private Sector Development at The World Bank to present the recent report, "Rethinking The Role of the State in Finance." The detailed report with links to data and deeper analysis can be found at www.worldbank.org/financialdevelopment . The report sought to identify the role of the state as countries emerge from the crisis. The four main areas covered by the report are regulation and supervision, competition policy, direct interventions, and infrastructure development. In the survey responses, there was little debate as to the role of the state as supervisor and regulator, but the other categories were more discussed. Key takeaways suggest a call for better designed incentive systems, increased macro prudential measures such as consumer protection, and greater state involvement in ensuring a sound financial infrastructure through facilities such as credit sharing registries. The main challenge of infrastructure development will be to limit counterparty risk. In addition to credit sharing, this could be achieved by introducing collaterisation on the interbank markets. Competition is largely viewed as leading to improved access, and there is an important need to eliminate distortions that come from the idea of 'too big to fail'. It is better to set up a system that encourages healthy entry and timely exit.

On the issue of state owned banks, the report found them to be useful in the short run, but inefficient in the long run. That said, state owned banks play an important role in mitigating the crisis especially in emerging markets such as Brazil, China, and Mexico. A key advantage of state owned banks is that they can be countercyclical without distorting markets as long as they have a clear mandate and the same supervisor as all other banks. Overall, there is a role for the state in direct interventions, but this role should diminish as the crisis subsides.

Gert-Jan Koopman spoke next from the DG Comp office highlighting the coincidence of his office's work with that of the World Bank, particularly on the issue of incentives. These can be tailored to be important tools preventing bank failures across the board. An issue that is particular to EU markets is the disconnect between supervision on the local and national levels. This can lead to surprising results such as the finding that national supervisors consistently gave asset valuations that were found to be too high. Examples like these suggest the potential benefits of harmonisation. The DG Comp study found little correlation between banks' business models or the degree of concentration and the extent of trouble. While there is no clear pattern, some common themes emerge amongst troubled banks. These include excessive reliance on liquidity, a focus on badly understood products, poor risk management and poorly designed control systems. There could be a role for the DG Comp office to use state aid requirements to incentivise reduced bank size. As long as they are subject to similar supervision and regulation as other banks, state development banks are good. They have continued to lend to the real economy throughout the crisis.

The discussion included questions of the importance of harmonisation at the EU level, the role of the state on insurance markets, diversity in bank size and lending function, and the importance of lending to the real economy.

Event notes by Amma Servaah